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Impact Assessment Report on the future of EU-US trade relations

Accompanying the document

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

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COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT REPORT

ON THE FUTURE OF EU-US TRADE RELATIONS

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1.1. Organisation and timing

During their 28 November 2011 Summit meeting, President José Manuel Barroso, President Herman Van Rompuy and President Barack Obama established the High Level Working Group on Jobs and Growth (HLWG). They tasked it with identifying policies and measures to increase trade and investment to support mutually beneficial job creation, economic growth, and competitiveness.

From its inception, the HLWG on Jobs and Growth has proceeded at good speed based on close cooperation between the European Commission and the US authorities, led by DG TRADE and the USTR respectively. A joint work programme was established, deadlines were agreed, and a series of thematic subgroups went into details in all areas covered.[1] The HLWG has been intended to give both sides reassurance that trade negotiations, if launched, would produce results that are likely to fall within a mutually acceptable range of outcomes.

By June 2012, the HLWG had made significant progress in analysing jointly a wide range of potential options for expanding transatlantic trade and investment. In its interim report, the chairs of the HLWG, Commissioner Karel De Gucht and USTR Ron Kirk, reached the conclusion that a comprehensive agreement addressing a broad range of bilateral trade and investment policies as well as issues of common concern with respect to third countries could potentially provide significant benefits to both economies. This report was considered a preliminary result and in certain areas further substantive analysis was required before a definitive recommendation could be made.

The HLWG continued its intensive work in the second semester 2012 with the aim of specifying the extent to which the parties agree on the scope of a potential trade initiative and the degree of shared ambition regarding their respective priorities. A final report has been published on 13 February 2013. It concluded that a comprehensive agreement, which addresses a broad range of bilateral trade and investment issues, including regulatory issues, and contributes to the development of global rules, would provide the most significant mutual benefit of the various options considered. It recommended to U.S. and EU Leaders that the United States and the European Union launch, in accordance with their respective domestic procedures, negotiations on a comprehensive, ambitious agreement that addresses a broad range of bilateral trade and investment issues, including regulatory issues, and contributes to the development of global rules.

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.[2]

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[1] Among the areas that were discussed at both expert and political level were: tariffs, regulatory issues (including technical barriers to trade and sanitary and phytosanitary rules), services, investment, public procurement, intellectual property rights (including geographical indications) and trade rules which cover, inter alia, trade facilitation/customs, trade-related aspects of competition and state-owned enterprises, trade-related aspects of labour and environment, horizontal provisions on small- and medium-sized enterprises, and access to raw materials and energy.

[2] The European Parliament resolution received a majority of 526 for, 94 against and 7 abstentions:http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2012-388.

In view of the potential economic and social benefits, deeper transatlantic economic integration could provide for the EU, the February 2013 European Council called upon the Commission and the Council to follow up on the recommendations of the HLWG without delay during the current Presidency.[3]

In advance the decision to request a negotiating mandate, the Commission services have undertaken an impact assessment of a potential trade initiative with the United States.[4] An Impact Assessment Steering Group (IASG) was created for the purpose of this impact assessment 16 May 2012 and met 30 May 2012, 7 November 2012 and 15 November 2012. This impact assessment report and the HLWG report will feed into the Commission's deliberations regarding any decision to propose draft negotiating directives.

1.2. Studies, public consultations and expert evidence

1.2.1 Studies

An extensive economic study on the potential economic impact of further trade liberalisation of "Non-Tariff Measures in EU-US Trade and Investment" was already available when the impact assessment was launched (henceforth Ecorys 2009).[5] The goal of the study was to shed light on the existence of non-tariff measures[6] (NTMs) and regulatory divergence at a sectoral level, the magnitude of this divergence and the potential economic impact of a reduction or harmonisation of these measures.

The analysis of non-tariff barriers relied on the most comprehensive and realistic methodology applied to date. Ecorys used a variety of methods to produce quantitative estimates of NTMs in place on both sides: literature reviews, business surveys, econometric analyses, extensive consultations with regulators and businesses, and inputs by sector experts. The core of the fact-finding exercise was the business survey which generated 5,500 responses from US and EU firms in 23 sectors, with a response rate in some sectors representing over 60 percent of turnover of that sector. The survey yielded estimates of overall levels of restrictiveness (NTM indexes) that have then been cross-checked against OECD (2007) restrictiveness indicators[7] and against the Product Market Regulation (PMR) indexes[8] as well as by sector experts. For the service sectors a combination of OECD restrictiveness indicators and survey results has been used.

The Ecorys 2009 study contained two scenarios. In an ambitious scenario, it considered what might happen if about 100% of actionable[9] NTMs and regulatory divergences (representing

[3] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/135324.pdf

[4] The Directorate-General for Trade has been the lead service for this impact assessment report. Other DGs and services involved in its preparation were: EEAS, MARKT, TAXUD, ENTR, SANCO, ENV, CLIMA, ECFIN, AGRI, MARE, MOVE, CONNECT, EMPL, HOME, JUST, COMP, ESTAT, DEVCO, ENER, RTD, JRC, BUDG, the SG and the LS.

[5] The study can be found at: http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc_145613.pdf.

[6] In the following analysis, non-tariff measures are defined as "all non-price and non-quantity restrictions on trade in goods and services. This includes border measures (customs procedures etc.) as well as behind-the border measures flowing from domestic laws, regulations and practices that have an effect on trade and investment".

[7] http://www.oecd.org/trade/servicestrade/42935959.pdf

[8] http://www.oecd.org/eco/regulatoryreformandcompetitionpolicy/indicatorsofproductmarketregulationpmr.htm

[9] A NTM was considered 'actionable' only when it is within the reach of policy to eliminate it or to find remedies for reducing its negative effect on trade. In some cases this is not possible. For example, barriers to

about 50% of all NTMs and regulatory divergences) were eliminated. A more realistic scenario examined the likely effects of a 25% elimination of all NTMs and regulatory divergence. However, the Ecorys (2009) study neither looked at the possibility of international "spillover effects" of bilateral trade liberalisation, nor did it analyse the impact of tariff elimination or took into account any effects beyond the direct economic impact (e.g. social and environmental aspects). Furthermore, the scenario considering the removal of 100% of actionable barriers, though in theory possible, is deemed an unlikely outcome of negotiations.

To update and complement the Ecorys 2009 study, DG Trade commissioned an additional study from the Centre for Economic Policy Research (henceforth CEPR 2013 study) to underpin the analysis of this impact assessment. The new study is based on an updated database of trade patterns (GTAP 8). It simulates the effects of the possible outcomes of the different pillars of possible negotiations (tariffs, NTMs in goods, services, and procurement-related NTMs), and expands the analysis to quantifiable social and environmental impacts.

In the CEPR 2013 study, **two main scenarios** are taken into account in the simulations. The scenarios differs in terms of the level of ambition in each of the pillars: coverage of elimination of tariffs varies from 98% to 100% of tariff lines, while the reduction of NTMs on goods and services. varies from 10% to 25% of existing barriers.[10] With regard to public procurement between 25% and 50% of barrier elimination is simulated. Within the limits of the available data, barriers to foreign direct investments are also covered. The liberalisation of all pillars is run both separately and simultaneously. This way, we are able to comment on the effects of a "tariffs, services or public procurement only" option, and a "comprehensive agreement" option (liberalisation simultaneously all pillars with two different levels of ambition) against a "baseline option" ("business as usual" scenario). Regarding public procurement, the CEPR 2013 study uses the same modelling technique as the Ecorys study and the results are available for the same list of sectors which were included in the Ecorys study. Finally, the model accounts for processed agricultural and non-processed agricultural products as two separate sectors, yet it does not differentiate the industries and/or the product categories.

The "baseline scenario" covers all current EU and US signed or initialled bilateral agreements, in particular those with South Korea. In addition, the EU agreements that are currently being finalised (EU-Canada and EU-Singapore) are included under stylised assumptions. The baseline of the study covers the period until 2027 with projections of the world economy up to that year. This marks 10 years after the full implementation of the potential agreement between the EU and the US, which is assumed to be completed by 2017. The base year of the data used in the simulations is 2007.

The CEPR 2013 study in particular supports the analysis of social effects providing estimates for the expected changes on wages for skilled and unskilled labour. The analysis is also complemented by an analysis of labour (skilled and unskilled) reallocation across sectors resulting from the potential trade agreement(s). Regarding environmental issues, the study produces estimates on the impact of CO2 emissions in the United States, the European Union and in the rest of the world as well as an estimation of the intensity of natural resources use.

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market access that are associated with differences in consumer preferences are unlikely to be lifted by policy intervention. The assessment of the proportion of regulation that is realistically prone to policy-induced convergence was based on expert advice, and is still the best available estimate.

[10] This amounts to half of what the scenarios of Ecorys presume.

1.2.2 Public consultations and expert evidence

The impact assessment has been prepared following extensive consultations with all interested stakeholders, including Member States, representatives of civil society and industry. An initial online public consultation on the HLWG was carried out between February and April 2012 and posted on the DG Trade website and "Your voice in Europe".

In this first public consultation, nearly all stakeholders pointed to regulatory barriers as the major obstacle to trade and investment. In fact, among the respondents there was nearly uniform agreement that most potential for improvement of EU-US trade and economic relations lies in regulatory cooperation, for both goods and services. Stakeholders believed that substantial benefits could be achieved by removing differences in regulatory frameworks, including for instance the harmonization or mutual recognition of technical certification, rules and standards, the simplification of customs procedures and the sharing of information between regulatory authorities. This information helped shaping the discussions of the HLWG.

A second, more structured and detailed public consultation was organised from June 2012 to September 2012, specifically to support this impact assessment. The European Commission received 77 (publicly-releasable) contributions from businesses/ business associations, trade unions/ organisations representing trade unions, government institutions, non-governmental organisations such as consumers' organisations and citizens on both sides of the Atlantic. Responses originated, to a large extent in the EU, with a smaller number of responses coming from the US. These contributions covered a wide part of the economy. The sectors with the highest stakeholder input in the consultation were agriculture-related sectors; air transport services; chemicals (including pharmaceuticals); retail and wholesale trade, hotels, restaurants and real estate; textiles, clothing, leather and footwear; metals and metal products; transport equipment, other machinery and equipment (domestic appliances, agricultural machinery). A smaller number of responses originated from sectors such as financial services; ICT services[11]; wood and paper; medical equipment or arms and ammunition.

As with the previous exercise, the results of the public consultation showed that stakeholders are generally highly supportive of a transatlantic initiative that would boost trade and investment and generate growth and jobs across the Atlantic. Regarding the scope of a future transatlantic initiative, most stakeholders supported again a comprehensive, ambitious and realistic agreement that would be negotiated under a single package. While slightly more than half of the respondents indicated that tariff elimination would help their ability to export/ import and do business in the US, there has been wider, general agreement that the real potential for a EU-US agreement lies first of all in regulatory cooperation, both in goods and services (see Annex 5 for a summary of the responses to the second public consultation).

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, if possible, joint proposals on concrete measures to achieve greater regulatory coherence. Detailed joint submission from EU and US industry have been received, among others, from the car, chemicals and pharmaceutical industry. The input of stakeholders in the various public consultations has been used throughout the analysis of this impact assessment.

[11] As over half of the EU-US cross-border trade in services depends on the Internet, any barriers to ICT services inevitably has both a direct effect on the ICT sector itself, and an indirect effect on other business sectors in bilateral trade.

In parallel to the online consultation, DG Trade organized or participated in a number of outreach activities designed to inform the public. 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.[12] Their comments have been analysed and taken into consideration in the process of preparing the IA report.

In addition, DG Trade took part in the Liaison Forum organised by DG EMPL on 1 October 2012. During this meeting DG Trade delivered a presentation on the HLWG, and informed social partners about the planned process. Small and medium size enterprises (SMEs) were informed about the public consultation through the weekly newsletter of DG ENTR, which is distributed to its network partners over the intranet.

1.3 The Impact Assessment Board

The impact assessment report was presented to the board on 18 December 2012. The board did not ask for a resubmission, but requested a number of changes in the report. In line with the opinion of board, the report has been updated by specifying in more details the problems concerning issues and sectors to be addressed in possible trade negotiations. The update also provides more detail on the calculation of the numerical estimates of NTMs, strengthens the assessment of impacts on consumers, employment, investment flows and third countries. Finally, stakeholders' views are more systematically presented throughout the analysis.

2. PROBLEM DEFINITION

2.1. Introduction

The EU and the US are the world's major global traders and investors. In fact, the EU is the largest economy in the world, representing 25.1% of world GDP and 17.0% of world trade and the US is the second largest economy accounting for 21.6% of world GDP and 13.4% of world trade.[13]

Together the EU and the US account for almost half of the world GDP and one third of total world trade. The transatlantic economic relationship is among the most open in the world and the two markets are deeply integrated through large flows of trade and investment (bilateral trade volume of goods and services amounted to €702.6bn in 2011, while bilateral investment stock was €2.394tr in 2011).[14]

The bilateral trade relationship is extremely important for both partners. In 2011, the EU was the first trading partner of the US with 17.6% of trade in goods (Canada being the second and China the third), while the US was the EU's second largest trading partner with 13.9% of the EU's total trade in goods (China being the first[15]). The bilateral trade balance has traditionally

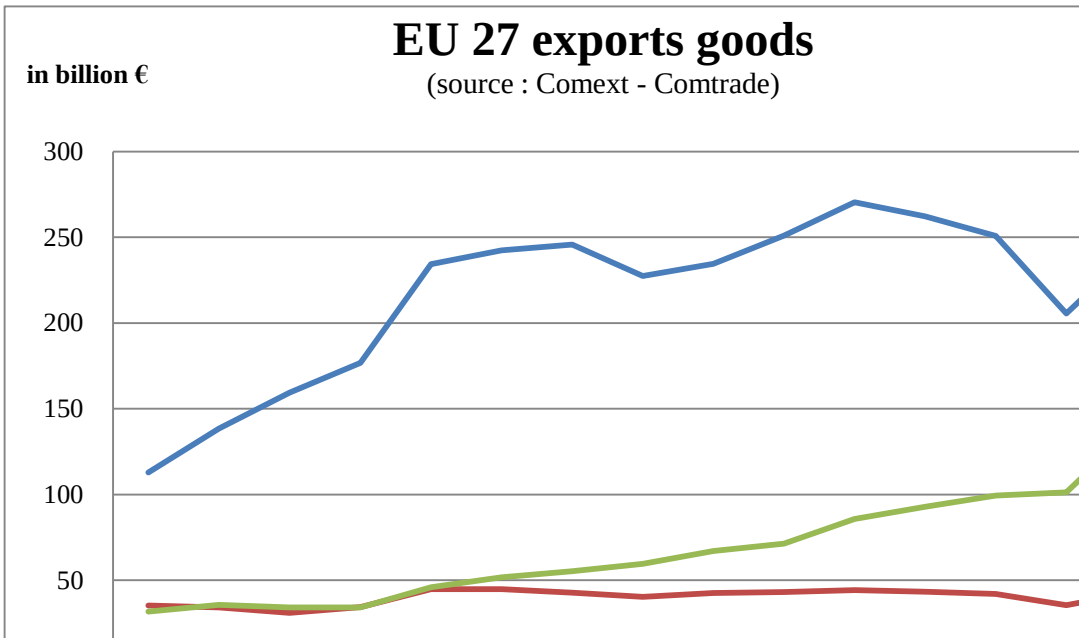
[12] For a report of the meeting see: http://trade.ec.europa.eu/civilsoc/meetdetails.cfm?meet=11385.
[13] Source: World Bank's World Development Indicator, current prices: http://data.worldbank.org/indicator.
[14] Source: Comext , Balance of Payments, Eurostat.
[15] If Hong-Kong is included. excluding Kong-Kong, China is second and the US first.

been to the advantage of the EU, standing at €73.5bn in 2011 (see Annex 4 for a detailed description of the current EU-US trade and investment relations).[16]

However, the relative share of bilateral relationship in the two economies' total trade has been in decline over the past decade. This relative decline is particularly sharp when looking at EU trade in goods. Between 2000 and 2011, while EU exports of goods to the world increased at an average annual growth rate of 7.6%, EU exports to the US only grew by 1%.[17] As a result, the share of the US in total EU goods exports declined from 28.1% in 2000 to 16.9% in 2011. Meanwhile, the purchases of goods from the US represented 20.8% of the total imports of the EU in 2000 and they only accounted for 11.1% in 2011 (a reduction close to 50%).

Moreover, a closer look at the trend of respective exports of goods in chart 1 and 2 shows that, following a period of buoyant bilateral trade growth in the second half of the 90s, in the period from 2000-2011, the EU exports to the US and the US exports to the EU have stagnated in absolute terms. This stands in sharp contrast with the significant increase of EU and US exports to China,[18] over the same period.

Chart 1 **EU 27 (goods exports, billion euro)**



Source: Comext, Comtrade

Chart 2 **United States (goods exports, billion euro)**

[16] Source : Comext, calculations based on trade figures in euros.
[17] Source : Comext, calculations based on trade figures in euros.
[18] Figures for China include Hong-Kong.

