

Siebert, Horst; Langhammer, Rolf J.; Piazzolo, Daniel

**Working Paper — Digitized Version**

## TAFTA: fuelling trade discrimination or global liberalisation?

Kiel Working Paper, No. 720

**Provided in Cooperation with:**

Kiel Institute for the World Economy – Leibniz Center for Research on Global Economic Challenges

*Suggested Citation:* Siebert, Horst; Langhammer, Rolf J.; Piazzolo, Daniel (1996) : TAFTA: fuelling trade discrimination or global liberalisation?, Kiel Working Paper, No. 720, Kiel Institute of World Economics (IfW), Kiel

This Version is available at:

<https://hdl.handle.net/10419/869>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

# Kieler Arbeitspapiere

# Kiel Working Papers

**Kiel Working Paper No. 720**

**TAFTA: FUELLING TRADE DISCRIMINATION  
OR GLOBAL LIBERALISATION?**

by

Horst Siebert  
Rolf J. Langhammer  
Daniel Piazzolo



Institut für Weltwirtschaft an der Universität Kiel  
The Kiel Institute of World Economics

Institut für Weltwirtschaft  
an der Universität Kiel  
Düsternbrooker Weg 120  
D-24105 Kiel  
Fax: 0049.431.85853

**Kiel Working Paper No. 720**

**TAFTA: FUELLING TRADE DISCRIMINATION  
OR GLOBAL LIBERALISATION?**

by

Horst Siebert  
Rolf J. Langhammer  
Daniel Piazolo

Januar 1996

657/105

The authors themselves, not the Kiel Institute of World Economics, are solely responsible for the contents and distribution of each Kiel Working Paper.

Since the series involves manuscripts in a preliminary form, interested readers are requested to direct criticisms and suggestions directly to the authors and to clear any quotations with them.

## **Abstract**

This paper analyses the prospects and problems of a Transatlantic Free Trade Area (TAFTA) between the European Union and the United States. Possible economic reasons for the proposal of TAFTA such as the intensity of bilateral trade and a strong interdependence in investment flows and the similarity of the EU and the US in their factor endowment and tariff structure are examined.

There are cases shining favourably on the idea, but the implementation of TAFTA will imply substantial costs due to the internal and external consequences. The main problem of a free trade area between the two most important economic blocs is the impact on the multilateral approach of trade liberalisation.

The authors suggest a Transatlantic Liberalisation Initiative (TALI) as an alternative to TAFTA. Under TALI, the EU and the US should accelerate their implementation of their Uruguay Round commitments and liberalise in areas that are not yet covered by WTO agreements. This should be done under the Most-Favoured Nation clause and would be a strong motivating force for multilateral liberalisation. In addition, TALI could be a forerunner in reducing market segmentation and in establishing a semi-internal market between Europe and America.

**JEL Classification:** F15

**Keywords:** Transatlantic Free Trade Area; regional integration;  
European Union; United States; multilateral liberalisation

## I. The Issue\*

There are quite a few already existing or projected Free Trade Areas around these days: EFTA in Europe which except for Switzerland has been absorbed by the European Union or the European Economic Area, the new Central European Free Trade Area (CEFTA) of the post-communist countries, the Asean Free Trade Area (AFTA), NAFTA in North America and Mercosur in the South. Furthermore proposals are discussed about the Free Trade Area of the Americas (FTAA) and the Asia Pacific Economic Cooperation (APEC). So after EFTA, CEFTA, AFTA and NAFTA – do we also need the TAFTA – the Transatlantic Free Trade Area?

From a political perspective, TAFTA can serve as the driving force for a revitalised political transatlantic relationship. Economists may call it an international collective good lowering transaction costs from the political side. There exists the fear of the creeping erosion of the special transatlantic relationship after the demise of the common threat. Europeans have claimed to perceive either a "Pacific tilt" in American foreign policy or a neo-isolationism [Financial Times, 1995]. For some Americans, the projects of Eastern enlargement of the European Union and monetary union in Europe have led the Europeans to become more Eurocentric. The shared belief in democracy, human rights and the market economy has been and is the foundation of the strong transatlantic relationship [Commission of the European Communities, 1995]. Prominent politicians have argued that the future of this special relationship would require a framework of agreements. An agreement on a free trade area is seen as a good point of departure.

From an economist's point of view, the core question is whether regionalism constitutes a threat to the multilateral trading system. An answer to this question is of paramount importance when assessing the likely effects of a Transatlantic Free Trade Area (TAFTA) not only from a single country point of view but from world welfare viewpoint. A recent WTO study analysing the effects of more than 100 regional trade agreements since World War II has negated this question [WTO, 1995a]. It concludes that regional integration and the multilateral trading system have been complements rather than alternatives in the pursuit of open trade. Even more, the co-existence between the two has been found to be at least satisfactory if not broadly positive [ibid].