Source: Comext, Comtrade

A number of factors have contributed to the stagnation and relative decline in trade between the EU and the US. The respective regional trade integration processes that the two economies have been leading might have played a role. The EU's 2004 and 2007 enlargement as well as the EU's Neighbourhood Policy have boosted trade with the neighbouring regions, and in particular Russia and Turkey (which have become major trading partners). Similarly, the North American Free Trade Agreement (NAFTA), which entered into force 1994, promoted stronger trade linkages between the US, Canada and Mexico.

However, the major driver is obviously the rapid rise of emerging market economies in developing countries, particularly China. In the last decade, the emerging economies of Asia have been growing faster than the EU and the US. Their increased competitiveness, output and export volumes have changed the structure of world trade flows, by reducing the share of developed economies such as the EU and the US. The United States' trade with (e.g.) China, India, Korea, and ASEAN has been growing significantly faster than trade with established markets including the EU. Likewise, China[19] has been the EU's fastest growing export market, and has rapidly established itself as the EU's largest trading partner, ahead of the US. The WTO accession of China has played an important role.

The slow progress of the Doha Development Agenda (DDA) could have contributed to the intensification of regional trade agreements. We observe that the increasing economic and trade importance of Asia has been accompanied by a rapid expansion of FTAs within Asia. The EU and US have negotiated landmark trade agreements with Korea and are both currently negotiating FTAs with partners in South-East Asia.[20] The trend of trade diversion away from the transatlantic trade relationship is thus likely to continue. The US trade strategy is currently centred on the Trans-Pacific-Partnership (TPP), which US industry and US policy makers perceive as being the gateway agreement to the fast growing Asia-pacific region.

[19] Including Hong Kong.

[20] The EU negotiates with Singapore, Malaysia and Vietnam. The US is engaged in the Trans-Pacific-Partnership (TPP), which among others includes also Singapore, Malaysia and Vietnam.

From the EU perspective, the possibility of the US offering preferential market access to its South-East Asian trade partners bears the risk of diverting existing trade away from the EU. Additionally, as trade integration with Asia gathers pace and fully occupies the US business and policy agenda in the US, interest in the EU may fall, accelerating further the current trends of trade deviation.

2.2. The problem

2.2.1 Bilateral trade is not fulfilling its potential

Although the economic relationships between the United States and the European Union can be considered to be among the most open in the world, and while transatlantic markets are deeply integrated through large flows of trade and investment, stakeholders complain about barriers to trade and investments that seem to block economic potential in the transatlantic market place in a large number of sectors. 46% of respondents to the public consultation declared themselves concerned by unnecessary regulatory barriers, 45% by tariffs, 38% by customs procedures and 20% by barriers to investment. Many stakeholders pointed to specific problems they face in their business such as foreign ownership rules in transport services, divergent technical regulations for passenger cars or certain non-compatible standards for machinery.

In general, transatlantic tariff barriers are comparatively low, given the magnitude of trade between the EU and the US. However, tariffs still impose costs that are not negligible. The WTO estimates[21] average MFN tariffs of the US and the EU at 3.5% and 5.2% respectively. Moreover, both the US and the EU maintain tariff peaks in sectors of economic interest to the other partner (see section 2.3.1).

In addition, since EU and US companies are deeply interlinked (with supply chains expanding across the Atlantic) and invest heavily in each other's markets, intra-company trade is high. This means, that tariffs imposed lead to a direct increase in production costs for EU and US companies, which in turn renders the companies less competitive compared to other competitors on the world market (a concern raised by both EU and US companies in the public consultation). In that sense, even low tariffs are in practice a tax on transatlantic intra-firm trade.

However, most importantly, regulatory differences for goods and services act as greater impediments to transatlantic trade and investment flows. In the context of sophisticated regulatory regimes – and even though very often the aim of the respective regulatory regimes is similar – differences in individual regulations, including implementation and enforcement mechanisms, can result in additional burdens for EU and US businesses. According to the results of the public consultations, this is particularly true for SMEs, which report lost opportunities in terms of jobs and growth.

Economic analysis (Ecorys 2009) suggests that trade cost equivalents[22] are usually higher than 10% and above 20% for many sectors. For example, in the insurance sector, the trade costs in the US are estimated to add some 19.1% to transatlantic trade and trade related investment costs, while in the EU the restrictions add some 10.8% to costs. Net trade cost

[21] EU: http://stat.wto.org/TariffProfiles/E27_e.htm; US: http://stat.wto.org/TariffProfiles/US_e.htm.

[22] The amount of additional cost burdens for trading across the Atlantic, compared to the domestic market, i.e. internally in the EU or the US.

equivalents are more equal in sectors like automotive and chemicals, with 26.8% (US) / 25.5% (EU) and 21% (US) / 23.9% (EU) respectively. Trade cost equivalents are the highest for food and beverages, with 73.3% (US) and 56.8% (EU).

Regulatory cooperation exercises between the US and the EU to overcome these unnecessary barriers to trade and investment have been in running for the past years, and even decades, both at sectoral and at horizontal level, with different degrees of limited success. For example, the High Level Regulatory Cooperation Forum has significantly improved the common understanding of each side's regulatory system, facilitating cooperation on cross-cutting regulatory issues and enabling early dialogue in key emerging sectors.

Regulatory dialogues also play an important role in a number of sectors and this has greatly contributed to the better understanding of the respective sectoral regulatory frameworks and may have provided incentive for greater regulatory convergence in the medium term. We must acknowledge, however, that there are still systemic obstacles limiting our capacity to bridge gaps or align regulatory approaches. Up to now, really successful sectoral regulatory cooperation initiatives that have led to effective positive changes on the ground have been limited.

There are several examples of ineffective or inadequate cooperation. For instance, in the field of conformity assessment and certification, the horizontal dialogues with the Department of Commerce and sectorial discussions with OSHA (Occupational Safety and Health Administration), have not brought tangible results. In particular, EU requests for the introduction of suppliers' declaration of conformity for low-risk electrical equipment were rejected by OSHA, both on risk grounds and because of the costs involved in setting-up an effective post-market surveillance system in the US.

An important limiting factor for most existing horizontal and sectoral agreements are the divergences in regulatory approaches which are either enshrined in differences of legislation or result from the situation that US agencies have a high degree of autonomy and are primarily accountable to Congress. The fact that most agreements concluded with the US are executive agreements may be an important factor explaining the limited effectiveness of some of the sectoral agreements concluded with the US, such as the 1999 mutual recognition agreements (MRA) or the 1998 veterinary agreement.

The access to the US public procurement market is another area where European firms report difficulties. The US has limited international legally binding commitments in this area, whether under the WTO Government Procurement Agreement (GPA) or in its bilateral FTAs. Only 32% (€178bn)[23] of the U.S. procurement market is open to EU businesses under the commitments recently taken by the US in the framework of the GPA. However, these commitments are not yet implemented.

In the public consultation, stakeholders also raised the issue of diverging protection of geographical indications. While the EU has an elaborate system for protecting its rich variety of geographical indications, the US system is based on a trademark regime. Trade friction is often the result, particularly when EU geographical indications are used by US businesses not only on the domestic, but also on the world market. At the same time, positive feedback was provided on the EU-US wine agreement of 2006.

Given the huge volume of economic interaction and the vast respective market size of the EU and the US, trade and investments freed from such restrictive measures could potentially

[23] European Commission estimates, based on the US Statistical reports to the GPA Secretariat, US Federal Procurement Data System (FPDS) reports and the US census.

create big benefits for businesses and consumers, creating jobs and growth on both sides of the Atlantic.

2.2.2 Why unfulfilled trade potential is undesirable

As highlighted in the document accompanying the Commission Communication *Trade, Growth and World Affairs*, international trade is a driver of prosperity.[24] Completing all ongoing free trade negotiations (DDA and bilateral agreements), could result in a growth dividend that would add more than 0.5% to EU GDP. Making further progress on services and regulatory issues with major trading partners could push this figure above 1% of EU GDP.

Globally, trade and investment liberalisation are important drivers of economic and social gains. Given that in 2011 the US accounted for 16.8% of overall EU goods and services trade, while the EU represented 17.2% of US overall trade, the immediate consequence of untapped trade and investment potential is a lower level of economic welfare on both sides of the Atlantic compared to the level that might be attained. Strengthening transatlantic trade (including intra-firm trade) and investment links would provide EU and US firms the opportunity to benefit from long-term gains in competitiveness and productivity deriving from new business opportunities, increased competition pressure and innovation resulting from better opportunities for technology and knowledge transfer as well as research cooperation between the two of the most developed industrial and technology-driven economies.

In times where any budget-neutral source of economic growth is precious, the failure to harness the full benefits of trade and foreign investment must be considered an undesirable state of affairs.

2.2.3 The consequences of restricted access and choice for consumers

The Communication *Trade, Growth and World Affairs* also underlines the fact that trade brings a wider variety of goods and services to consumers and companies, sometimes at lower prices. The current benefits of trade to EU consumers alone are estimated at €600 per capita per year.[25]

At present, both EU and the US consumers are deprived of some of the opportunities flowing from a wider choice of goods and services. For example, the foreign ownership restrictions in the US aviation markets clearly restrict consumer choice, i.e. using a European airline to fly to certain US destinations, and ultimately lead to higher transport prices for passengers and freight. In the absence of an international roaming agreement between the EU and the US that allows for increased competition and hence lower rates, consumers pay higher prices for mobile communication when travelling across the Atlantic. Consumers may also lack choice and access to the latest technologies and medical treatments because regulations do not provide for mutual recognition of technical standards.

[24] Trade as a driver of prosperity; COM(2010) 612}; {SEC(2010) 1268}.

[25] A Broda and Weinstein study (2006) estimates the gains to American consumers from the growth on global variety during 1972-2001 to have been around 2.8% of GDP: http://www.nber.org/papers/w10314.pdf?new_window=1. Translated into an EU context, suggest average European consumer benefits in the range of €600/year.

NTMs identified in the expert studies increase the cost of exporting to US by 10% to 70%, depending on the sector. This in turn affects consumers who pay the costs for many of these measures in terms of higher prices, reduced competition, and less know-how incorporated into the products they buy.

2.2.4 Lost labour and welfare benefits

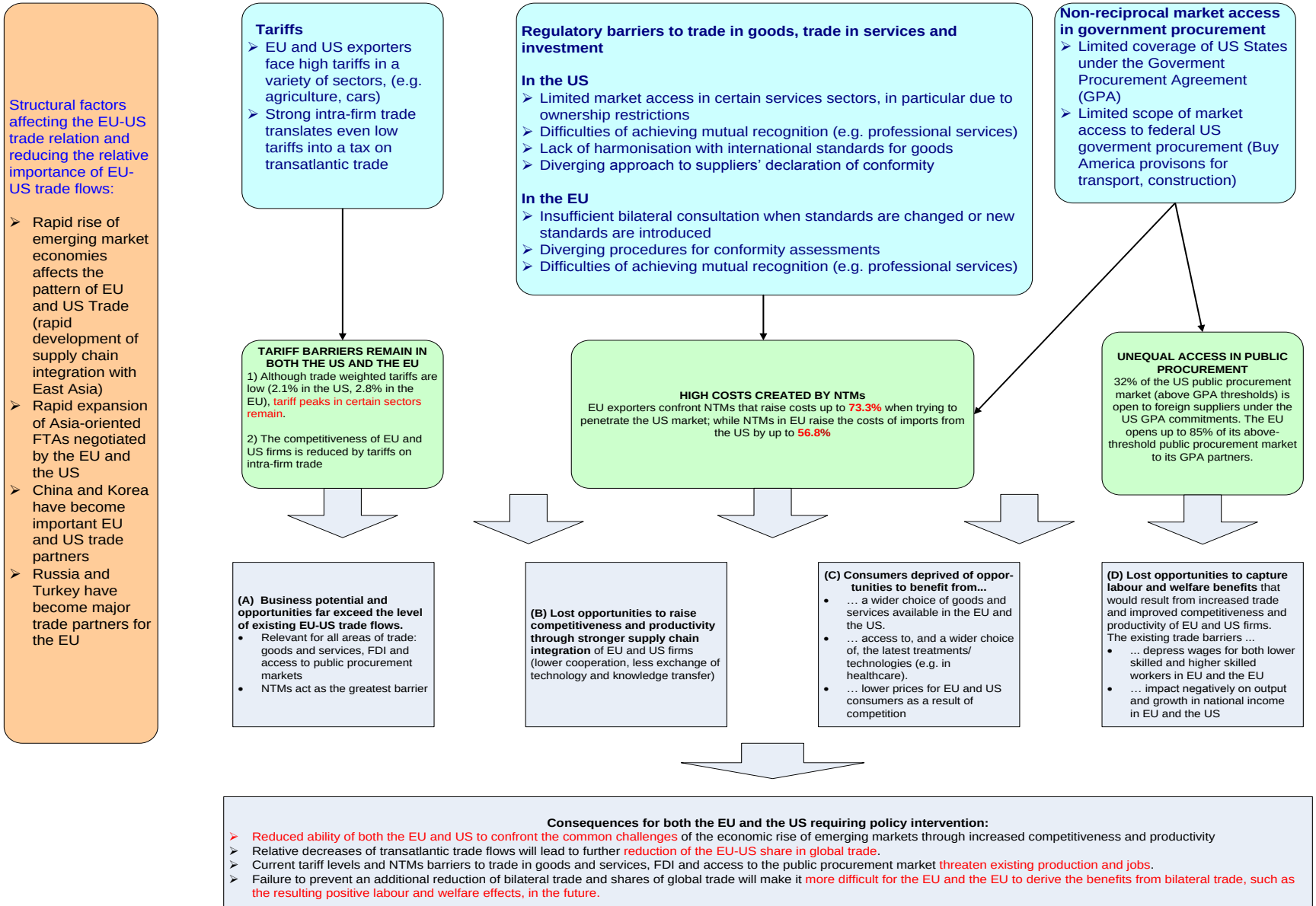
Stagnating bilateral trade undermines the competitiveness of firms in the EU and the US, and therefore results in failure to capture employment opportunities for their workforce. Less competitive firms and resulting lower productivity also means lower wages for their personnel as the margin to distribute the firms' productivity growth among capital and labour is reduced.

Around 13% of EU total employment depends directly or indirectly (via activities that supply inputs to the exported goods and services) on exports to the rest of the world. This means that around 30 million jobs across the EU depend on sales to third countries. In terms of magnitude, the transatlantic marketplace plays a major role since the US is the trading partner that contributes to sustaining the largest share of these jobs (17% of total).[26]

Consequently, transatlantic trade barriers that hamper output growth result in lost opportunities to create new jobs, depress wages for both lower-skilled and higher-skilled workers in both the EU and the US and threatens existing employment through reduced competitiveness of EU and US firms.

The underlying causes behind trade and investment flows between the EU and the US remaining below their potential are analysed in detail in section 2.3 (problem drivers). The chart on the following page relates the problems identified to the underlying causes, grouped thematically and links them to the actual or potential consequences for both the EU and the US, in the form of a 'problem tree'.

[26] Calculations for 2008. For more information see: "Use of WIOD to analyse the impact of trade: employment generation vs. emissions responsibilities", DG JRC IPTS, available at: http://www.wiod.org/conferences/brussels/IPTS_background.pdf.


Structural factors affecting the EU-US trade relation and reducing the relative importance of EU-US trade flows:
Rapid rise of emerging market economies affects the pattern of EU and US Trade (rapid development of supply chain integration with East Asia)
Rapid expansion of Asia-oriented FTAs negotiated by the EU and the US
China and Korea have become important EU and US trade partners
Russia and Turkey have become major trade partners for the EU
Tariffs
EU and US exporters face high tariffs in a variety of sectors, (e.g. agriculture, cars)
Strong intra-firm trade translates even low tariffs into a tax on transatlantic trade
Regulatory barriers to trade in goods, trade in services and investment
In the US
Limited market access in certain services sectors, in particular due to ownership restrictions
Difficulties of achieving mutual recognition (e.g. professional services)
Lack of harmonisation with international standards for goods
Diverging approach to suppliers' declaration of conformity
In the EU
Insufficient bilateral consultation when standards are changed or new standards are introduced
Diverging procedures for conformity assessments
Difficulties of achieving mutual recognition (e.g. professional services)
Non-reciprocal market access in government procurement
Limited coverage of US States under the Goverment Procurement Agreement (GPA)
Limited scope of market access to federal US goverment procurement (Buy America provisons for transport, construction)
TARIFF BARRIERS REMAIN IN BOTH THE US AND THE EU
1) Although trade weighted tariffs are low (2.1% in the US, 2.8% in the EU), tariff peaks in certain sectors remain.
2) The competitiveness of EU and US firms is reduced by tariffs on intra-firm trade
HIGH COSTS CREATED BY NTMs
EU exporters confront NTMs that raise costs up to 73.3% when trying to penetrate the US market; while NTMs in EU raise the costs of imports from the US by up to 56.8%
UNEQUAL ACCESS IN PUBLIC PROCUREMENT
32% of the US public procurement market (above GPA thresholds) is open to foreign suppliers under the US GPA commitments. The EU opens up to 85% of its above-threshold public procurement market to its GPA partners.
(A) Business potential and opportunities far exceed the level of existing EU-US trade flows.
Relevant for all areas of trade: goods and services, FDI and access to public procurement markets
NTMs act as the greatest barrier
(B) Lost opportunities to raise competitiveness and productivity through stronger supply chain integration of EU and US firms (lower cooperation, less exchange of technology and knowledge transfer)
(C) Consumers deprived of opportunities to benefit from...
… a wider choice of goods and services available in the EU and the US.
… access to, and a wider choice of, the latest treatments/ technologies (e.g. in healthcare).
… lower prices for EU and US consumers as a result of competition
(D) Lost opportunities to capture labour and welfare benefits that would result from increased trade and improved competitiveness and productivity of EU and US firms.
The existing trade barriers ...
... depress wages for both lower skilled and higher skilled workers in EU and the EU
… impact negatively on output and growth in national income in EU and the US
Consequences for both the EU and the US requiring policy intervention:
Reduced ability of both the EU and US to confront the common challenges of the economic rise of emerging markets through increased competitiveness and productivity
Relative decreases of transatlantic trade flows will lead to further reduction of the EU-US share in global trade.
Current tariff levels and NTMs barriers to trade in goods and services, FDI and access to the public procurement market threaten existing production and jobs.
Failure to prevent an additional reduction of bilateral trade and shares of global trade will make it more difficult for the EU and the EU to derive the benefits from bilateral trade, such as the resulting positive labour and welfare effects, in the future.

2.3. The problem drivers

There are a number of underlying drivers and factors contributing to the landscape of trade barriers between the EU and the US. They can be grouped in two main categories: those that might be addressed by trade policy including regulatory cooperation, and those that are less likely to be affected by such policy measures.

In the former group are factors that cause trade to fall below its potential. In the latter group are factors such as geographical distance and consumer attitudes and preferences, which contribute to determining the potential and limits for transatlantic trade. It is clear that trade policy has only very limited influence on these. The following section will therefore concentrate on the factors that can effectively be influenced by trade policy measures.

The group of problem drivers susceptible to change through trade policy and/or regulatory cooperation is comprised of barriers relating to tariffs, regulatory measures (which affect both trade in goods and services, including public procurement) and related investment. It is clear that unnecessary differences in regulatory approaches, particularly when the same regulatory objective and similar levels of protection of the public interests are intended, raise not only the cost of compliance for business, but also the cost of enforcing regulations for public authorities.

2.3.1 Tariffs

In general, both the EU and the US have low tariffs on goods, with simple average MFN tariff rates of 5.2% and 3.5%. The trade-weighted tariff protection in the US for EU exports is estimated at 2.1%, while the trade-weighted tariff rate for US exports to the EU is estimated at 2.8%.[27]

EU tariff peaks are concentrated on the agricultural side with levels depending on the methodology used to estimate ad valorem equivalents of specific tariffs. On the industrial side the highest EU tariffs (22%) can be found in trucks, followed by some footwear (17%) and audio-visual products (14%), and clothing (12%). On the US side peaks in agriculture are somewhat lower with the clear exception of processed agricultural products (e.g. tariffs on tobacco are 350%). Compared to the EU, the US clearly has more peaks in industrial products, e.g. in textiles (40%), clothing (32%), leather and footwear (56%). However, in general, these higher tariffs only account for a fraction of bilateral trade (2 % of EU imports and 0.8 % of US imports).

2.3.2 Regulatory measures[28]

Regulatory measures constitute the greatest obstacle to increased trade and investment between the EU and the US, identified in numerous studies and surveys and public consultations, as well as by way of anecdotal evidence. Incompatibilities in regulation and

[27] http://stat.wto.org/TariffProfiles/E27_e.htm; http://stat.wto.org/TariffProfiles/US_e.htm

[28] In the following, regulatory measures are defined in line with the definition of non-tariff measures as "all non-price and non-quantitative restrictions on trade in goods and services. This includes border measures (customs procedures etc.) as well as behind-the border measures flowing from domestic laws, regulations and practices that have an effect on investment".

lack of understanding of our (differing) approaches to regulation have created unnecessary barriers to transatlantic trade. These divergences in many cases tend to increase the cost of compliance, and therefore of doing business. The most costly barriers in terms of additional trade cost equivalents stem from the dissimilarity of the regulatory structures in the EU and the US. These include primarily:

- 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

Technical regulations in key sectors: As highlighted by the public consultations, unnecessary regulatory divergences are particularly burdensome in key sectors of the economy, such as automotive, chemicals or pharmaceuticals/health. A significant number of respondents to the public consultations declared themselves concerned by divergent technical regulations acting as barriers in transatlantic trade. Addressing sectoral regulatory issues will thus be decisive in any future trade negotiations.

Standardisation: Standardisation processes and the use of voluntary standards in regulation play a crucial role in facilitating or deterring transatlantic trade, in particular for manufactured goods. Repeated discussions between EU and US regulators have shown differences in the way regulators in the two jurisdictions set the approach to standards development in general and to "international" standards, as well as the way in which bodies that develop standards and the results of their work are recognised. These two approaches differ in a large number of areas of regulation, thereby creating the potential for additional regulatory barriers to trade.

Although in some areas (such as electronics), the use of international standards is widespread, there are a number of sectors where differences resulting from the different standard setting practices, do create unnecessary barriers to trade. For example, the US has a more decentralised system of standard setting, with several bodies developing "competing" standards in the same areas. With some exceptions (such as motor vehicles, medicines or consumer product safety), operators are free to choose the standards which suit them best (or which are required by the market/customers). Standards are usually elaborated by private (sometimes for-profit) standard setting bodies, which usually have an open membership that can include non-US persons/organisations. In contrast with the EU system, where European voluntary harmonised standards play a formally recognized role in supporting the application of EU policies and legislation, there is no established link between voluntary standard development and regulatory policy in the US. US regulatory agencies can select from the standards already available in the market those that best suit the regulatory objectives being pursued, thereby rendering their application mandatory, but standards are not developed from the start in support of specific regulatory requirements.

Efforts to reconcile these diverging views and systems have been high on the bilateral agenda for years. In a joint document adopted in November 2011, entitled "Building

bridges between the US and EU standards systems",[29] the EU and the US agreed on specific actions to improve each side's processes for the use of voluntary standards in regulation. Stakeholders therefore have the expectation that, building on the on-going work of the TEC and High Level Regulatory Cooperation Forum, new mechanisms will be created to promote cooperation, collaboration, and coherence in this area, in view of minimizing unnecessary regulatory divergences and better aligning the respective regulatory approaches. Stakeholders also expressed their wish to see the TEC continue its work until any such mechanisms would be set up.

Conformity assessment procedures: Although the level of consumer / user protection can be considered similar in many areas of regulation, regulators on either side of the Atlantic have developed sometimes differing approaches to the conformity assessment of specific products and risks. For example, the US requires third party testing or certification for a number of products for which no equivalent requirement exists in the EU, in particular regarding safety of electrical products or machinery. The latter is of particular concern to EU business. There are also cases where the EU requires third-party certification, while in the US lawful commercialisation depends is based on a self-declaration of conformity (e.g. safety standards for motor vehicles).

In other sectors, such as cosmetics, different conformity assessments apply due to a different classification of the products. While in the EU there is a specific regulation for cosmetic products, the US either does not regulate some of these products or, on the contrary, classifies them as over-the-counter drugs, which implies a much stricter regulatory regime.

At the same time, the US government does not have a centrally organised system of designation and supervision of Conformity Assessment Bodies (CABs) to perform mandatory conformity assessment tasks. The US also establishes different requirements to those applied by the EU as regards accreditation bodies (e.g. in relation to their exercise of public authority, independence from commercial pressure and non-profit making status). Unlike in the EU (which has set up a public authority-led market surveillance system), the US system relies primarily on private organisations and control by the market both for conformity assessment and product requirements, as well as on a stringent liability system.

On the other hand, CABs accredited under an international scheme (such as the International Laboratory Accreditation Cooperation (ILAC) and the International Accreditation Forum (IAF) are eligible to certify conformity in the US for certain categories of products, such as those covered by the Consumer Product Safety Improvement Act. Only CABs established in the EU and that have been notified to the European Commission by the Member States can perform mandatory conformity assessment tasks in the EU.

Mutual recognition: The 1999 agreement on mutual recognition between the European Community and the United States of America[30] has not lived up to initial expectations and its output in terms of further harmonisation of technical requirements at multilateral level has been disappointing. As a traditional type MRA, it was neither based on prior alignment or sufficient convergence of the parties' regulations, nor did it seek to promote that objective. Certain parts of the 1999 MRA have not been implemented in practice – for instance, with respect to electrical equipment and medical devices – because, at the time, it was not possible for regulators to build the degree of mutual confidence necessary to bring the agreement into operation. Even when they operated well from a technical point of

[29] http://trade.ec.europa.eu/doclib/docs/2011/december/tradoc_148393.pdf
[30] Compare for more details: http://trade.ec.europa.eu/doclib/docs/2012/may/tradoc_149385.pdf.

view (e.g. in the field of radio and telecom equipment), the benefits of the MRAs were often mitigated by their substantial administrative costs (burdensome designation procedures and need for regular updates of legislative references in the MRA's sectoral annexes).

Mutual recognition is also essential for facilitating the temporary movement of service suppliers of certain professional services such as accountants, architects, lawyers, engineers, etc. In the absence of international agreements on the mutual recognition of qualifications, individual service suppliers must apply to an individual regulator at state level for approval on a case-by-case basis in order to have their particular qualifications recognised in that jurisdiction, a time-consuming and expensive process which acts as a significant deterrent to the provision of these services on a transatlantic basis.

SPS procedures: while sharing a comparable level of ambition as far as consumer protection is concerned, the EU and US risk assessment and management procedures are different (e.g. diverging timing for inspections, different approaches to traceability and pest prior risk analysis, different test methods, diverging implementation of international standards and regionalisation). Rules going beyond international standards, complicated and sometimes unclear procedures make the application process so burdensome and time consuming for companies. EU stakeholders complain that the current situation discourages them from exporting even basic products like fruits and vegetables or milk.

Upstream cooperation: Lack of transatlantic upstream cooperation may cause unnecessary divergences between our respective regulations, and lead to increased costs and administrative burdens for companies, as well as inefficiencies in the enforcement of our respective regulatory regimes. Once adopted and in force, diverging regulations are often difficult sometimes impossible to remove or adjust; and else, only at high administrative cost for authorities and market participants. Early cooperation and consultations between regulators and legislators increases the chances to minimise incompatible outcomes, without impairing on the sovereign right to regulate. Stakeholders identified upstream cooperation as a key area for further progress. Joint efforts in the HLRCF and the TEC are aimed at improving upstream cooperation both horizontally (for instance, through the Common Understanding on Regulatory Principles and Best Practices) in emerging growth sectors and on new technologies, such as electric vehicles and nanotechnology. This work can provide a good basis for potential future trade negotiations.

Services: The overall extent of mutual openness of the EU and US markets for services results in a limited set of traditional market access barriers giving the impression of a relatively balanced situation. However, this is misleading as, in terms of actual autonomous liberalisation on the ground, the EU is in practice significantly more open for American service providers than the US is for EU providers in several key areas, such as foreign ownership in transport. The result is that EU businesses continue to complain about market access barriers in the US market, notably in the air and maritime transport market as well as the postal and courier services market, and professional services such as lawyers, architects, engineers, etc.[31] While it is impossible for EU airlines to hold more than 25% of an US carrier and the US cabotage market is totally closed to EU business both in air and maritime transport, the reverse does not hold for the EU. This has serious negative effects also on the EU express and courier services industry. Many of the additional regulatory barriers stakeholders brought to the attention of the Commission are

[31] Stakeholders are also affected by indirect ownership rules in the US ICT market and by an apparent lack of pro-competitive regulation in the business-to-business market in the US.

on the US sub-federal (i.e. state) level, notably with regard to insurance regulation and professional services, such as legal services.

In a number of services sectors, regulators on both sides of the Atlantic seek to achieve similar outcomes in terms of prudential oversight and consumer protection. Diverging approaches can lead to different effective rules, and for many service suppliers, unnecessary duplication and excessive administrative burdens. In the absence of the recognition of equivalence between different regulatory frameworks, EU service providers subject to rigorous EU oversight may need to comply with additional conditions imposed by the US upon foreign service providers. This increases the costs of EU providers in areas such as insurance and hence reduces their competitiveness with regard to US suppliers of similar services.

2.3.3 Limited access to the government procurement market in the US

Currently, the access for EU businesses to the U.S. procurement market is guaranteed by the WTO Agreement on Government Procurement and the Memorandum of Understanding signed in 1995. Following the recently revised market access commitments under the GPA, the US has a fairly comprehensive coverage for its federal procurement, once these commitments are in force. Nevertheless, some significant procuring federal entities, such as the Federal Aviation Agency, are still not covered. Moreover, the U.S. maintains a preferential regime for national SMEs and attaches Buy American rules to mass-transit projects. Significant areas of government procurement at all levels of government are closed to EU business due to "Buy America(n)" provisions, giving preferential treatment to US business. The affected EU sectors are active in areas such as railway equipment or construction.

The recent revision of the GPA has also not changed the current commitments of the US at state level. 13 US states are still not covered at all under the GPA. In addition, the coverage of the 37 states committed under the GPA varies and does not cover the procurement of cities, municipalities that are in charge of procurement in the domain of utilities.

2.4 The need for EU policy intervention

The barriers and problems of transatlantic trade discussed above can potentially be resolved or mitigated by trade policy. If the main objective of policy intervention is to create more favourable conditions for trade and investment between the EU and the US, such objectives can in principle be attained either by policy intervention in individual areas (i.e., tariffs, regulatory obstacles for goods, services, procurement) or by the use of comprehensive trade instruments such as an FTA. EU policy, confirmed by political statements such as that at the European Council on 28/29 June 2012,[32] favours deep and comprehensive FTAs, provided that certain conditions can be met.

Under Article 5(3) TEU, the subsidiarity principle does not apply in areas of exclusive EU competence. Trade policy and the negotiation of international trade agreements are areas of exclusive EU competence pursuant to Article 207 of the Treaty on the Functioning of the European Union, which states that the European Parliament and the Council, acting by

[32] Conclusions of the European Council meeting 28/29 June 2012.

means of regulations in accordance with the ordinary legislative procedure, shall adopt the measures defining the framework for implementing the common commercial policy.

In the following, in line with the principle of proportionality, all reasonable policy options are discussed to assess the likely effectiveness of such policy intervention.

3. OBJECTIVES

3.1 General objectives

In line with the Treaties[33], 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."

In this context, the general objectives of European trade policy can therefore be defined as:

- promoting smart, sustainable and inclusive growth through the expansion of trade;[34]
- the creation of job and labour opportunities and welfare gains including lower consumer prices and other consumer benefits;
- improving Europe's competitiveness in global markets.

3.2 Specific objectives

In respect of future EU-US economic and trade relations, the EU's objectives set out above would translate into three concrete pillars:[35]

- 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.

[33] Art. 206 of the EU Treaty (ex Article 131 TEC).

[34] See chapter 1 of Title V of the Treaty on European Union (TEU), in particular Article 21 paragraph 2 (e), Article 206 (ex Article 131 TEC) of the Treaty on the Functioning of the European Union (TFEU), COM(2010) 2020 and COM(2010)612/4.

[35] Making use of all areas discussed in the HLWG: tariffs, non-tariff barriers for goods (including sanitary and phytosanitary rules), services, investment, public procurement, intellectual property rights (including geographical indications) and trade rules (which covers trade facilitation/customs, trade-related aspects of competition and state-owned enterprises, trade-related aspects of labour and environment, horizontal provisions on small- and medium-sized enterprises, strengthening supply chains, and access to raw materials and energy).

- Achieving reciprocal market access to the government procurement markets of both parties.

3.3 The EU's operational objectives

Based on expert studies and the public consultations, a number of more specific operational objectives that flow from these aims are identified and described below. Understandably, they reflect primarily the European perspective, however, the section concludes with a brief outline of perceived US objectives. The operational objectives indicate the specific areas in which potential negotiations are likely to be concentrated.

(a) As regards **trade in goods**, we should aim at eliminating all tariffs, considering options for the treatment of the most sensitive products. Even more importantly, we should aim at eliminating or reducing the trade cost of unnecessary regulatory obstacles to trade in goods and related investment.

To the extent that regulatory obstacles stem from legitimate, non-discriminatory and proportionate regulatory measures, and from unavoidable differences in the regulatory environment, we should aim at reducing as many of the existing incoherencies as possible in order to limit the trade costs associated with them. Since not all unjustified regulatory divergences can be eliminated in one go, we should set as an objective a "living agreement" that allows for progressively greater regulatory convergence over time. Moreover, strengthened institutional mechanisms should be set up to enhance upstream regulatory cooperation.

(b) With regard to **trade in services** and related investment, we should set as an operational objective the binding of the existing level of autonomous liberalisation and the "future proofing" of such liberalisation by subjecting it to a ratchet, which would capture any future new liberalisation. Furthermore, we would seek to achieve genuine new market access through an effective opening of key services sectors. We should also address regulatory barriers through closer regulatory co-operation and by establishing common regulatory disciplines.

(c) Finally, in respect of **public procurement,** we should aim at improving EU firms' access to public procurement opportunities in the US, inter alia by setting the following operational objectives: 1) increasing the coverage of federal procurement (e.g. additional procuring entities and removing Buy America conditions attached to federal funding); 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; 3) persuading the US to progressively eliminate trade barriers to cross-border procurement ("Buy America(n)" provisions, sectoral derogations, in particular on mass-transit and with respect to SMEs).