---

\* This paper is based on a lecture given by Horst Siebert at the American Institute for Contemporary German Studies at the Johns Hopkins University in Washington, D.C., on December 14, 1995.

To qualify this conclusion, it is important to recall that post-war regional integration has been based on two main pillars:

- the continuous process of integration with deepening and widening in Western Europe;
- the "hub-and-spoke" agreements between the EU and the US on the one hand and developing and transformation countries on the other hand. The EU has concluded bilateral agreements with many Mediterranean and African countries to support efforts of expansion in these countries. Preferences were granted without requesting reciprocity. Furthermore, the EU has recently signed Association Agreements with most Central European transformation countries. Similarly, the US has bilateral agreements with countries of Latin American and the Caribbean and a plurilateral treaty with Canada and Mexico on the North American Free Trade Agreement (NAFTA).

A third avenue of regional integration is characterised by its failure: almost all trade agreements among developing countries were caught in distributional conflicts and moved into disintegration or stagnation at best [Langhammer, 1992].

These three pillars did not comprise bilateral "mega" agreements between the Big 3 of World Trade - EU, US, Japan. Liberalisation of trade between these three occurred on the multilateral level. This has changed with the emergence of the Asia-Pacific Economic Co-operation (APEC). The ambitious goal of APEC is a free trade area around the Pacific by the year 2010 for the developed countries - i.e. including the US and Japan - and by the year 2020 for all member countries. The chances for meeting the timetable of this target are mixed. APEC is a mini-WTO including similar challenges rooted in huge income and growth disparities, political rivalry, cultural differences and historical legacies.

The other idea of the regional integration among the Big 3 also involves the US, excludes Japan and includes the EU. This is TAFTA. Both approaches of regional integration involving the US plus the afore mentioned European integration and the "hub-and-spoke" arrangements run parallel to the planned implementation of the results of the Uruguay Round.

This parallelism opens up questions: Is TAFTA a threat to the WTO-approach of multilateralism or a supplementary approach? Can TAFTA open up a route to universal free trade that is not yet available through the WTO? Can TAFTA accelerate global liberalisation? If a cost-benefit analysis comes to the conclusion

that TAFTA is not the right approach to liberalise, could the willingness to liberalisation - as expressed in promoting TAFTA - be integrated in the multilateral context?

The paper will discuss economic cases for and against TAFTA, analyse the alternatives to TAFTA and conclude by arguing in favour of a multilateral approach of liberalisation between the US and the EU.

## II. Possible Cases for TAFTA

### 1. Strong Trade Relationship

The customs union theory supplies a rule of thumb to assess free trade arrangements among countries:

The welfare-enhancing effect of efficiency gains inside the union (often referred to as a result of trade creation) is expected to exceed welfare-decreasing discrimination outside the union (referred to as trade diversion)

- the larger the initial share of the member countries in world trade
- and the larger the initial share of intra-regional trade in the total trade of the member countries.

These two criteria can be applied to TAFTA.

The EU and the US are the leading individual players of world trade closely followed by Japan. However, this ranking does not indicate a dominant position in world trade. In 1993, together they accounted for 34 per cent of world total exports (including commodities) and 38 per cent of world manufactured exports (Table 1). Hence, more than 60 per cent of world trade cannot be attributed to them but to trading partners in Asia and other countries of the Western hemisphere. Whether TAFTA meets the first criterion is particularly questionable due to the observation that the trend since 1980 has been declining. This is most visible in manufactured exports where trade policies are especially relevant because of higher trade barriers than for commodities.

Table 1 – EU and US Shares in World Exports<sup>a</sup>, 1980-1993

	Total trade		Manufactures	
	EU	US	EU	US
1980	18.9	13.4	29.3	17.8
1990	20.6	14.5	24.8	16.1
1991	20.3	15.4	23.8	16.8
1992	20.2	15.1	23.3	16.5
1993	19.5	14.9	22.1	16.1

<sup>a</sup>Excluding intra-EU trade.

Source: Calculated from UN, Monthly Bulletin of Statistics, current issues.

As concerns the second criterion, the magnitude of intra-area trade, similar conclusions can be drawn as to the first one (Table 2). Both the US and the EU largely trade with other countries and again the trend in intra-"TAFTA"-trade is declining, especially in manufactures.

Merging the two criteria yields that in 1993 only about 7 per cent of world manufactured exports was due to US exports to the EU and EU exports to the US (after 8 per cent in 1980). While this may signal a still untapped potential for additional trade between the two areas it mainly suggests that the discrimination effect of bilateral trade liberalisation to the detriment of third countries must not be underrated. For both partners, the current volume of trade outside TAFTA exceeds intra-area trade by far.