3.4 The perceived US operational objectives

The bulk of US exports enter the EU market at very low tariff rates and the EU services market is already very open. Therefore, the US is likely to aim at achieving its objectives by concentrating on the remaining tariff peaks (mainly for agricultural products) and on certain aspects of regulatory measures (particularly disciplines on SPS measures and the aim for EU recognition of US located CABs on a national treatment basis).

As regards the other US objectives, a substantial number of issues can be identified from on-going bilateral dialogues and exchanges. The list of items expected to be requested by the US for the enhancement of bilateral trade and economic relations could include *inter alia*: the elimination of the remaining EU tariffs for industrial goods, the establishment of a bilateral process through which the US could provide input to the EU's process for setting standards, norms, and systems in a variety of fields; the further liberalisation of trade in services beyond the sectors and modes committed by the EU in the GATS and with other trading partners.

3.5 Consistency of the EU's operational objectives with other EU policies

The EU's operational objectives described above are fully consistent with, and indeed stem from the principle that the European Union should "encourage the integration of all countries into the world economy, including through the progressive abolition of restrictions on international trade".[36]

The EU's operational objectives are also in line with the Europe 2020 Communication, which announced that the European Commission would draw up a trade strategy in 2010 including "proposals for high-level strategic dialogues with key partners, to discuss strategic issues ranging from market access, regulatory framework, global imbalances, energy and climate change, access to raw materials, to global poverty, education and development".

Accordingly, the Communication on Trade, Growth, and World Affairs highlights the priority of "finalizing all the ongoing negotiations (…) and making significant further progress in our relations with strategic partners." [37] The US is considered as one of the EU's top strategic partners, with which the deepening of bilateral economic, trade and investment links is stressed in the Communication as being a priority.

The Communication, while placing the multilateral process of negotiation, and particularly the successful conclusion of the WTO Doha Development Round, as the EU's primary policy, also recognizes the importance of deep and comprehensive bilateral FTAs. The latter can usefully reinforce the benefits derived from the multilateral process, in particular by providing improvements in trading conditions, not just for the bilateral partners to an agreement, but also by providing benefits to other trading partners through indirect trade stimulus.

A bilateral EU-US trade initiative leading to substantial further opening of both the EU and US market would send the signal that the world's two largest economies continue to promote open markets and free trade and investment flows. In this sense, a bilateral agreement can serve as a stepping-stone, rather than as a stumbling block for multilateral liberalisation.

The operational objectives within the negotiations for an FTA also respond to the EU's intention to "step up its efforts to remove remaining tariff and non-tariff barriers in non-EU countries", in particular for the benefit of SMEs, as highlighted in the Communication "Small Business, Big World - a new partnership to help SMEs seize global opportunities".[38]

[36] Article 21 para 2 (e) TEU.
[37] COM(2010)612/4, p. 2.
[38] COM(2011)702, p. 17.

Last but not least, in line with EU policies, these objectives allow for appropriate coverage of trade related matters concerning the environment and sustainable development. They will thus comply with the principle that the Union's policies and actions should "help develop international measures to preserve and improve the quality of the environment and the sustainable management of global natural resources, in order to ensure sustainable development".[39]

4. POLICY OPTIONS

With a view to attaining the objectives set out in Chapter 3, the following chapter outlines different policy options for the future EU-US trade policy:

A. a baseline scenario which does not carry any substantial policy change and would allow for modest progress focused on regulatory issues for goods under the TEC and the High Level Regulatory Cooperation Forum as the main platforms;

B. tariff-only, services-only or procurement-only agreements; and

C. a comprehensive scenario that involves the negotiation of a full- fledged EU-US FTA covering tariffs, regulatory barriers for goods, services, investment and government procurement simultaneously.

For option C, we consider two sub-scenarios – one conservative and one more ambitious– that vary on the extent to which tariffs will be lowered, and the extent to which non-tariff measures (NTMs) can be removed.

This impact assessment, structured as an analysis of all theoretically possible options, aims to support any final political decision on how to proceed with the bilateral economic relations between the EU and the US. The impact assessment carried out in chapter 5 of the report will assess the opportunity and feasibility of these various options in terms of their likely economic, social and environmental impacts, with a view to providing clear indications on what would be the best direction for enhancing the EU-US trade and economic relationship from an EU perspective.

4.1 Policy Option A: No policy change (the baseline scenario)

The first option would be to continue to operate under a framework similar to the current configuration of bilateral relations. This would entail maintaining the on-going bilateral economic dialogues, most importantly the Transatlantic Economic Council, the High Level Regulatory Cooperation Forum (focussing on NTMs for goods), as well as the different sectoral dialogues dealing with regulatory issues, with possible incremental improvement of their functioning and effectiveness.

Under this scenario, the EU would also pursue cooperation in those sectors where the parties have already signed agreements. In this respect, the most important bilateral agreements include: the MRAs for certain standards for goods (1999) and other agreements such as the Veterinary Agreement (1998). The coming years would possibly

[39] Art. 21 para 2 (f) TEU.

bring further limited improvements in the implementation of these agreements. The status quo is de facto a regulatory-barriers-only option, which for the moment is predominantly focused on goods.[40]

The analysis of this baseline scenario is essentially based on developments in the bilateral economic relationship that are likely to be generated by the evolution and the current trend of the EU and the US economies as well as by the global economic situation. The TPP initiative and the possible EU FTAs with Malaysia and Vietnam are not included in the baseline scenario because the possible outcome of the negotiations is unknown and the content of the TPP negotiations is kept confidential.[41]

4.2 Policy Option B: Tariff-only, services-only and procurement-only agreements

While option A, continued cooperation with regards to regulatory measures, represents the status quo, another possible option is the addition of agreements in areas such as tariffs, services and procurement. 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).

Policy option B.1: A tariff-only agreement:[42] A tariff-only agreement would tackle the existing tariffs and therefore constitute a potential improvement in terms of trade and economic activities. However, concentrating on a tariffs-only agreement would inevitably neglect some major areas relevant for trade such as, regulatory obstacles and government procurement or trade in services, in which stakeholders report the main trade barriers between the EU and the US.

Moreover, in the absence of possible trade-offs in the negotiations between tariffs, non-tariff barriers, services and government procurement, the expected abolition of tariffs is unlikely to cover all tariff lines. In the political reality of negotiations, most likely the most trade restricting tariffs (those that have the biggest impact on bilateral trade) will be retained or phased out last. The tariff-only scenario will therefore assume a more conservative 98% elimination of all tariff lines, falling short of the goal of full duty elimination announced in the interim report. It should be noted, however, that even 98% duty elimination may be difficult to achieve in the absence of comprehensive negotiations and we take the upper bound of a reasonable range of assumptions.

Policy option B.2: A services-only agreement:[43] Although the respective services markets of the EU and the US are already very open in relative terms, some of the remaining barriers to trade concern certain services sectors, for example the US air and maritime transport market. These sectors are sensitive in the United States and politically it is

[40] Consequently, a separate scenario focussed on NTM for goods-only is not discussed.
[41] Given the current uncertainty for the conclusion of DDA, the baseline equally excludes the conclusion of the current multilateral trade negotiations at the WTO.
[42] Subject to article XXIV of the GATT, WTO rules would allow the EU and the US to negotiate a tariff-only agreement.
[43] Subject to article V of the GATS, WTO rules would allow the EU and the US to negotiate a services-only agreement.

highly unlikely that the US would agree to a liberalisation in the context of a stand-alone services agreement, which does not cover areas of particular interest to the US such as agriculture. Furthermore, the current US focus is on the plurilateral services initiative[44] at the WTO. In fact, given the ongoing preparations for a plurilateral services initiative, in which both the EU and the US are currently 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 will nevertheless assume a scenario of removing 10% of all existing barriers to trade in services in the case of a bilateral services-only agreement and in line with requests from certain stakeholders. This may be an optimistic assumption and again has to be taken as the upper bound of a reasonable set of assumptions.

Policy option B.3: A government procurement-only agreement:[45] EU industry faces many barriers to market access in the field of US government procurement, particularly at the sub-federal level. The EU has already made extensive commitments covering large parts of its procurement market within the GPA and in its bilateral FTAs. It negotiates on the basis of maximum opening, possibly restricted by specific derogations and reciprocity clauses. Besides, in areas not committed internationally, the EU public procurement market remains *de facto* open. The US approach is different, as it considers its procurement market closed unless specific binding market access commitments are taken in its international negotiations.

With a view to finalising the market access negotiation linked to the GPA revision, the EU and the U.S. have established the EU-U.S. Bilateral Government Procurement Forum. In this context, both sides committed to explore the expansion of reciprocal government procurement opportunities through bilateral negotiations, primarily on national treatment basis beyond those set out under the GPA and the 1995 MoU. Under the Forum, the potential additional market access could only be "traded" against market opening in the area of public procurement and not on alternative trade areas of potentially greater "offensive" interest for the US. Nevertheless, given the shared goal stated in the interim report of increasing market access at all levels of government on the basis of national treatment, an estimated 25% reduction of barriers is used under this scenario.

4.3 Policy Option C: A comprehensive EU-US Free Trade Agreement

Under this option, the EU and the US would enter into negotiations for an EU-US Free Trade Agreement (FTA). In keeping with established policies both in the EU and the US, such an agreement would have to be of a deep and comprehensive nature, involving, *inter alia*, a major effort to eliminate all tariffs and a considerable number of non-tariff barriers for goods, as well as liberalization of trade in services and the liberalization and facilitation of investment flows in both services and non-services sectors. Such an approach would allow the negotiators to create synergies between the different areas.

[44] This initiative aims at bringing together the most important countries in trade in services, potentially aiming producing an Art. 5 GATS type of services-only agreement.

[45] Government procurement has been effectively excluded from the application of the main multilateral trade rules under the GATT and the WTO (Articles III:8(a) and XVII:2 of the GATT 1947. In the General Agreement on Tariffs and Trade, originally negotiated in 1947, government procurement was explicitly excluded from the key national treatment obligation. More recently, government procurement has also been excluded from the main market access commitments of the General Agreement on Trade in Services (Article XIII:1 of GATS).

A key component of such an FTA would have to be to address a critical mass of regulatory obstacles to trade, and achieve their elimination or at least a substantial reduction of their cost for traders and investors. Under this option, the impact assessment looks at two different scenarios proposing different degrees of trade liberalization: a "conservative" scenario in line with the individual agreements discussed above and an "ambitious" scenario simulating further trade liberalisation that goes beyond what would be possible in such individual separate cases.

The conservative scenario (policy option C.1) envisages *de facto* that the parties would negotiate an agreement in line with the "standard template" trade agreements that the EU and the US are currently negotiating with trade partners. The agreements that both sides negotiated with Korea can be considered as representing the EU and US templates, although it has to be noted that the Korea agreements are more ambitious than the 'conservative scenario' as regards tariff reduction and the elimination of sectoral regulatory obstacles to trade.

The ambitious scenario (policy option C.2) is a trade agreement which would potentially differ (in terms of scope and level of ambition) from the current EU and US standard approaches. It would 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 TBT, SPS,[46] 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).

In order to be able to adapt to future evolutions, an ambitious agreement with regard to regulatory coherence would have to be of a "living nature". Regulatory obstacles to trade that cannot be eliminated or reduced in a first phase should continue to be discussed under clear time lines following from an institutionalised mechanism. This mechanism could also include disciplines on strengthened upstream cooperation.

In terms of tariff elimination, current EU policy for deep and comprehensive FTAs aims at complete tariff coverage for all products as the starting point of negotiations. The interim report of the HLWG has identified the goal of full duty elimination, while noting that specific modalities would be needed for the most sensitive products.

Taking into account the political reality, the conservative scenario estimates the impact of an elimination of 98% of tariff lines, while the ambitious scenario models the impact of 100% tariff elimination. The outcome of the negotiations could of course be in between these two scenarios, which therefore provide a reasonable range of possible tariff reductions.

As regards regulatory barriers to trade, the selection of a conservative and ambitious scenario concerning trade cost reductions of a regulatory nature equally captures a range of possible negotiation outcomes in future negotiations. The selection of 10% and 25% in trade cost reductions of regulatory barriers (for goods and services) was made in order to provide, a realistic range of outcomes with a conservative scenario as the lower bound and an ambitious, but still feasible scenario as the upper bound. It has to be noted that the assumed quantitative estimates of trade cost reductions relating to reduction of regulatory differences are averages. In reality, these will differ from sector to sector, depending on

[46] In 1998, EU and the US signed a Veterinary agreement which has all the potential to be a useful tool to overcome regulatory divergences. In the context of an ambitious FTA its scope could potentially be enlarged to cover plant health issues.

the outcome of the negotiations. In some sectors these might be higher, in others they will be lower. The estimates are based on our experience with other trading partners, notably the FTAs with Korea and Singapore as well as the ongoing discussions with Canada.

With regard to the liberalisation of government procurement, given the potential of improvement on the US side and the joint goal of achieving treatment close to national treatment stated in the interim report, more ambitious scenarios are envisaged with 25% and 50% of barrier elimination.

Upper bands for the level of reduction of regulatory barriers (25% for goods and services and 50% for public procurement) are nevertheless imposed by the recognition that, even in an ambitious scenario, not all the costs of trade can or will be removed in the context of a comprehensive negotiation. This is the case, because some of these are linked to legislation addressing environmental, safety and public health concerns. All trade policy options will fully respect the right of each side to regulate in a manner that ensures the protection of health, safety, and the environment at the level that each side deems appropriate.

Box 1: Overview of the scenarios analysed in this impact assessment report

Box 1: Overview policy options

Baseline:
- All FTAs concluded by the EU and the US
- Future EU FTAs: Canada and Singapore
- Entry into force 2017, estimation up to 2027

Policy option A:
- Status quo

Policy option B:
1. B.1: Tariff-only agreement (98% tariff elimination)
2. B.2: Services-only agreement (10% reduction of barriers)
3. B.3: Government procurement-only agreement (25% reduction of barriers)

Policy option C:
- Comprehensive FTA (2 scenarios – higher/lower level of ambition)

1. C.1: Conservative estimate:

Tariffs:	98% duty elimination
NTMs goods:	10% reduction of barriers
Services:	10% reduction of barriers
Public Procurement:	25% reduction of barriers

2. C.2: Ambitious estimate:

Tariffs:	100% duty elimination
NTMs goods:	25% reduction of barriers
Services:	25% reduction of barriers
Public Procurement:	50% reduction of barriers

5. IMPACT ANALYSIS

This chapter analyses the impact of the different policy options outlined above. It will begin by summarizing the modelling strategy and setup of the additional economic study commissioned in the context of the impact assessment (CEPR 2013). It then looks at the overall economic impact resulting from the different policy options discussed in chapter 4. It also includes a sectoral analysis of economic impacts in the EU and the US based on particularly important sectors, and looks into environmental and social impacts. The impacts on administrative costs and simplification effects are also briefly analysed.

5.1. Model and assumptions

The CEPR 2013 study[47] estimates the economic impact of changes in the barriers to trade between the EU and the US using a computable general equilibrium (CGE) model, based on the structure of the world economy as captured by the GTAP 8 database.[48] CGE models are widely used tools for the economic analysis of trade policy changes and allow simulating different scenarios that can be compared against a baseline scenario. The GTAP8 database used in this exercise, results from the work of a wide network of economic experts. It is used extensively by dozens of agencies and international institutions around the world, ensuring the systematic checking of the appropriateness of the underlying data and parameters, and a high degree of confidence in the robustness of the results.

The model used is a "multi-region global" CGE model with the following features: it covers global world trade and production including spillover effects, it allows for economies of scale and imperfect competition, it includes intermediate linkages between sectors, and it allows for trade to impact on capital stocks through investment effects. Consequently, the CGE model also accounts for the impact of reductions of barriers to trade on the capital stock, thereby capturing the induced expansion (or contraction) of the different sectors of the economy over a longer time horizon following the modelled trade policy shocks. As with any model, it can only give indications of the impact that might result from assumptions specifically set in advance.[49]

The spillover effects modelled relate to the fact that some of the NTMs result from differences in regulations and procedures that cannot be altered on a purely bilateral basis, such as the alignment of domestic standards with international standards. Once addressed, they will improve market access for third countries as well.

The CEPR 2013 study has focused on spillover levels of 20% as being most realistic, on the basis of an examination of barriers identified and on the assumption that most of the remaining NTMs between the EU and US would only be reduced on a bilateral basis,[50] A

[47] See the results of the model in Annex 2.

[48] The GTAP database is a fully documented, publicly available, global database that contains complete bilateral trade information, transport and protection linkages. The current release (GTAP 8) features dual reference years of 2004 and 2007 as well as 129 regions for all 57 GTAP commodities. Further information about the database can be found at: https://www.gtap.agecon.purdue.edu/databases/v8/default.asp.

[49] For more details on the methodology, please see Annex 3.

[50] It has to be noted that the horizontal spillover assumption is used for modelling reasons. In reality, they might vary from sector to sector, depending on the outcome of negotiations. In some sectors spillovers might be higher, in others they will be lower. As a result, for some of the goods sector the spillover effect may be

horizontal spillover of 20% means that a fifth of the NTM cost reduction also yields benefits for third countries, while the remaining 80% of any reduction delivers a strictly bilateral benefit.[51]

The model also considers a second "indirect" spillover effect. This is meant to gauge implications of third countries adopting common standards agreed between the EU and the US. Given that, collectively, the EU and US would stand as the world's biggest trading block, there is a very real possibility that mutual agreement on regulations and standards would be adopted, partially, by third countries. In this sense, where the EU and US act as a "regulatory frontrunners", there is some scope for setting de facto common, global standards. This implies that the EU and US will then have improved market access in third markets from reduced trade barriers, while there will also be additional new market access for third countries in the EU and US when using the new standards as well as scope for reductions in barriers between third countries as they converge further on common standards. Therefore, indirect spillovers offer scope for lower costs and greater trade between third countries as well. We have modelled indirect spillovers at 50% of the direct spillover rate. This means for example that for a 5% trade cost reduction between the EU and US, and with 20 percent direct spillovers, we will have a 1% reduction for third countries exporting to the US or EU, and a 0.5% reduction for EU and US export costs to third countries, and for trade between third countries.

5.2 Policy option A: The baseline scenario

Given the results achieved so far under existing bilateral dialogues it is reasonable to assume, that – in relation to reducing regulatory trade costs – any effects achieved under this option would be limited and would not translate into substantial growth of bilateral trade and investment volumes. Thus, no additional significant GDP gains can be expected in either the EU or the US in the short to medium term. While there might eventually be some progress under the TEC and the High Level Regulatory Cooperation Forum with regard to preventing the emergence of trade barriers, any such progress is likely to be in line with the current trend.

The baseline scenario therefore assumes no changes in trade policy: tariffs and regulatory obstacles remain as they are at present, subject to the conclusions of trade negotiations currently underway and very close to conclusion, as explained below. The world economy can thus be expected to evolve up to 2027 in line with the growth projections of the main international institutions notably those from the IMF, which is the main source of the baseline scenario used in CEPR 2013. These projections include the recent global economic slowdown caused by the financial crisis that broke out in 2008. See table 1 for an overview of the assumed annual growth rates of the baseline scenario. All economic, social and environmental impacts reported in the following sections represent the deviation from this baseline scenario.

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overestimated, given that the EU and the US might only agree to accept, for example, safety regulations as equivalent on a bilateral basis.

[51] It should be noted that for services, areas such as air and maritime transport where the US is currently closed to foreign service providers are both subject to MFN reservations in the GATS, meaning that the EU could potentially obtain preferential access which is not extended to other trading partners.

Table 1

Annualized GDP Growth Rates			
	2001-2007	2007-2016	2007-2027
European Union	2,28	0,70	1,17
USA	3,30	1,74	1,90
Other OECD	2,54	1,84	2,02
Eastern Europe	6,55	2,03	3,20
Mediterranean	4,98	3,55	3,93
China	11,21	9,06	8,24
India	7,91	7,53	6,19
ASEAN	5,70	5,01	5,19
MERCOSUR	4,28	3,86	3,97
Low Income	5,94	5,43	5,56
Rest of World	6,12	3,81	4,41

note: 2007-2027 are used for projections
note: baseline includes all FTAs currently in place and the EU-Singapore and EU-Canada FTAs.

5.3 Policy option B: Tariff-only, services-only and procurement-only agreements

5.3.1 Overall economic impact of a tariff-only agreement (policy option B.1)

A "tariff-only" agreement would provide overall benefits both for the EU and the US. In the political reality of negotiations, the most trade restricting tariffs (those that have the biggest impact on bilateral trade) will be retained or phased out last. The tariff-only scenario will therefore assume a more conservative 98% elimination of all tariff lines, falling short of the goal of full duty elimination announced in the interim report. In reality, a 98% coverage might still be too high, because "tariff-only" negotiations would give fewer possibilities for the EU and the US to trade off concessions and benefits across all pillars such as services and procurement, where in particular the EU has strong interests (and which would require the biggest internal efforts on the US side).

Based on these assumptions, under a tariff-only agreement EU GDP would rise by 0.10% amounting to a yearly increase of national income of €15bn by 2027 compared to the baseline option. The US GDP would increase by 0.04% with an increase of national income of €5bn.

Table 2

2027 benchmark

A tariff-only agreement

	GDP (quantity index) % change	National income, bn euros
European Union	0.10	15.376
United States	0.04	4.942

Under the tariff-only scenario, EU bilateral exports to the US would increase by 6.57%, while the US bilateral exports to the EU would increase by 12.36%. The impact on the total value of the EU's bilateral exports is estimated to reach €44bn, while the US bilateral exports show an increase of about €54bn. (See Annex 2 for the full set of estimations.)

While the relative impact on US exports is stronger than the impact on EU exports, the total effect on welfare and GDP is more positive for the EU. This can be explained by three factors. Firstly, the structure and interlinkage of the EU and US economies with the world economy differ to the extent that in the EU exports make up a larger share of GDP and hence the same growth in exports (other things equal) results in a higher growth of GDP in the EU than in the US. Secondly, we observe that stronger efficiency and productivity gains drive stronger increases in GDP and income in EU. Thirdly, higher wage increases in the EU (both for skilled and unskilled labour) lead to higher domestic demand producing a stimulating effect on the EU economy.

5.3.2 Overall economic impact of a services-only agreement (policy option B.2)

Given the importance of services in bilateral EU-US trade (€269bn, 2011) this option is analysed in line with the assumptions of the tariff-only policy option. As would be the case for a tariff-only agreement, a services-only agreement would lack trade-off possibilities. Consequently, the estimate is based on the conservative set of assumptions detailed above (compare box 1).

Under such assumptions, EU GDP would rise by 0.01% amounting to a yearly increase of national income of €2.5bn in 2027 compared to the baseline option. US GDP would increase by 0.03% with an increase of national income of €4.4bn.

Table 3

2027 benchmark

A services-only agreement

	GDP (quantity index) % change	National income, bn euros
European Union	0.01	2.540
United States	0.03	4.406

Under the services-only scenario, bilateral EU exports would increase by 0.69%, while bilateral US export would increase by 0.66%. The positive impact on the value of the EU's bilateral exports is estimated to reach €4.6bn, while the US bilateral exports show an increase of about €2.9bn.[52]

In the case of a services-only agreement, both the EU and the US benefit in terms of exports and income growth. However, the positive impact on welfare and GDP are expected to be higher for the US than for the EU.

5.3.3 Overall economic impact of a procurement-only agreement (policy option B.3)

After the political conclusion of the negotiations in December 2011, the GPA revised text and additional market access commitments were formally adopted by the GPA Parties on 30 March 2012. Although part of the WTO framework, the GPA negotiations were de facto bilateral procurement-only negotiations. The U.S. expanded access to their central

[52] The CGE model used cannot fully capture the direct impact of policy change on foreign direct investment (mode 3) or the cross-border movement of natural person to provide a service (mode 4). This methodological shortcoming affects all standard CGE models (see Annex 3 for more information on the structure of the model). In other words, the effect of the reduction in the NTMs that are associated with the services sectors (including those that apply to investment) is captured in the model only to the extent that such reduction affects cross-border trade flows and /or induces greater competition in the market.

According to the latest data available from Eurostat, services represented only 39% of EU-US bilateral cross-border trade flows (in 2011) while they were responsible for 54% of EU-US FDI (inward and outward) stocks (in 2009). This shows the significance of FDI as a channel for market access for services providers. Consequently, the estimates for services in this section and in all following sections can be regarded as the lower bound quantification of the expected economic gains of services liberalisation. For all scenarios that include services, the economic effects that can be expected from the liberalisation of services may be considerably higher when all the gains associated with greater foreign direct investment activities are in place.

The effect of the reduction of NTBs on cross-border trade (i.e. excluding mode 3 and mode 4) should be interpreted in the context explained above (i.e. that cross-border trade in services only represents around one third of the cross-border trade with the USA). It also has to be noted that the price elasticities used in the CGE model for services sectors are lower than for goods (reported in Annex 3). The use of lower elasticities for services aims at capturing the fact that most services sectors are likely to be less responsive to changes in the level of protection (i.e. a decline in NTMs) given that firms' operations are also affected by factors that are beyond the reach of policymaking such as language barriers, geographical proximity, need for interaction between consumers and providers, etc., which are particularly relevant for the services industry.

level entities, including some US federal agencies, but the ultimate goal of the EU to substantially increase market access on the US sub-federal level could not be reached.

Since the coverage and depth of the commitments of the US States could not be expanded, it is unlikely that much additional market access for EU business would be achievable under a procurement-only scenario, without considering other potential trade-offs in non-procurement trade areas where the US, in particular its States, might have offensive interests in the EU market. Therefore, the estimate are based on the conservative set of assumptions (see box 1).

Consequently, the economic impact of a procurement-only agreement is rather limited. Based on the data base used for the CEPR 2013 model, the EU GDP would rise by 0.02% on a yearly basis and lead to EU income gains of €3.6bn by 2027 compared to the baseline option. The US GDP would increase by 0.01% and lead to income gains of €1.5bn.

Table 4

2027 benchmark

A procurement-only agreement

	GDP (quantity index) % change	National income, bn euros
European Union	0.02	3.660
United States	0.01	1.455

In the simulated procurement-only scenario EU bilateral exports would increase by 1.1%, while the US bilateral export would increase by 0.78%. The positive impact on the total value of the EU's bilateral exports is estimated to be €3.0bn, while the US bilateral exports are expected to increase by about €3.4bn. The higher impact on EU bilateral exports reflects the fact that currently the US procurement market is more closed than the EU procurement market. A horizontal cut of barriers to transatlantic procurement, as simulated by the CEPR 2013 model, consequently has a larger impact for the EU industry than for US industry.

Certainly, tariff-only, services-only and procurement-only agreements could be partially or comprehensively combined. A combination of the estimates discussed above provide a reasonable indication of how such results would look like.

5.4 Policy option C: A comprehensive Free Trade Agreement

The scenarios of a conservative FTA (C.1) and an ambitious FTA (C.2) have in common that they assume the parallel negotiations of all pillars mentioned above (tariffs, NTMs for goods, services, procurement). They differ to the extent of the level of ambition in those pillars. Scenario C.1 assumes conservative reductions of tariffs and barriers while scenario C.2 is more ambitious, but still remains within the range of the possible (see box 1).

The levels of ambition for the conservative scenario are aligned with the tariff-only, services-only and procurement-only assumptions, although one could reasonably argue that the trade-offs possible under this scenario could likely lead to higher results than in the individual pillars. They can therefore be interpreted as the lower bound of a reasonable range of assumptions. This range between the lower end of ambition and a rather ambitious set of assumptions provides a working hypothesis for a realistic range of outcomes into which the results of potential negotiations would fall. In fact, since results within this range are consistently positive, varying only in the degree of overall gain, scenarios C.1 and C.2 provide an economic assessment of the range of potential outcomes of negotiations of a full-fledged FTA.

Policy option C (comprehensive FTA) moves beyond the status quo in the area of regulatory obstacles for goods, which provides for major additional gains. Another advantage is the liberalisation of all pillars (tariffs, services, regulatory issues and procurement) in parallel leading to synergy effects of trade liberalisation.

5.4.1 Overall economic impact of a conservative FTA (policy option C.1)

Under the more conservative scenario and assuming a 20% spillover effect, according to the model used in the CEPR 2013 study, GDP would increase in the EU by 0.27% (in 2027, yearly basis) compared to the baseline option. For the US, the magnitude of the GDP increase is expected to be about 0.21%. The estimated gains in terms of national income for the EU amount to an increase of €48bn and €33bn of the US. Most of the gains from the regulatory cost reduction stem from purely bilateral liberalisation. The spillover effects have only a marginal influence on the results.[53]

Table 5

2027 benchmark

Conservative scenario, 20% spillovers

	GDP (quantity index) % change	National income, bn euros
European Union	0.27	48.385
United States	0.21	33.022

Under this scenario, bilateral EU exports would increase by 16.16%, while the US bilateral export would increase by 23.20%. The total value of the EU's bilateral exports would rise by €108bn, while the US bilateral exports show an increase of about €101bn. (See section 5.5.1 and Annex 2 on the full set of estimations.)

In summary, we observe that, while the relative impact on the US imports and exports is stronger than the impact on the EU, the total effect on welfare and GDP is higher for the EU. This could be explained by the factors detailed under section 5.3. In addition, under

[53] A sensitivity analysis undertaken shows that a hypothetically assumed spillover of 10% is predicted to lead to GDP increases of 0.25% and 0.19% respectively.

this scenario the terms of trade for the EU remain stable, while the terms of trade for the US decrease by 0.08%.

5.4.2 Overall economic impact of an ambitious FTA (policy option C.2)

Scenario C.2 is more ambitious as to the extent of trade cost reductions (tariffs, NTMs for goods, services, procurement) achieved by both sides (see Box 1).

Under the ambitious scenario, the model predicts GDP increases for the EU of 0.48% compared to the baseline option. In the US, GDP increases would amount to 0.39%. For the EU, these estimated gains amount to an increase of national income by €86bn. For the US, the comparable amount would be €65bn.

Table 6

2027 benchmark

Ambitious scenario, 20% spillovers

	GDP (quantity index), % change	National income, bn euros
European Union	0.48	86.453
United States	0.39	65.015

Under this scenario, bilateral EU exports would increase by 28.03%, while US bilateral exports would increase by 36.57%. The impact on the value of the EU bilateral exports would be an increase by €187bn, while the US bilateral exports would show an increase of €159bn. (See Annex 2 for the full set of estimations.)

Compared to the conservative scenario, we observe a similar pattern of expected higher relative impact on the US exports, while the total effect on welfare and GDP seems to be more positive for the EU. In line with the reasoning above, this could be explained by the factors discussed under section 5.3. As in the conservative FTA scenario, the terms of trade for the EU remain stable, however, the terms of trade for the US decrease even further (0.19%) in the case of an ambitious FTA.

5.5 Impact on sectoral competitiveness in the EU and the US

The macro-economic analysis above shows that trade liberalisation between the EU and the US, and in particular the FTA option, improves overall welfare for both partners. Reducing trade barriers boosts competitive pressure in industries that to some extent have been sheltered from global competition. The opening up of the economy to outside competition (by reducing tariffs and the cost of NTMs) can however have a diverging impact on trade and output, by sector and by firm within each sector. In some cases, within a particular sector, the overall result may aggregate the effects on the different industries. For example in agriculture, some short-run impacts of an EU-US trade initiative could be a decrease in EU output, in particular for certain meat producing sectors. These effects will most likely be followed by adjustment dynamics. An initial

shock in most affected sectors is expected to lead to restructuring of the sectors concerned and only the expected efficiency gains due to productivity growth will provide for positive results in the longer term.

As shown by the responses to the public consultation, the broad majority of stakeholders supports further trade liberalisation and expects a positive impact on their sector. This support for trade liberalisation included sectors such as automobiles, air and maritime transport, machinery, chemicals, pharmaceutical products, the processed food and drinks industry, professional services, metal products and textiles, as well as numerous umbrella organisations representing stakeholders both in the area of goods and services.

Nevertheless, 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.

It is important to note that the CGE model used in the simulations underlying this analysis cannot take into account technology changes or changes in the quality of output produced (only to the extent that it translated into higher prices and therefore higher output values), as responses to the trade liberalisation. Therefore, the sectoral analysis presented below provides a lower end estimate of the actual economic and competitiveness gains of each trade policy option. In reality, many firms will respond by improving their technologies and products when faced with increased competition.

As can be deducted from the assumptions above, **policy options A** will not lead to sector output changes compared to the baseline trends.

Under **policy option B.1**, the sectors currently concerned by the highest tariff barriers would be the main beneficiaries. The EU other machinery and manufacture sectors would benefit from such an agreement in terms of output increases (0.35%/0.6%), while we would see a decrease in the output in the motor vehicles (0.65%), other transport equipment (0.26%), electrical machinery (0.31%) and chemicals sectors (0.11%), (compare table 6 for an overview of sectoral output changes under the policy options with the strongest impact on the sector level).

For **policy option B.2**, the EU services sectors benefitting the most in terms of increased output would be the finance (0.12%) and insurance industries (0.30%). The impact on other EU services sectors is negligible.

In terms of output increases, the biggest beneficiaries under the procurement-only scenario (**policy option B.3**) are the EU motor vehicles (0.28%) and the EU chemicals sectors (0.15%). The impact on other sectors is limited, except for the EU electrical machinery sector which will decline by 0.24%.

Since the most extreme impacts on the sectoral level (positive and negative) are derived in the FTA scenarios (C.1 and C.2), the following analysis will discuss these two scenarios in depth, looking at output changes and changes to trade flows.

In case of a conservative FTA (**policy option C.1**), the model used in CEPR 2013 shows that the sectors where we can expect to see the largest increase in output, i.e. overall production, in the EU are the processed food (0.3%), motor vehicles (0.24%), other machinery (0.4%), other manufactures (0.69%), water transport (0.55%), air transport (0.3%), finance (0.23%), insurance 0.44%) and construction (0.31%) sectors. In other sectors (e.g. chemicals and business services), there would be more limited output increases (0.09%/0.15%). We would see *decreases* of output in the electrical machinery (3.74%), other transport equipment (0.17%) and the metal and metal product (0.71%) sector.