Table 2 – Intra-TAFTA Trade Shares, 1980-1993

	US share in				EU share in			
	Extra-EU Exports		Extra-EU Imports		US Exports		US Imports	
	Total	Manufactures	Total	Manufactures	Total	Manufactures	Total	Manufactures
1980	12.7	13.0	16.1	28.4	26.7	25.4	16.1	26.5
1990	18.1	18.8	17.5	22.2	24.9	26.1	20.1	22.5
1991	16.6	17.5	18.3	22.4	24.3	25.4	18.4	20.9
1992	16.7	17.6	17.5	21.1	22.9	23.8	18.2	20.7
1993	17.1	17.9	16.9	19.7	20.8	21.0	16.5	18.1

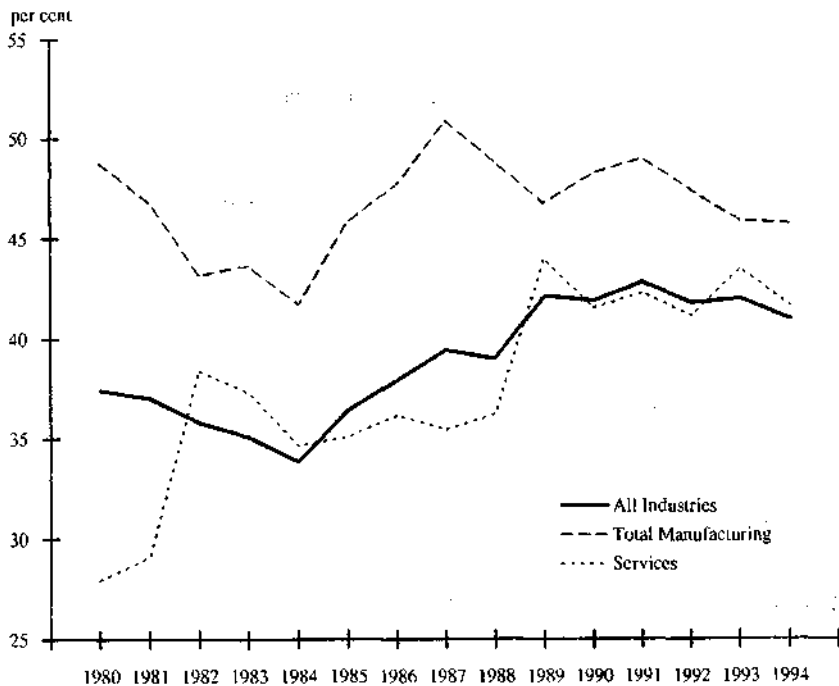
Source: See Table 1.



## 2. Strong Investment Relationship

A main characteristic of the EU-US economic relations is the extensive flow of foreign direct investment in both directions. The EU as well as the US are for one another the most important hosts for investment activity partly because the Japanese market is largely closed for FDI. By end-1994, about 41 per cent of the US FDI stock was located in the EU-15 (Graph 1). Until 1993, the US had more direct investment in the UK than in all countries of the Asia-Pacific area. It was not earlier than 1994 that the latter area bypassed the UK as a host.

Graph 1 – Share of the EU in US FDI-Stock by Sectors 1980-1994 (in per cent)



Source: US Department of Commerce, Survey of Current Business, various issues.

Graph 1 shows the importance of the EU as a host for US FDI stock in three sectors since 1980. It demonstrates in all industries (including the oil sector) and in the strongly liberalised EU service sector that this share followed a rising trend while in the traditional forerunning sector, manufacturing, shares fluctuated in the range of 42-51 per cent.