In terms of bilateral trade, the biggest sectoral effect is expected to take place in the motor vehicles sector – a sector representing almost 21%% of total EU exports to the US – with an increase of over 70% of EU exports to the US. EU exports of chemicals to the US are also expected to increase by more than 20% (€17bn).

The simulation shows that the most significant rises in EU global exports (exports to all third countries) can be found in the processed food, motor vehicles, other manufactures, maritime transport, and finance (including insurance) sectors. The EU's global imports would rise substantially for the processed food, motor vehicles, other transport equipment, metal and metal products, wood and paper products sectors.

In an ambitious FTA (**policy option C.2**), the sectors most affected in the EU would largely be the same, but the expected increases or decreases in output are larger.

We can expect in particular an increase in output in the EU processed food (0.57%), chemicals (0.37%), motor vehicles (1.54%), other machinery (0.37%), other manufactures (0.79%), water transport (0.99%), air transport (0.44%), finance (0.42%), insurance (0.83%), business services (0.25%), construction (0.53%), personal services (0.26%) and in other services sectors (0.28%), whereas output in the electrical machinery (7.28%), other transport equipment (0.08%) and metal and metal product (1.5%) sectors would decline.

In terms of bilateral trade, EU processed foods, chemicals, electrical machinery, motor vehicles, other transport equipment, metals and metal products exports are expected to increase the most, with motor vehicles (346.80%/€59bn) and chemicals (34.20%/€22bn) exports benefitting the most in nominal terms.

The model forecasts significant rises in EU global exports for the processed food, chemicals, motor vehicles, other transport equipment, metals and metal products, wood and paper, other manufactures, water transport, air transport and the finance (including insurance) sectors. The EU's global imports would rise substantially for the processed food, chemicals, electrical machinery, motor vehicles, other transport equipment, metal and metal products, wood and paper products and communications sectors (compare Annex 2 for detailed quantitative results).

Under both scenarios, C.1 and C.2, the relative changes in exports are expected to be larger for the US than for the EU as the EU is a more important exporter for the US than the US is for the EU and hence smaller nominal changes lead to a higher relative impact. Reductions of regulatory barriers operate to some extent on an MFN basis, which will enable other trading partners to benefit from free-riding on these reductions in trade costs. This is captured by the 20% spillover rate used in the simulations.

Table 7 summarises the policy options that have the largest impact on specific sectors in terms of their output. (See Annex 2 for the full set of estimations.)

Table 7

2027 benchmark

European Union, output change by sector, percent (20% spillover)

	Tariff-only option (B.1)	Conservative scenario (C.1)	Ambitious scenario (C.2)
Agr, forestry, fisheries	0.03	0.05	0.06
Other primary sectors	0.00	0.01	0.02
Processed foods	0.06	0.30	0.57
Chemicals	-0.11	0.09	0.37
Electrical machinery	-0.31	-3.74	-7.28
Motor vehicles	-0.65	0.24	1.54
Other transport equipment	-0.26	-0.17	-0.08
Other machinery	0.35	0.40	0.37
Metals and metal products	0.03	-0.71	-1.50
Wood and paper products	0.06	0.08	0.08
Other manufactures	0.60	0.69	0.79
Water transport	0.14	0.55	0.99
Air transport	0.15	0.30	0.44
Finance	0.06	0.23	0.42
Insurance	0.06	0.44	0.83
Business services	0.05	0.15	0.25
Communications	0.05	0.10	0.17
Construction	0.12	0.31	0.53
Personal services	0.04	0.15	0.26
Other services	0.05	0.16	0.28

5.5.3 Sector specific analyses of the electrical and electronic equipment, insurance industry and motor vehicles sectors

Given the economic impact presented above, the information provided by respondents to the public consultation, as well as conveyed by studies and trade experts, the following three sectors were examined in greater detail: electrical and electronic equipment, insurance services and the motor vehicle sector. It is in these sectors where some of the largest impacts in the EU are expected. Several of the issues highlighted in relation to these sectors, such as the size of the spillover effect or the importance of NTMs over tariff barriers, offer insights into potential impacts in other sectors.

5.5.3.1 Electrical and electronic equipment

The electrical equipment industry is comprised of electrical products, such as power generators, electric motors, electricity distribution and control apparatus, wires and cables, batteries and accumulators, lighting and lamps and electrical equipment for vehicles and electronic products such as intermediary mass products, components for TV, radio

transmission, telephone networks and terminal equipment. The electrical and electronic equipment sector, as a result of deeper trade integration, is simulated to have a somewhat significant decrease of output in the EU. This section therefore analyses the assumptions leading to the projected impact. As can be seen in table 7, EU output would decrease by 3.74% in the case of a conservative FTA and 7.28% in the case of an ambitious FTA. Major hubs of the electrical and electronic equipment sector are Germany, Italy and the United Kingdom, but the sector is quite diversified and dispersed across the EU.[54] Therefore the effect can be assumed to be distributed across the Member States of the EU.

While this result of reduced output is partly driven by an assumed reallocation of production factors to other more competitive sectors, which would benefit more from the FTA, such as the motor vehicle sector or the chemical industry, another driver of the simulated reduced output can only be explained by looking into specific effects relevant to the sector itself.

A detailed decomposition of the effects contributing to this simulated output decline shows that the main driver is the direct spillover effect. In the case of both a conservative FTA and an ambitious FTA and assuming a 20% spillover, it accounts for about 80% of the total effect on the sector.[55] In comparison, the tariff reductions only account for 6% and 2% respectively. In other words, the model reveals that regulatory alignment is harmful to EU industry because third countries would also benefit from the bilateral liberalisation in light of their comparative advantages.

For modelling purposes, a horizontal spillover has been assumed across all sectors. However, in the reality of negotiations, the spillover of reduction of NTMs itself is up for negotiations, depending on the agreed implementation (i.e. bilateral vs. erga omnes elimination of NTMs). In view of the different concepts of international standards between the EU and the US, it is not expected that the approach followed would necessarily involve in any case the acceptance of international standards or other measures, which are more likely to have some type of MFN effect and therefore entail spillover effects to third countries. Instead, the expected approach to be followed in the negotiations with the US would focus on regulatory coherence and a degree of mutual recognition between the EU and the US standards, particularly in the field of safety regulation relevant for electrical and electronic equipment. Sector experts assume that bilateral negotiations with the US would mainly lead to bilateral and not erga omnes recognition of standards. This in turn would mean, contrary to the 20 % general spillover effect assumed, a significantly more limited spillover effect in this sector, or even none at all. Counting out spillover effects would considerably reduce negative effect on the sector. Annex 2 decomposes the total effect into effect relating to tariffs, NTM reduction and spillover.

5.5.3.2 Insurance industry

Insurance and re-insurance services exports are more important for the EU than for the US. EU exports of insurance services amounted to €5.4 billion in 2010 while in the US they totalled €2.6 billion.

[54] http://ec.europa.eu/trade/creating-opportunities/economic-sectors/industrial-goods/machinery/

[55] As expected, under the assumption of a 10% spillover sensitivity analysis, output decline in the EU is less strong (2.24% and 4.40% respectively). Without spillover the output decline would even diminish further to 1.25% in the case of an ambitious FTA and 0.68% in the case of the less ambitious FTA.

The CEPR 2013 study estimates that the output in the insurance sector is expected to expand by 0.44% in the EU in the case of a conservative FTA and 0.84% in the case of an ambitious FTA. Bilateral exports from the EU to the US are estimated to increase between 4.2% in the case of a conservative FTA and 8.30% in the case of an ambitious FTA. Major insurance exporting EU Member States are France, Germany, Italy and the UK, but smaller specialised insurance companies that are present also in the US exist in numerous other EU Member States.

In terms of market access relevant measures, in particular the fragmentation and lack of convergence in regulation across various US states – each of which has its own set of regulators and rules and the absence of (optional) federal regulation – acts as the main obstacle for supplying insurance services in an efficient manner to the US market as a whole. This, for example, is illustrated by the pre-approval requirement for each life insurance product at state level. In this regulatory context, one of the issues of greatest concern to EU firms is the collateral and capital requirement in the US for cross-border reinsurance transactions. The collateral requirements are sometimes greater than 100 percent of the premium being reinsured. In November 2011, the US National Association of Insurance Commissioners (NAIC) amended its credit for reinsurance models to reduce the collateral requirements for non-US reinsurers which are based, licensed and domiciled in "qualified jurisdictions". The NAIC's revised model regulation is an important and significant step in the right direction, but concerns about a discriminatory treatment between US and non-US re-insurers and inconsistent application across US states remain.

5.5.3.3 Motor vehicle sector (including parts and components)

The automotive industry[56] is composed of both very large enterprises manufacturing cars, with multi-nationally oriented activities, and producers of car components of various sizes, including numerous small and medium enterprises (SME) predominant in the supply chain. The gross production value of the automotive industry in the EU-27 amounted to €522bn in 2009, while value added was € 99bn.

With 22% of global production, the EU is the largest motor vehicle producer in the world. Out of 80.8 million motor vehicles produced in 2011, 17.6 million were produced in the EU, and 8.7 million in the US.[57] Import penetration in the US motor vehicle market is already relatively high and competition is strong, with all major car producers being present on the market. The EU carmakers perform well on the US market with a market share of 7% and an even higher share in the top price segment.

The importance of EU-US trade relations for the sector is reflected in the fact that 17.8 % of total EU automotive exports were destined for the US in 2011. In that same year, the US supplied 13.3% of total EU imports.[58] The EU had a positive global trade balance with the US of approximately €23bn.

The main car producing EU Member States are Germany, Spain, France, the UK, the Czech Republic, Italy and Belgium. It is noteworthy that a strong production capacity has been built in many of the EU Member States which jointed the EU upon the 2004 enlargement. Moreover, a network of small and mid-sized car parts suppliers spans across the EU and consequently disperses the effect of trade liberalisation across the EU.

[56] The automotive industry provides capital goods like commercial vehicles, commercially operated cars and buses, as well as consumer goods like privately operated cars and light duty vehicles.
[57] International Organisation of Motor Vehicle Manufacturers, 2011, available at: www.oica.net.
[58] Comext, Eurostat

A strong interconnection should also be highlighted between car company holdings across the Atlantic, parent-daughter relations and full-blown production presence of EU industry in the US market as well as US industry presence in the EU. As a matter of fact, the strong production base of the "EU" car industry, particularly in the US Southern Atlantic region, is responsible for a large part of the US car exports to the EU.

Regulatory divergence creating NTMs can be considered to be the main barrier to achieving a truly transatlantic car market. The main reason for regulatory divergence and the existence of NTMs in the automotive sector arises from differences in the way standards and regulations are set in the EU and US. Because the US is not a signing party to the international 1958 UNECE agreement, the aim of which is to increase harmonisation of technical regulations in the field of safety and environmental performance and which provides for the mutual recognition of the approvals granted, UNECE regulations do not apply in the US. The US developed its own standards in parallel, the Federal Motor Vehicle Safety Standards (FMVSS), while in the EU, the commercialisation of vehicles is based on a type approval system that relies more and more on UNECE Regulations partially replacing EU legislation. These differences in regulatory environments give rise to many costly measures that hamper trade for EU firms to the US, and vice versa.

Consequently, with tariffs at around 2.5%, the barriers encountered by the EU car exporters in the US are mainly technical barriers to trade related to emission, safety and noise standards diverging between the EU and the US. These differences favour domestic manufacturers who do not carry these double costs. According to analysis based on companies input and expert opinion, NTMs in the US result in an additional cost of 30% of the exported value of European motor vehicles sold in the US.[59] Studies estimate that the trade cost associated with these NTMs is equivalent to a tariff of 26.8%.[60] These figures could, however, be considerably lower once economies of scale come into play.

While the US has low tariffs applicable on imports, car imports to the EU are protected by tariffs of 10%. Not surprisingly, the CEPR 2013 study estimates that a tariff-only agreement with the US (option B.1) would have a negative effect on the output of the European automotive industry (-0.65%).

Since NTMs are the main hurdle to imports, even a limited elimination as in the conservative FTA scenario (C.1, 10% reduction of NTM in goods) would create benefits that outweigh the negative tariff impact of a potential FTA for the EU.[61]

The CEPR 2013 study estimates that the output of the motor vehicles is expected to expand by 0.24% in the EU in case of a conservative FTA and 1.54% in case of an ambitious FTA. In addition, bilateral exports from the EU to the US of the motor vehicles sector (including components) are estimated to increase between 71% in the case of a conservative FTA and more than double in the case of an ambitious FTA (149%).

Taking into account cross-sectoral liberalisation, it is equally estimated that in case of an ambitious FTA, where 25% of NTMs would have been tackled, the EU motor vehicle

[59] Ecorys 2009, http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc_145613.pdf.
[60] Ecorys 2009, http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc_145613.pdf.
[61] This analysis is based on the assumption of a horizontal spillover of 20%. As discussed in section 5.5.3.1 it can reasonably be assumed that in reality the outcome of negotiations on the NTMs in certain sectors would rather result in bilateral than in erga omnes recognition of safety standards which are also of particular relevant for the motor vehicles sector. Since the direct spillover effect on output is negative in the motor vehicle sector (-1.81% in the EU and -3.28% in the US, in the case of an ambitious FTA), the positive effect on output in the car sector could eventually be even higher.

bilateral exports would increase by €87bn (€41bn in case of a conservative FTA) resulting from competitiveness gains.

According to the simulations, and on the condition that a significant amount of regulatory barriers are reduced or dismantled, the EU motor vehicle industry is the sector expected to be the single largest beneficiary of a bilateral FTA between the EU and the US.

5.6 Economic impact on third countries

While obviously, in total and in relative terms, the biggest winners from an ambitious bilateral trade initiative between the EU and the US will be those two economies themselves, the sheer size of the transatlantic trade and investment relationship will result in a global economic impact. An ambitious FTA between the EU and the US is expected to raise total world income by €238bn of which €86bn are expected to materialise in third countries. Table 8 provides an overview of the gain in GDP and national income for the several world regions.

Table 8

2027 benchmark

Ambitious scenario, 20% spillovers

	GDP (quantity index), % change	Increase in national income, bn euros
European Union	0.48	86.453
United States	0.39	65.015
Other	0.14	86.829
Other high income	0.19	27.552
East Europe	0.33	1.521
Mediterranean	0.08	1.657
China	0.03	9.065
India	0.04	1.860
ASEAN	0.89	18.998
MERCOSUR	0.03	2.151
Low Income	0.20	1.639
Rest of World	0.12	22.387

The table shows that numerous regions of the world would substantially benefit from an increase of transatlantic trade and investment flows, notably Eastern Europe and the ASEAN region. Also very important is the finding that, due to the stimulating effect in the world economy, no region is expected to lose in terms of national income from an ambitious trade liberalisation between the EU and the US. It is noteworthy that the low-income countries would see a positive effect on their GDP (0.20%) and national income (€1.6bn). This effect is relatively limited since the composition of trade between the EU and the US on the one hand, and the composition of trade between developing countries and the EU and the US respectively is rather different. We can hence assume no major

trade deviate effects for low income countries. Consequently, the positive effects on low income countries originate completely from the indirect spillover effects. It can reasonably be argued 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.

While the impact of direct spillover is limited, the possibility of indirect spillovers are the main driving force for the gains of third countries. These indirect spillovers capture the possibility of third countries adopting the common standards agreed between the EU and the US. This is a real possibility given that collectively, the EU and US would stand as the world's biggest trading block and would act as a regulatory example-setters. In such context, there is scope for setting common, de facto global standards. Therefore, indirect spillovers offer the possibility for lower costs and greater trade between third countries as well. The ASEAN and Eastern Europe countries are the ones that would benefit the most from this. The differences between the gains resulting for the various regions can be explained by the existing trade patterns in the world economy.

The impact of a bilateral FTA between the EU and the US on the welfare of third countries also depends on the induced effects on their terms of trade.[62] Table 9 provides an overview on the resulting changes to the baseline terms of trade.

Table 9

2027 benchmark

Ambitious scenario, 20% spillovers

	terms of trade, percent change
Other high income	0.01
East Europe	0.02
Mediterranean	0.14
China	-0.04
India	-0.03
ASEAN	-0.08
MERCOSUR	0.07
Low Income	0.02
Rest of World	0.11

While most regions are expected to benefit from a slight increase of their terms of trade, (notably the Mediterranean region), others will lose. China, India and the ASEAN region, will face decreases in their relative terms of trade on the world market, as the result of an ambitious EU US FTA. However, they still do gain overall in terms of welfare and national income.

[62] In international economics, 'terms of trade' is defined as: (price of exportable goods)/(Price of importable goods). In layman's terms it means what quantity of imports can be purchased through the sale of a fixed quantity of exports.

In the medium term, agreement between the EU and the US on joint rules or standards could lead to reinforced multilateral disciplines on a number areas, providing new impetus to the multilateral trading system.

5.7 Impact on small and medium enterprises (SMEs)

Small and medium-sized enterprises (SMEs) perform a critical role in the European economy and employ two-thirds of the EU work force. In addition, Europe's capacity to build on the growth and innovation potential of SMEs, which are very often at the forefront of new technologies and applications will be decisive for the future prosperity of the EU. In line with the Commission's strategy on SMEs internationalisation,[63] any trade initiative should be conducted under an approach that would particularly help SMEs to compete internationally.