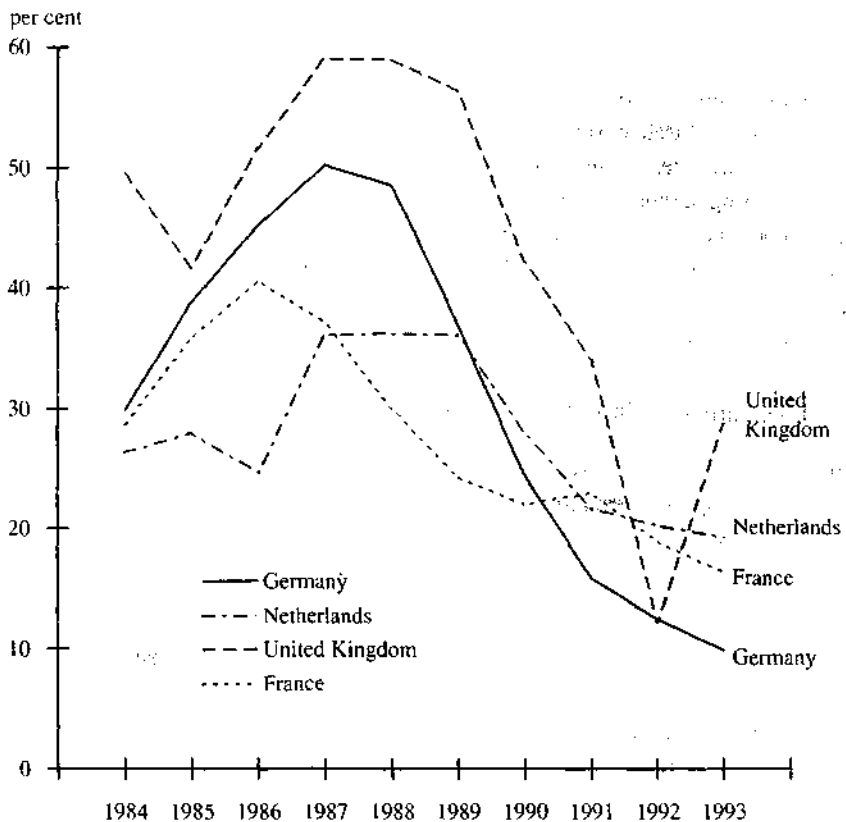
The other direction of investment flows is likewise substantial. During the late eighties, EU investors had more than 40 per cent of their total extra-EU flows in the US (and Canada). Yet, the trend was declining (down from 60-70 per cent in the eighties) following the renewed attractiveness of developing countries in Asia and Latin America.

The graphs of the share of the US in FDI of four EU countries show the eminent position of the US as a destination of European investment at the late eighties (see Graph 2). Since then the attraction of the US for European FDI has fallen rapidly while hosts within the EU became much more attractive.

Taking all these figures together, the distinguishing characteristic of the EU and US economic relations is the mutual inter-linkage through FDI. Both regions have considerable ownership interests in the other region's market and are therefore strongly inclined to maintain well functioning transatlantic ties. As a result, trade relations in recent history have been generally harmonious. Without doubt, trade disputes have arisen due to certain sectors, which are high on the agenda for further liberalisation and which will be addressed below. However, the number of bilateral disputes has been small compared to overall trade and has left the transatlantic relationship intact and co-operative. This has been explicitly confirmed by the latest US Trade Representative Report on Trade Barriers [USTR, 1994].

### 3. Similarity of Factor Endowment

The EU and the US are similar in their income stage, their levels of technology and in the availability of capital and skilled labour. When two regions are similar in their capital-labour ratios, then there will be little inter-industry trade, and intra-industry trade based on imperfect competition will be dominant. Intra-industry trade is based on economies of scale as well as variety of preferences on the demand side and allows countries to benefit from larger markets and to consume a greater variety of goods. Under such conditions, the traditional trade creation and trade diversion debate based on perfect competition loses much of

Graph 2 - Share<sup>a</sup> of the US in Major EU Countries' FDI Outflows 1984-1993 (in per cent)

<sup>a</sup> Three years moving average

Source: OECD, International Direct Investment Statistics Yearbook, various issues.

its relevance. Intra-industry trade accounts for one-fourth of world trade and is especially important for the trade in manufactures between EU and the US. What makes a high share of intra-industry trade an asset in the context of TAFTA is that it is much less vulnerable to protectionism than inter-industry trade. Political opposition against liberalisation is diffused if freeing trade leads to expansion of both exports and imports in the same sector. Lay-offs of labour and capital in individual industries due to tough import competition can be avoided if liberalisation promises to stimulate own exports from this sector, too.

Liberalisation is furthermore facilitated if the degree of openness between the members of a free trade arrangement is similar. This is the case with the US and EU in which external imports contribute to total domestic supply to a similar extent. In manufactures, the US (plus Canada) had a so-called import market penetration ratio (imports as a percentage of total domestic supply) of 11.8 per cent in 1990/91 (latest year available) compared to 13.2 per cent in the EU. However, there are notable differences between the ratios in individual industries, suggesting different sectoral levels of protection in the US and the EU (Appendix Table). As a striking example, the EU is much less open to imports in the highly protected clothing industry (29 per cent) than the US (42 per cent). Such differences could lead to industry-specific resistance in bilateral trade liberalisation.

#### 4. Low Tariffs Against Third Countries

Both the EU and the US have low average industrial tariffs. Before the Uruguay Round the weighted average tariff for industrial goods amounted to 5.7 per cent for the EU and 5.4 per cent for the US. After the implementation of the Uruguay Round decisions the weighted average tariff for industrial goods will be 3.6 per cent for the EU and 3.5 per cent for the US [GATT: 69].

Thus, to cut the remaining tariffs completely, should neither result in major revenue losses nor be strongly opposed by affected industries. The former is relevant in the US because under US law such losses have to be compensated for by other revenues.

However, there are still some sensitive sectors with high levels of protection, for instance, agriculture. Even after the full implementation of the Uruguay Round the estimates of the unweighted average tariff equivalents of agricultural protection are 30 per cent for the US and 75 per cent for the EU [Ingco, Reincke, 1995, cited in Schott, 1995]. The average US tariffs on apparel items will still be about 17.5 per cent after the implementation of the Uruguay Round and the EU tariffs about 12 per cent.

It is obvious that the dismantling of tariffs in bilateral trade parallel to the implementation of the Uruguay Round implies small preference margins compared to Most Favoured Nation (MFN) treatment. Static trade effects would be small, too. Schott [1995: 6] estimates that the total elimination of tariffs on bilateral trade would increase US exports to the EU by about 10.8 per cent and

EU exports to the US by 6.3 per cent. This would be equivalent to an increase of total US trade of only 2.3 per cent (1993 figures) or 0.2 per cent of US GDP. For the EU, such static effects would be even lower (1.1 per cent and 0.1 per cent). Even if one takes into consideration that neither non-tariff barriers nor dynamic effects are taken into account, it is suggestive to argue that intra-"TAFTA" tariff liberalisation confined to merchandise trade is unlikely to have a strong effect on national income of the two trading partners.

### III. The Costs of TAFTA

As has been shown above, there are some arguments that shine favourably on the idea of TAFTA. Benefits, however, have to be confronted with costs both for the partners as well as for the rest of the world. Do benefits compensate enough for such costs. What are the costs of TAFTA?

In fact, TAFTA would have far reaching internal and external consequences.

#### 1. The Internal Dimension of TAFTA

First, there are internal adjustment problems especially in hitherto protected industries and sectors due to the requirements of the WTO rules. The WTO is stricter than GATT in its tolerance of free trade agreements and in its advocacy of the interests of the non-members. The GATT Article XXIV was written to allow only exceptions to multilateral liberalisation in the case of full integration of trade. Yet, in the past, the intention of the Article XXIV was not kept up in reality. The ambiguity of this article and political pressure led to a large number of free trade areas among GATT members that do not fulfil the requirements of the GATT framework, namely the 100 per cent liberalisation in "substantially" all sectors [Bhagwati, 1991]. The WTO has learnt from this permissive practice. Reform proposals advocate that in the future a free trade area would comprise all sectors including agriculture. Disadvantages of the non-members due to the free trade area have to be compensated. If these proposals become reality, there are two possibilities for countries seeking mutual preferential treatment:

- all (and not only "substantially all" as in the GATT article XXIV) sectors will be subject to free trade.

- Alternatively, the MFN principle holds. The countries would have to extend their mutual reductions in tariffs to all WTO members.

This alternative would mean that there is no "exclusive" TAFTA. Under the first option, all of the outstanding issues in trade relations between the EU and the US would have to be solved. There are quite a few sensible sectors requiring considerable adjustment; first and foremost: Agriculture. The US Trade Representative claims in his "1994 National Trade Estimate Report on Foreign Trade Barriers" that the elimination of the entire EU agricultural support system including the variable levies, price supports and export subsidies would increase US exports to all EU markets between \$4 billion and \$5 billion while decreasing US imports about \$2 billion [USTR, 1994: 73].

As mentioned before, tariff equivalents are still very high on agricultural products. The arduous negotiations during the Uruguay Round were characterised by many disputes over agriculture. The US and the EU were the initiating and pushing forces of the Round, but these two countries were also responsible for the long dead lock over agriculture until the Blair House breakthrough in 1992. The agreement of the Uruguay Round represents a significant milestone for the liberalisation of the global economy, but has still left protectionism for agricultural products on a high level. It is highly unlikely that vested interest groups within the EU and the US that were able to bloc far-reaching liberalisation within agriculture could be overcome with a bilateral agreement between the EU and the US.

Agriculture is the one issue that has the most potential to bring trade negotiations on TAFTA to an early and prolonged halt. One reason for this circumstance is that the EU is plagued by the Common Agricultural Policy and its necessary reforms due to the forthcoming Eastern enlargement. Yet, the EU still refuses to reduce subsidies substantially and to shift subsidisation to the national level.

Other delicate sectors facing contentious negotiations comprise steel, textiles, services, aviation and the defence industry.

To get the flavour of other outstanding issues here are some of the complaints of the US trade representative about the EU trade barriers taken from the 1994 USTR Report:

- The EU Motion Pictures Quotas and Broadcast Directive. The EU passed a Broadcast Directive that requires that a majority of broadcast emission be reserved for European origin programs.
- Government procurement that discriminates against non-EU bids.
- Lack of intellectual property protection.
- Investment barriers.
- Barriers to the Telecommunications market.
- Government support for the Airbus Industry.