It can be assumed that SMEs are expected to gain mainly from a comprehensive EU-US FTA. Firstly, the US is the most important market for European internationalised SMEs[64] (18% of the export of EU27 to third markets in 2010). Enhancing market access in the US for EU business will particularly help SMEs, if the main goal is to tackle regulatory barriers. As the public consultation revealed again, there is a particular need among SMEs for greater advice and assistance on how to cope with diverging regulatory environments. Difficult paperwork, bureaucratic procedures (administrative costs), conformity of products and services to national technical standards and other laws and regulations in foreign countries have been indicated by EU SMEs as some of the most important barriers to internationalisation.[65] The public consultation carried out in the framework of the impact assessment highlighted the non-proportional burden of diverging regulatory systems. While the nominally larger amount of exports of bigger firms allow them to accommodate some extra (overhead) costs on research and compliance concerning diverging regulatory systems compared to the regulatory environment in home markets, such cost can be prohibitive for SMEs. An FTA between the EU and the US that addresses these issues, paying particular attention to the constraints on SMEs, could therefore open markets for SMEs on both sides of the Atlantic with the beneficial effect on job creation, innovation and competitiveness that could not be achieved by a tariff-only, services-only or a procurement-only trade initiative.[66]

Secondly, SMEs are prominent in the sectors most benefiting from a potential EU-US FTA, such as the processed food, the machinery and the motor vehicle parts sector where they account for respectively 99%, 99% and 94% of the sector. Their importance in these sectors is considerable also in terms of value added (47%, 51% and 12% respectively) and in terms of employment figures, with respectively 63%, 57% and 17% of the total sectoral labour force coming from SMEs. Ultimately, an increase in output and exports in these

[63] "Small Business, Big World – a new partnership to help SMEs seize global opportunities", November 2011.
[64] "Opportunities for the Internationalisation of SMEs" August 2011: http://ec.europa.eu/enterprise/policies/sme/market-access/enterprise-europe-network/intern_event_en.htm .
[65] Survey 2009-2010, Opportunities Internationalisation SMEs, EIM/GDCC.
[66] 67% of the EU and more than 50 % of the US workforce work for SMEs. Source EU: EU–DG ENTR http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2012/annual-report_en.pdf.
Source US: US – AmCham.

sectors can be expected to lead to strong boost for SMEs present in those sectors. The effects on SMEs will follow the sector impact discussed in section 5.5.

5.8 Analysis of environmental impact

International trade and economic development can have various impacts on the environment. In principle, the following three effects of changes in trade flows on the environment are possible:

- The "scale effect", that is the expansion or decrease of economic activity through trade.
- The "composition effect" that arises from changes in production and consumption patterns triggered by tariff dismantling and reductions in the trade cost of NTMs.
- The "technique effect" that traces improvements in the emission efficiency of production induced by changes in the composition of inputs in the production process.

It is the combination of these effects that determines the overall impact of trade on the environment. The empirical results of studies that have examined the relationship between trade and the environment in the last few years are mixed.[67] Perhaps the most interesting finding is that the income gains associated with increased trade are in principle sufficiently large to pay for the necessary costs for pollution abatement (i.e. the costs of additional measures and activities to negate any repercussions on the environment) and still leave an economic surplus. In other words, by combining trade with environmental reforms one can find ways to raise consumption without compromising the natural environment. Obviously, it is then up to society and the political will of the constituency and the policy makers to seize these economic gains to use part of them for measures improving the environment.

In the public consultation, a limited number of stakeholders pointed to possible negative effects of harmonising environmental and safety standards on the lowest common denominator. In this respect, it has to be noted that in line with the WTO rules, the EU usually includes general exceptions in its trade agreements with respect to the environment and public health, which can legally override the trade obligations. It is therefore reasonable to assume that the EU and the US will keep its "policy space" with regard to these matters.

Although the EU can clearly be considered the frontrunner, political commitments in both the EU and the US to increase the share of renewable energy and to decrease overall energy consumption are ambitious. Increased economic cooperation between the EU and the US should, in principle, facilitate greater cooperation on climate protection as well as on other environmental issues including biodiversity, natural resources and waste, given that trading does encourage technology transfers.

[67] "Trade and Environment" by Håkan Nordström and Scott Vaughan, 1999: http://www.wto.org/english/res_e/booksp_e/special_study_4_e.pdf.

A quantitative analysis of the effects of an FTA on climate and climate change through an analysis of CO_2 emissions is conducted in section 5.8.2. Assessments of the environmental impacts of an FTA on biodiversity, natural resources, waste, as well as on firms and consumers, are included in section 5.8.2.

5.8.1 Analysis of the impact of the policy options on the climate and climate change resulting from CO_2 emissions

This section analyses the possible impact of a reduction in trade barriers between the EU and the US on climate change, measured here as changes in global CO_2 emissions. It presupposes that the option of a comprehensive FTA is pursued and assumes that the negligible trade effects expected from the baseline option will have correspondingly negligible effects on the environmental dimension. Any intermediate options as discussed can be assumed to have limited negative impacts on the environmental dimension. In fact, as a consequence of reduced production in third countries, the tariff-only option (B.1) will lead to a decrease in CO2 emissions by 0.02%, while scenarios B.2 and B.3 are neutral with regards to CO2 emissions.

The option of an ambitious "comprehensive FTA" (policy option C.2) can therefore be considered to represent the extreme point of the range of possible outcomes in terms of potential negative impact on the environment.

For the baseline projection of CO_2 emissions, the model was calibrated to the medium-term projections from the IEA "World Energy Outlook" (2010), which is based on existing and operational climate change policy measures – including the emission ceilings under the Kyoto Protocol, the EU emissions trading system (EU ETS) and other policy measures in the EU and in the US – without assuming any further climate policy changes up to 2027. It takes into account the effect of the trade liberalisation on the sectoral structure of the economy and includes all three effects mentioned above (the scale effect, the composition effect and the technique effect), including the impact of increased transport.

Only the EU has signed up to the Kyoto Protocol under the United Nations Framework Convention on Climate Change (UNFCCC), pursuant to which parties have ceilings on their CO2 emissions up to 2012 when the first commitment period of the Protocol expires. The EU has binding domestic legal ceilings up to 2068, while the US has had a less committal approach up until now. The US federal government has not set horizontal and obligatory national ceilings.

However, the United States has agreed in principle to work with more than 180 other nations under the UNFCC to bring about the “stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic [human-caused] interference with the climate system.” Though some claim the federal government has done little to live up to that agreement thus far, there is growing momentum to pursue reductions in emissions of carbon dioxide (CO2) and other heat-trapping gases that cause global warming. California, Florida, Hawaii, Minnesota, New Jersey, Oregon, and Washington have all enacted laws or established policies setting global warming pollution reduction targets, while states in both the Northeast and West have signed agreements to achieve regional targets.

[68] Pursuant to the Climate and Energy package: http://ec.europa.eu/clima/policies/package/index_en.htm.

To remain within these emission targets, additional production in these economies will therefore need to take place within the existing emission ceilings commitments, through a combination of increased emissions efficiency (energy-saving investments) and re-allocation of production from more to less emission-intensive sectors. Changes in the composition of the EU and the US economy as a result of a bilateral FTA may also lead to re-location of production outside the EU and the US (which may induce "leakage" of emissions). Within the energy intensive sectors covered by the EU ETS these re-allocations are driven by the emission price mechanism. For sectors outside the EU ETS, this may require strengthening of climate change regulatory policy measures.

Outside the EU and the US, emissions change mainly as a result of spill-over effects from the lowering of NTMs, trade diversion effects, and changes in production patterns.

Even under the most extreme scenario (C.2), the impact on global emissions is expected to be small (11m tonnes CO2, 0.07% of the current annual rate compared to the baseline). The main changes are expected in the US (3.9m tons) and the EU (3.6m tons)[69] because of growth in these economies and China (4.3m tons), because of its less environment-friendly product techniques. Other parts of the world see either a rise or a dampening of their emissions, but impacts are more limited.

5.8.2 Assessment of the potential impact of the policy options on biodiversity, natural resources and waste, and the environmental consequences for firms and consumers

Every scenario under the FTA and the intermediary policy option increases trade and thus the need for resources for production.[70] This may increase waste and may pose dangers for both natural resources and the preservation of biodiversity. Indirectly, the changes in output in some sectors may affect their environmental impacts, whether positive or negative. As half of EU land is farmed, the impact on agriculture can play a role here.[71] For example, a strong decline in the beef sector would reduce extensive grazing, which contributes to maintaining valuable habitats, land management and maintenance of grassland carbon pools.

However An estimation of the intensity of use of natural resources based on the sector input-output relations predicts only a minimal increase (0.01%) in the intensity of use even under the most extreme scenario (C.2),.[72]

In addition, it is expected 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. An ambitious reduction of NTMs is expected to significantly improve trade in environmental goods and services (where the EU has a competitive advantage).

[69] Potential additional EU emissions will have to be dealt with under EU Emission trading Scheme.

[70] This section presupposes that the option of an FTA is pursued and given that the negligible trade benefit effects expected from the baseline and intermediate option will have correspondingly negligible effects on the environment (compare Annex 2 for results of the quantitative analysis).

[71] See, for example, "Provision of public goods through agriculture in the European Union" T.Cooper, K. Hart, D. Baldock, IEEP, 2009.

[72] In the CEPR 2012 model, the natural resource use intensity depends on the input-output relations between the different sectors and to the extent that this leads to changes in the size of the agriculture, forestry and fisheries sectors. An increase of agriculture, forestry and fisheries sectors leads to more intense natural resource use, a decrease of these sectors would lead to a less intense use of natural resources.

Clean technologies and clean industrial processes, energy efficiency, renewable energy, water and waste management, a new generation of bio fuels, electric vehicles, and ICT technologies, are all important areas for potential future cooperation in the context of EU-US trade negotiations and are already partially on the agenda of the TEC. A trade agreement would therefore give a boost to these talks and potentially further open the US and EU market to advanced environmental technology, benefitting EU and US business and their workforce on the one hand and possibly leading to more efficient use of natural resources on the other.

5.9 The social impact

5.9.1 Overall estimation of changes in welfare for the EU and the US

Increased trade between the EU and the US would lead to an increased demand for labour, and raise the welfare of both parties through lower consumer prices and higher national income. The greater the extent of liberalisation proposed in the various policy options, the greater are the estimated welfare gains.

The economic and as a result also the social impact are expected to be negligible in the case of the policy option A, B.2, and B.3, and small in case of a tariff-only agreement (policy option B.1). Only a comprehensive trade and investment agreement would allow for a substantial positive increase in welfare. Even a conservative FTA would allow for an increase in EU GDP of 0.27%, i.e., in absolute numbers an increase in income for the EU of €48bn. An ambitious FTA would allow for increases by 0.48% or €86bn respectively. Welfare increases in the US would also be significant, with an increase in the US GDP of 0.21% to 0.39% and in absolute numbers: between €33bn and €65bn.

In terms of what this initiative would mean for employment in the EU and the US, it should be noted that the CEPR 2013 long-run analysis is based on a fixed labour supply assumption. In other words, the sources of employment and unemployment are considered to be "structural" and therefore any changes in sectoral labour demand will be associated with variations in wages as the labour force becoming available is reallocated across industries.

However, this does not mean that there will be no important changes taking place in the labour markets of the EU and the US. Tens of millions of jobs are supported directly and indirectly by US-EU bilateral trade. A comprehensive and ambitious trade initiative between the US and the EU could create new business opportunities worth hundreds of billions of euros, which will in turn support hundreds of thousands of new jobs on both sides of the Atlantic. According to our current estimates, for each additional billion euros of trade in goods or services, an additional 8000 and 15000 jobs are supported in the US and in the EU, respectively.[73] This means that a greater number of jobs in each economy will be supported by exports which will contribute to a more sustainable employment base as these jobs will be found in firms that are either directly or indirectly successfully exposed to the strong competition pressure of the global markets.

Another important social impact will be through wages. Given the efficiency and productivity effects resulting from the increasing transatlantic economic integration, both

[73] Source: http://trade.gov/publications/pdfs/exports-support-american-jobs.pdf; http://trade.ec.europa.eu/doclib/docs/2012/may/tradoc_149511.%202_24.05.2012.pdf

the EU and the US would benefit from increases in equilibrium wages of skilled and unskilled workers. Wages of unskilled workers are expected to rise in the EU, between 0.30% (conservative FTA) and 0.51% (ambitious FTA) and respectively between 0.22% and 0.38% in the US, compared to the baseline scenario. The wages of skilled workers are expected to rise in the EU, between 0.29% (conservative FTA) and 0.50% (ambitious FTA), and respectively between 0.21% and 0.36% in the US. Hence, the expected benefits are very similar for skilled and unskilled workers in the two economies, but it is noteworthy that contrary to the usual perceptions also unskilled workers derive a positive income dividend in terms of higher wages.[74] Nonetheless, it is also apparent that EU wages will increase more than US wages. The other important finding is that in the two economies skilled and unskilled wages would benefit more from the transatlantic FTA under the ambitious scenario.

In line with the limited or negligible expected economic impact of agreements in individual areas, a tariffs-only agreement (scenario B.1) could be expected to have a positive impact on skilled and non-skilled wages in the EU, but significantly below those of an FTA (0.12% compared to between 0.30% and 0.50%), while services-only or procurement-only agreements would, in isolation from an agreement in other areas, provide only negligible benefits in terms of wages.

Within these global figures, a wide divergence of situations at a local level is likely, depending on the particular regions' dependence on the affected sectors and socio-economic situation, quality of labour force etc. While urban areas are generally better placed to respond to challenges of international competition, predominantly rural areas focused on specific activities and with limited alternatives are more vulnerable.[75]

An analysis of the social impact of the different policy options also has to include effects on standards and rights related to job quality, social inclusion and protection of particular groups, gender equality, equal treatment and opportunities, non-discrimination, access to and effects on social protection, health and educational systems as well as public health and safety. However, it is reasonable to assume that the social impact in these areas of an FTA between developed economies such as the EU and the US is broadly neutral. Nevertheless, increased trade cooperation and flows of goods and services could create potential synergies and cooperation between regulators, NGOs and other stakeholders such as organised labour, both in the two societies and vis-à-vis third countries.

Even though trade policies may be considered gender neutral by design, they may have gender effects. The precise effects will depend on which sectors are impacted. They obviously depend on the economic development of the respective countries and their organisation of society. As in other industrialised countries, the EU and the US exhibit similar trends in the increased presence of women in higher education and in the labour market. Female employment rates in the EU and the US are similar (about 61.5 %) and the gender wage gap nearly equal – 17% in the EU (hourly earnings) and 19% in the US (yearly earnings).[76]

[74] This can be explained by the strong output growth in sectors that are engaged in physical production activities such as the car sector (strong growth in the EU) or the other machinery sector (strong growth in the US).

[75] Regions 2020. An Assessment Of Future Challenges For EU Regions, Commission Staff Working Paper, European Commission, 2008.

[76] http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Gender_pay_gap_statistics

5.9.2 Sectoral analysis of the impact on employment

While the assumption underlying our analysis rules out any long-run net employment creation or destruction (given the fixed labour supply assumption in the model), the model captures the reallocation of workers across sectors in response to the change in trade policy. Workers will be moving into the sectors that are going to benefit from greater demand. Given the fixed labour supply assumption, this entails in turn that other sectors will have to shed workers. The greater the aggregate economic impact of the trade liberalisation, the more important this phenomenon of labour movement across sectors will be.

Policy option A will have no effect on sectoral employment. Policy options B.1., B.2 and B.3 are estimated to show effects limited to certain sectors. Under policy option B.1, EU employment will decrease in the motor vehicles sector (0.67%/0.66%) for unskilled/skilled employment respectively. Policy option B.2 is estimated to increase employment in the insurance sector by 0.28% both for unskilled and skilled employment. The biggest impact under policy option B.3 can be expected in electrical machinery with increases of 0.27%/0.26% and in the metal and metals products sector with decreases of 0.28% for unskilled/skilled employment respectively.

Under the ambitious FTA scenario (policy option C.2) for both unskilled and skilled workers job increases in the EU are expected in the agriculture, fisheries and forestry, processed foods, chemicals, motor vehicles, other machinery, other manufactures, water transport, air transport, finance , insurance, construction, and other services sectors. The sectors with the greatest gains in terms of unskilled employment would be motor vehicles (1.26%), followed by insurance (0.56%) and other manufactures (0.51%). In terms of skilled employment, the sectors with the largest employment gains would be again motor vehicles (1.28%), followed by insurance (0.57%) and other manufactures (0.52%).

Under the conservative FTA scenario (policy option C.1) the impact on jobs across sectors in the EU would be similar, albeit slightly less pronounced than in the ambitious FTA scenario. One difference is worth pointing out: the chemical sector in the less ambitious scenario will lose (unskilled and skilled) jobs in net terms (-0.7% and -0.6% respectively), while in the more ambitious scenario, the sector would benefit from net employment gains of 0.08%.

It is also worth noting that the net job increases in some sectors will take place by drawing resources from other sectors where output is expected to fall. In the ambitious scenario that is the case in the "other primary sectors", as well as electrical machinery, other transport equipment, metal and metal products, wood and paper products, business services, communication, and personal services sectors. In particular, certain EU agricultural sectors could come under pressure to make workers redundant. The strength of this effect will in reality depend on labour mobility within the EU and between sectors.