On the other side, the EU Commission is reported to have complained about a number of trade impediments, too [Süddeutsche Zeitung, 1995].

- "Buy-American" requirements of government procurement:
- The unitary tax of some US states that leads to tax demands against European firms based on their world wide turn over.
- Entry barriers to the US banking market.
- Problems of European exporters with the US customs authorities.

While these issues are promising areas of liberalisation between the EU and the US, they were so often the center of dispute between the EU and the US during the Uruguay Round that bilateral liberalisation without shifting the burden of adjustment to third parties is unlikely to be within close reach. The multilateral trading order failed to come to solutions in these fields due to the transatlantic controversies. Would a bilateral attempt now be more successful? Given the political situation in the US and the EU, this is unlikely in the near future. Trade diplomats believe that only after 1997 the idea of a TAFTA could be considered seriously. Before that date all political resources would be absorbed by the presidential election in the US and the 1996 post-Maastricht governmental conference in the EU. Consequently, the US President and the President of the EU Commission postponed the signing of a formal agreement about trade liberalisation at the Madrid meeting in December 1995. They decided to commission a study how to reduce the trade barriers and how to promote the economic links.

In addition to the issues mentioned above, there is ample scope for co-operation in areas such as product testing, standardisation, international crime, the environment and drugs trafficking.

Furthermore, an internal US legal requirement might reduce the attraction of TAFTA for the US government. The US has the "pay-as-you-go" budget rule dictating that tariff revenues foregone have to be compensated by reduced spending or increased taxes. Jeffrey Schott estimates the foregone US tariff revenues at a total of US \$ 7.3 billion assuming that TAFTA was implemented over five years [Schott, 1995]. Given the present zeal for budget stringency, the perspective of losing this amount will strain support for TAFTA.

## 2. The External Dimension of TAFTA

### a. *Discrimination of third countries*

The discrimination issue is of critical importance when assessing the compliance of TAFTA with the WTO requirements. Third countries competing with TAFTA suppliers under perfect competition will carefully observe whether their exports to either the US or EU are diverted as a result of intra-TAFTA trade liberalisation. Trade diversion occurs when a member country replaces tariff-ridden imports from the rest of the world, which were the low-cost source in the absence of preference agreements, with imports from the higher-cost partner country. Trade diversion is welfare reducing.

As in the case of the trade creating effect, the overall trade diversion effect of TAFTA is expected to be small due to the existing low level of weighted average tariff. However, the temptation might arise to use TAFTA as a weapon against the Asian New Industrialising Economies and especially against Japan. North America and Europe have constituencies that fear Asian productivity as the main source of job killing. Increased global competition might tempt political leaders to use TAFTA both as a protective shield and a leverage in bargaining with other countries. They could be inclined to ignore that necessary efficiency adjustments can be postponed, but not cost- and painless.

In collective bargaining, non-TAFTA countries could understand TAFTA as a signal that the world's richest countries are more concerned in jointly discriminate against the rest than in opening their markets to the developing countries. There is the danger that TAFTA would be seen as a only slightly modified form of the rich men club.



*b. Free trade arrangements with third countries*

The EU has a most complex and extensive system of preferential trading agreement with other countries (Table 3). Similarly, the US has existing free trade agreements with Canada and Mexico plus Canada apart from the "hub-and-spoke" agreements with other countries of the Western hemisphere. In addition,

Table 3 – The Hierarchy of EU Trade Preferences, Early 1995

Trade Policy Regime	Countries affected (Name of Agreement)
Free movement of goods, persons, capital and services	Iceland, Liechtenstein, Norway ("European Economic Area")
Reciprocal free trade	Switzerland Bulgaria, the Czech Republic, Hungary, Poland, Romania, Slovak Republic ("European Agreement") Estonia, Latvia, Lithuania Israel Turkey
Unilateral free access to the EU market on a contractual basis	15 Mediterranean countries  70 African, Caribbean and Pacific countries ("Lomé Convention")
Autonomous preferences	Other developing countries (beneficiaries under the "Generalised System of Preferences")
Purely most favoured nations treatment	USA, Japan, Canada, Australia, New Zealand Successor republics of the Soviet Union (except Baltic States)
Mainly most favoured nations treatment	Remaining state-trading economies

Source: WTO, Trade Policy Review - European Union (1995b), p. 19.

the US is a member of APEC that aims to achieve free and open trade and investment for a region that accounts for one half of the world economy. Would the one partner allow that the products from these countries come in after the detour through the other? Could products from Mexico arrive in the EU through NAFTA barrier-free? Could products originating in Norway be exported without tariff to the US when they these products came through the EU? This would mean a de facto free trade area. Given the dense network of preferential treatment of the two regions, the coverage of such a TAFTA would become quite extensive. Why not global instead?

The alternative is a complex country of origin procedure in the EU and the US to make sure that only products from the right partner country arrive tariff-free. This customs procedure would be required to prevent trade deflection, i.e. the situation in which each good enters through the TAFTA country with the lowest tariff rate and is transshipped. To avoid trade deflection, one would need rules stating what a specific fraction of a final good originates from the partner country in order to be exempted from tariffs. With increasing globalisation of production and markets, this will lead to fierce disputes. Unlike in a customs union, rules of origin in a Free Trade Area could also be abused for protectionist purposes [Krueger, 1995]. The EU can offer a good example of a grotesque dispute highlighting the difficulties a complex system of bilateral trade arrangements will produce: in 1990 France claimed that the Nissan Bluebird, which was produced in Britain, was a Japanese product and had to be included under Japanese voluntary export restraint with France. According to French beliefs, the Nissan Bluebird did not contain enough European value added to be considered a European good to which free trade must be granted. The United Kingdom maintained that all British-made goods have free access to any EU market and a heated debate erupted over the local content requirements. Luckily for the future of the European Union, the dispute ended with the assurance of Nissan that the local content of its cars would soon be rising considerably.

### *c. Consequences for the multilateral trading process*

TAFTA might accelerate the trend towards regional trade blocs and weaken the multilateral approach of trade liberalisation. Yet, the WTO allows only a free trade area covering all sectors. Otherwise any reductions in tariffs have to be extended to all members of the WTO. Given historical experiences, it is very likely that TAFTA would not cover all sectors. This kind of TAFTA would not fulfil the WTO requirements as an exclusive free trade area. A sectoral

incomplete but regional limited free trade area would bent the WTO rules and undermine the multilateral process.

Leaders from the US and the EU might run into problems when dealing with other countries accused of protectionism and would have to face the question from them: If the US and the EU seek free and open trade in world so much, why have they created their own trading arrangements?

In theory, a Transatlantic Customs Union (TACU) might be consistent with the WTO. Krueger [1995] has shown that on welfare grounds a customs union is always Pareto-superior to an FTA. A customs union is an arrangement in which there is zero duty between members for the imports of goods and services, and a common external tariff. However, TACU requires considerable adjustment in both areas:

- Will the TACU members find the political strength of a zero duty among them? Again, this is unlikely in the near future for sectors like agriculture. This is the same issue as with TAFTA.
- In addition, will the TACU members agree upon a common external tariff which should be the lowest of the two former national tariffs in order not to treat third countries worse than before? This would not be easy to achieve because policies of North America and the EU towards third countries differ considerably for political and historical reasons. For instance, after Turkey has joined the EEC customs union (not the EU) will Turkey get tariff free access to North America or will the EU have to raise barriers against Turkey again? If the EU has to grant Mexico tariff free access thanks due to combination of TAFTA and NAFTA, why not to the other Latin American countries?

#### **IV. Alternatives to TAFTA on the Multilateral Level**

It has been shown that the implementation of TAFTA would face a number of problems due to the internal and external dimension of a free trade area. Yet, this does not imply to forego the impetus of liberalisation on which TAFTA would be based. The benefits of liberalisation can also be reaped through the multilateral process.

a. *The conventional way*

The EU and the USA should push the World Trade Organisation to pick up the work left by the Uruguay Round. In the areas of textiles, steel and agriculture protection has remained high. Following the pattern of the preceding GATT rounds, all member countries of the WTO should continue the common step-wise liberalisation. As reflected in the Uruguay Round, this procedure is also capable in dealing with new issues as trade in services or intellectual property rights.

The first WTO Ministerial meeting will take place in Singapore in late 1996 and would provide an excellent opportunity to launch a speeding up of multilateral liberalisation. Schott calls this approach "WTO 2000" and remarks that "WTO 2000" would not only ensure the full implementation of the Uruguay Round, but also avoid a process - implicit in a WTO-consistent TAFTA - that highlights politically sensitive issues [Schott, 1995].

b. *The fast route: A US-EU specific Trans Atlantic Liberalisation Initiative - TALI*

The EU and the US could prove their commitment to global leadership in free trade by accelerating their implementation of the commitments of the Uruguay Round [Langhammer, 1995]. Acceleration will yield the benefits of Uruguay Round liberalisation more quickly and provides an excellent opportunity for early and meaningful action by the transatlantic partners. Acceleration will challenge and motivate other countries to do likewise and thereby encourage world wide liberalisation. This idea of accelerating the implementation of the Uruguay Round is not new. It has also been proposed by a Group of Eminent Persons with respect to joint liberalisation initiatives of APEC members [APEC, 1995]. The "Transatlantic Agenda for Growth" proposed by the US Secretary of State and his German counterpart points into the same direction.