The majority of respondents to the public consultation did expect intensified trade and investment cooperation to lead to more and better jobs. Only about 10% of respondents fear that an FTA could have negative effects on employment in some of the EU sectors that are expected to decrease in output (compare section 5.5 – sector impact). Such potential effects in a limited number of sectors are however likely to be outweighed by higher employment in most other sectors. It is noteworthy that European trade union associations did not a priori expect that wages or labour standards in the EU and in the US would deteriorate as a consequence of a transatlantic trade initiative.

In fact, the potential reductions of employment in some sectors might be inducted by higher job and wage growth in the sectors that benefit from further trade liberalisation.

Furthermore, by reducing regulatory divergences and thereby increasing regulatory stability and legal certainty, a comprehensive FTA would also encourage increases of foreign direct investment (which are not fully covered by the model). Additional US investment in the EU in goods and services sectors, and corresponding job creation in Europe is likely to create long-term benefits for employment stability and wages. The conclusion of an ambitious FTA would reduce the risk of diminishing US investment in Europe and its further deviation to other parts of the world, notably Asia (compare chapter 2 – problem definition). It will thus contribute to the protection of employment in Europe.

Still against this background, there are legitimate concerns that labour is not sufficiently mobile between sectors and across Member States in the EU. As a consequence, there could be prolonged and substantial adjustments costs.[77] It is clear that even if labour is allowed to flow to the sectors where demand is growing, there will be sectors that will be shedding workers and that the reemployment of these workers in the expanding sectors is not automatic, in particular due to a possible mismatch in terms of workers' skill and the need for retraining as well as due to the geographical and structural inertia that characterises the EU labour markets.

In order to reduce a potential short-term negative impact in some sectors, following from adjustment to the new trade environment, the EU and its Member States have the necessary means such as the European Social Fund (ESF)[78], the European Globalisation Fund (EGF)[79] and numerous Member States mitigating measures to make sure that the overall gains deriving from increased trade can be used to mitigate negative effects concentrated in some sectors and ensure a balanced regional and social outcome. In the past, the EGF for example, has made payments to help workers to back into employment, following their dismissals in a wide variety of sectors including aluminum, broadband services, metal products, construction, car manufacture and the pharmaceutical industry.

[77] These frictions are explicitly taken into account in the model that was used in this analysis by imposing elasticity of substitution of less than infinity to all production factors, including labour. Technically, this leads to increasing labour costs when a sector expands and consequently slows down its expansion compared to a situation in which perfect mobility of "production factors" is assumed.

[78] The ESF is one of the EU's Structural Funds, set up to reduce differences in prosperity and living standards across EU Member States and regions, and therefore promoting economic and social cohesion. The ESF is devoted to promoting employment in the EU. It helps Member States make Europe's workforce and companies better equipped to face new, global challenges. Funding is spread across the Member States and regions, in particular those where economic development is less advanced. Over the period 2007-2013 some €75 billion will be distributed to the EU Member States and regions to achieve its goals. It is a key element of the EU's 2020 strategy for Growth and Jobs targeted at improving the lives of EU citizens by giving them better skills and better job prospects.

[79] With up **to € 500 million available each year**, the EGF helps workers find new jobs and develop new skills when they have lost their jobs as a result of:

- **changing global trade patterns**, e.g. when a large company shuts down or a factory is moved to outside the EU or
- **global financial and economic crisis** – EGF funding has been available for this since 1 May 2009 and is due to end on 30 December 2011. However, the Commission has proposed extending this provision until 31 December 2013 (when the whole EGF Regulation must be reviewed). http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52011PC0336:EN:NOT.

5.10 Analysis of the impact on human rights

Both the EU and the US are committed to high standards of protection for human rights, and are signatories to a broad set of conventions on human rights. In this context, the policy options discussed under A and B above are not likely to have a direct impact on these rights, as listed in the main UN conventions on human rights, the Charter of Fundamental Rights of the European Union and the European Convention on Human Rights (ECHR). Any trade initiative would be compatible with all the relevant legal instruments, such as the Charter that is an integral part of the EU Treaties. For option C, the inclusion of provisions on sustainable development, including but not limited to labour, would have a positive direct impact on the promotion and respect of human rights.

The European Union and United States should cooperate regarding labour rights and decent work issues. Both should act as role models, adhering to international principles and agreements on labour and decent work. Stakeholders supported this general position of the EU.

In this context, it should be noted that the US, unlike the EU, has not ratified a number of core ILO Conventions. One might argue that the US is obliged to implement their underlying principles by virtue of their ILO membership and US FTAs normally include a commitment to ensure that domestic legislation is in accordance with the principles underlying such conventions. The usual EU approach is to include a trade and sustainable development chapter in all negotiated FTAs in which the parties commit to take sustained efforts towards ratification of the remaining ILO fundamental conventions and effective implementation of those already ratified. The labour section of a comprehensive FTA would therefore have to consider how both parties can further cooperate in promoting the ILO decent work agenda.[80]

In line with standard practice of the EU in trade negotiations, particular attention should also be paid to data protection rights of individuals. A trade initiative containing provisions on cross border data flow should be compatible with the high level of protection in the EU and Article XIV of the GATS.

5.11 Impact on administrative costs

Administrative burden (or administrative costs) can be defined as the costs incurred by enterprises, public authorities and citizens in meeting legal obligations to provide information on their action or production, either to public authorities or to private parties.

The administrative efforts necessary for implementation are different for each of the policy options. The baseline scenario (policy option A) does not require or assume any changes in the administrative burden for companies, citizens and public administrations.

The complexity of implementation depends mostly on the extent of elimination or reduction of the trade costs resulting from NTMs. A more ambitious outcome in terms of

[80] It has to be noted that European trade unions believe that some US FTA practices are superior to those conducted in the EU, notably concerning disputes procedures and enforcement.

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.

For example, the negotiation of mutual recognition or the equivalence of standards would create additional work for the regulators involved in the discussions, but it would result in less administrative hurdles and reduce the duplication of regulatory compliance costs for business and citizens once such agreement has been reached. Such a result would also reduce administrative costs for regulators themselves, since it would allow them to rely on work undertaken by their transatlantic counterparts.

Other examples would be the avoidance of duplication of tests in the chemical, pharmaceutical and motor vehicles sectors or the coordination or even mutual recognition of factory inspections in the health care sector. This would significantly reduce costs both for regulatory agencies and for industry. Convergence in standardisation would avoid costs for industries, in the design phase of their products, as assuring compliance with several standards is an extra cost of the product development.

Hence, a positive effect can be expected, for policy option C (comprehensive FTA) and potentially some positive, but limited results in the case of a services-only agreement (policy option B.2), while other policy option would neither have a significant positive nor negative impact.

5.12 The impact on the budget of the European Union

Entering into an FTA with the US would have effects on the budget of the EU, notably through the loss of own resources in the form of customs duties. The current tariff revenue is around €2.6bn. Any impact will obviously depend on the level of ambition chosen for the trade policy initiative and the outcome of negotiations, including parameters of frontloading (the extent to which tariffs are lowered on day one of the implementation of the agreement).

The actual impact is likely to be considerably lower, because this estimate does not factor in any possible indirect benefits to the EU budget deriving from future gains in EU GDP. It is also noteworthy that higher GDP will also mean higher tax revenue for EU member States through direct and indirect taxation which will by far outweigh the eventual increase of "own resources" needed to balance the EU budget.

6. COMPARISON OF THE DIFFERENT POLICY OPTIONS

This section links the positive and negative impacts of each policy option explained in chapter 5 to the objectives mentioned in chapter 3. The comparison of the different policy options has been conducted according to criteria of efficiency and effectiveness in achieving the operational objectives and coherence with overarching EU policy objectives. The analysis has taken into account not only the trade and economic impacts of each alternative, but also their social and environmental impacts, as well as possible gains from administrative simplification and synergy effects. Finally, the impacts of the different options have been assessed considering the background of past experiences of trade negotiations in general and cooperation with the US in particular.

6.1 Positive and negative effects of the policy options

The baseline option (policy option A) does not achieve the operational objectives outlined above. The option calls for maintaining and improving the on-going bilateral economic cooperation programs such as the TEC and the HLRCF and further cooperation in areas where agreements have already been signed or cooperation is ongoing. This continued process of cooperation is projected to be a long-term commitment, and the reductions in tariffs or regulatory obstacles achieved are expected to be zero (tariffs) or low (regulation). The *efficiency* of this option has to be assessed as being close to zero given that its *effectiveness* in achieving the operational objectives can be considered to be limited. This policy option further runs the risk of continued trade deviation away from the transatlantic route to the world regions projected to have the highest growth, notably Asia (compare chapter 2). The baseline option could therefore potentially even lead to an overall reduction of bilateral trade between the EU and the US. Furthermore, the baseline option is *not coherent* with EU policy objectives calling for trade liberalisation as an instrument of increasing economic growth.

The baseline option will not have significant environmental or social effects and neither side will be able to profit from additional synergy or simplification effects with regard to administrative costs for business, citizens and public administrations.

The second option (policy option B) of tariff-only, services-only or procurement-only agreements would have a limited positive economic impact, but this impact falls short of the economic gains under the FTA scenario. Under the tariff-only agreement, the biggest winners are certain sectors of the US export industry, although under this scenario some tariff peaks will remain. In the case of a services-only agreement, the positive impacts are very limited for both the EU and the US. A procurement-only agreement is equally expected to have limited economic results. Estimations show an impact on the environment and social variables in line with the tendencies of the FTA option, but to a drastically lower degree. Given the more limited negotiating resources necessary, option B.1 or B.2 might be *efficient* to the extent that limited results would only require limited resources. However, the option would *not be effective* in tackling the major barriers to trade, notably with regards to goods. It would also *not be coherent* with the EU trade strategy.

Comprehensive FTA negotiations is the one most favoured by stakeholders who in the first public consultation indicated a very strong preference for an agreement that would cover regulatory barriers to trade in goods and services, and in the second consultation highlighted the potential lying in the removal of these barriers. The analysis has shown, that policy option C, with different degrees of trade liberalisation will result in the highest gains in terms of economic and social welfare. It is the *most effective* and *most efficient* option to tackle barriers transatlantic trade. At the same time, it is *fully coherent* with the current EU trade policy and the Europe 2020 strategy.

The reductions in the costs of trade foreseen under both FTA scenarios C.1 and C.2, especially in the more ambitious scenario, are likely to allow both the EU and the US to achieve considerable benefits, including lower consumer prices, deriving from trade liberalisation. The impact will however differ in respect of the sectors affected. The EU processed food, motor vehicles, other machinery, other manufactures, water transport, air transport; finance (including insurance) and construction sectors would benefit the most.

Other EU sectors would see more limited increases (e.g. chemicals and business services) and the EU electrical machinery, other transport equipment and the metal and metal product sector would see a decrease in output.

The economic benefits include increases in GDP, increases in exports, more jobs supported by trade, increases in wages for both unskilled and skilled employees, together with increases in competitiveness and an improved standing for both the EU and the US in respect of other global competitors.

This process of full-scale FTA negotiations will also allow both the EU and the US to profit from bigger synergy effects, for example in the area of the environment. While the possible further liberalisation of environmental goods, services and technology is expected to have a positive effect on the environment, a full-scale FTA may also have negative impacts on the environment arising from an increase in trade and production.

Finally, the EU and the US as well as, to a limited extent, third countries will be able to profit from simplification effects resulting from a reduction of regulatory obstacles in both economies.

Table 10 in section 6.2 groups the thematic analysis undertaken in the IA report under the criteria of *effectiveness*, *efficiency* and *coherence*.

6.2 Summary of the effects of the different policy options in table form (Table 10)

Criterion	Policy Options					
	A	B.1	B.2	B.3	C.1	C.2
Effectiveness						
Faster and more sustainable economic growth	0	+	0/+	0/+	++	+++
Improving labour opportunities, consumer and welfare gains	0	+	0/+	0/+	++	+++
Improving Europe's competitiveness in global markets	0	+	0/+	0/+	++	+++
Increasing the volume of bilateral trade in goods and related investment by reducing barriers	0	+	0	0/+	++	+++
Increasing the volume of bilateral trade in services and related investment by reducing barriers	0	0/+	+	0/+	++	+++
Improving access to the US government procurement market comparable to that offered by the EU	0	0	0	+	+	++
Gains from administrative simplification effects (for example through mutual recognition of regulation)	0	0	+	0	+	++
Efficiency (Time and resources spent in relation to estimated effectiveness)	0	+	0/+	0/+	+	++
Coherence with overarching EU policy objectives	0	+	0/+	0/+	++	+++

6.3 Identification of a preferred policy option

Based on the analysis above, there is a clear-cut case for the EU to enter into negotiations for a comprehensive and ambitious FTA (policy option C.2) as the preferred option.

We understand that also for the US, comprehensive FTA negotiations will be the preferred option as the US economic and social gains are equally the highest under this policy option. The US can however be expected to also gain comparatively under a tariff-only option. A tariff-only agreement can therefore be expected to be the second best or fall-back option for the US.

Overall, the joint preference for entering into an FTA becomes clear when looking at the tabular presentation in Section 6.2. Each of the different scenarios of option C would be preferable to the policy options A and B concerning the criteria of effectiveness, efficiency and coherence. Furthermore, each of the scenarios of policy option C would lead to more beneficial synergy and simplification effects compared to policy options A and B.

When comparing the different scenarios of option C, the preferred scenario is that of an ambitious FTA. This is due to the fact that, as outlined in the analysis above and in line with the different expert studies,[81] Most of the economic gains can be obtained from the reduction of NTMs. A higher reduction of NTMs facilitates economic growth and thus leads to welfare gains and the creation of job opportunities. Accordingly, the ambitious scenario performs better when weighed against the criteria of effectiveness, efficiency and coherence mentioned above and it creates more benefits with regards to the simplification of administrative burdens.

As a result of an ambitious EU-US FTA, all regions of the world will see welfare gains in terms of increased national income. These global welfare gains, if used for environmentally friendly purposes, should easily allow for the compensation of limited negative effects on the environment. Effects on human rights are likely to be indirect but positive.

In sum, while it is clear that some countries and regions will benefit most in relative economic terms, if trade barriers are dismantled bilaterally, an ambitious FTA between the EU and the US is expected to raise total world income by €238bn of which €86bn are expected to materialise in third countries. Such an initiative can reasonably be described as substantially supporting the world economy.

[81] Ecorys 2009 and CEPR 2012.

7. MONITORING AND EVALUATION:

7.1. Core indicators of progress towards meeting the objectives

General objectives	**Indicators**
Economic growth	- percent change in real GDP - absolute change in national income
Creation of job opportunities and welfare gains, including lower consumer prices	- percent change in unskilled and skilled employment across sectors - percent change in unskilled and skilled wages across sectors - consumer prices
Improving relative competitiveness of the EU	- EU relative market shares evolution in the global economy - placement of EU member states in rankings measuring global competitiveness, such as the "Global Competitiveness Report" of the World Economic Forum
Specific objectives	
Increase of bilateral trade in goods and investment in goods sectors	- relative and absolute change in value of bilateral exports and imports of goods by sector - relative and absolute/percent change of bilateral investment flows related to goods sectors
Increase of bilateral trade in services and investment in services sectors	- relative and absolute/percent change in value of bilateral exports and imports of services by sector - relative and absolute/percent change of bilateral investment flows related to services sectors
Increase of market access, especially for the EU, in the government procurement sector	Absolute and relative increase of number of tenders secured by EU companies
Operational objectives	
Elimination of tariffs on industrial goods and agricultural products	tariff schedules
Reduction of NTMs concerning trade in goods	- convergence of standards/technical regulations - specific annexes to the trade agreement - change in the respective regulations/laws - increase of transparency/availability of information - business surveys on the perceived reduction of NTMs
Reduction of regulatory barriers related to trade in services	- convergence of standards/technical regulations - specific annexes to the trade agreement - change in the respective regulations/laws - increase of transparency/availability of information - business surveys on the perceived reduction of NTMs
Reduction of regulatory barriers related to the US government procurement market	- change in regulations/laws - increase of transparency/availability of information - list of commitments and specific annex to the trade agreement - business surveys

7.2. Monitoring and evaluation arrangements

Monitoring requirements in respect of the specific objectives can be facilitated by short- and medium-term analysis of the measurable indicators mentioned above: changes in the relative value of bilateral exports and imports as well as the number of tenders secured by EU companies in the US. Concerning the operational objectives, the same is valid for monitoring of tariff reductions, as these become apparent in the tariff schedules being part a potential trade agreement.

A more complex set of indicators is necessary for monitoring reductions in the cost of NTMs. The negotiated commitments on regulatory issues for goods and services are one indicator, but it is important that the following convergence of standards and changes in regulations and law is analysed by gathering information through legal and administrative sources. The increase of transparency or the availability of information as well as the general perception of a reduction in the cost of NTMs could be analysed by surveys among stakeholders operating in the EU and the US. However, in order to obtain more extensive feedback, additional business surveys or surveys among EU and US citizens could be set up.

In line with the commitments made by the Commission in 2010 in Trade, Growth and World Affairs[82], there will be a rigorous evaluation on the effects of any new trade initiative concluded with the US during and ex post of any possible negotiations.

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[82] http://trade.ec.europa.eu/doclib/docs/2010/november/tradoc_146955.pdf