Acting as a regional "turbo" to accelerate the implementation of the Uruguay Round could take two forms. The TALI members could sign a uniform agreement to bring forward the final date when their commitments have to be in place. Alternatively, the TALI members could draw up a list of acceptable options dealing with most - or even better with all - of the agreed upon Uruguay Round commitments. The countries could choose from the list. Given the political constraints in both regions, the later "menue" form of accelerating certain aspects the Uruguay Round commitments seems to be more feasible.

Bringing the final date forward would be better, but requires considerable political will.

*c. Moving towards a semi-internal market*

The Trans Atlantic Liberalisation Initiative should also relate to issues not agreed upon in the WTO and could thereby become the motivating force for multilateral liberalisation in new areas. The EU and the US should decide to establish a common institutional framework in important areas. Such framework should be based on principles which enhance competition and enlarge the scope of options open to choice for sellers and buyers. This would lead to the abolition of trade and investment flows obstacles arising from the institutional setting like binding national standards, performance requirements, licensing etc. For instance, the EU and the US should agree upon the principle of mutual recognition of national rules wherever possible, the application of common merger-and-acquisition rules and on the opening up of public procurement and financial services. Thereby the EU and the US would create important prerequisites for a semi-internal or quasi-internal market applying home country rules and thus promoting institutional competition.

All these elements could be part of TALI and at the same within the MFN clause. This process of the Trans Atlantic Liberalisation Initiative would have several advantages: First and foremost, TALI is within the WTO rules and would be a big boost for a continuing multilateral liberalisation process. TALI would set a counter precedent to the growing regionalism. Furthermore, TALI is more realistic concerning the political possibilities of abolishing all protectionism in sensitive sectors like agriculture than TAFTA. Therefore, TALI would also be more credible. TALI could deal with the outstanding issues of the bilateral trading relationship of the EU and the US with a very beneficial effect for the multilateral trading order.

Other economists call a similar approach WTO-Plus. The common denominator of these proposals are the multilateral, fast implementation of the Uruguay Round commitments and the dismissal of the idea of exclusive preferential treatment as it was used before in the traditional free trade arrangements.

## V. Conclusion

Raising the prospect of TAFTA signals the willingness of the US and the EU to further liberalisation. As seen, TAFTA promises considerable benefits, but includes considerable risks for third countries. However, the transatlantic partners do not have to forego the potential benefits of TAFTA if they are prepared to share these benefits with other countries.

The conclusion is straight forward: It is better to push for freer trade through multilateral agreements than through bilateral agreements. The effects of multilateral commitments could be supplemented in areas in which a formal multilateral round is unlikely to make quick advances. A transatlantic agreement could be useful if it

- opens up at least in the US and the EU public procurement, financial services;
- results in common merger-and-acquisition rules;
- reduces the protectionist use of national standards;
- introduces the principle of mutual recognition of national rules and standards.

If the EU and the US feel the need for a transatlantic economic agreement to boost their special relationship, they should agree on the acceleration of their Uruguay Round commitments and the opening up of sectors not satisfactorily covered by the WTO.

## Bibliography

- APEC (Asia Pacific Economic Cooperation) Eminent Persons Group (1995), *Implementing the APEC Vision – Third Report*. APEC Secretariat, Singapore.
- Bhagwati, J. (1991), *The World Trading System at Risk*. Harvester Wheatsheaf, New York.
- Commission of the European Communities (1995), *Europe and the US: the Way Forward*. Communication from the Commission to the Council, Com(95) 411, Brussels.
- Financial Times (1995), *US and Europe eye each other up*. 12.5.1995.
- GATT (General Agreement on Tariffs and Trade) (1994), *The Results of the Uruguay Round of Multilateral Trade Negotiations – Market Access Goods and Services: Overview of the Results*. Geneva, November 1994 (mimeo).
- Krueger, Anne O. (1995), *Free Trade Agreements Versus Customs Unions*. National Bureau of Economic Research Working Paper 5084, Cambridge, MA.
- Langhammer, Rolf J. (1992), "The Developing Countries and Regionalism". *Journal of Common Market Studies*, Vol. 30, 1992, No. 2, 211-231.
- Langhammer, Rolf J. (1995), *Die transatlantischen Wirtschaftsbeziehungen. Partner oder Konkurrenten? Möglichkeiten einer transatlantischen Freihandelszone*. Kiel Institute of World Economics (mimeo). Forthcoming in: *Schriften des Presse- und Informationsrats der Bundesregierung*.
- OECD, *International Direct Investment Statistics Yearbook*. Paris, various issues.
- Schott, Jeffrey J. (1995), *Reflections on TAFTA*. Mimeo, Institute for International Economics, Washington, D.C., September 1995.
- Süddeutsche Zeitung (1995), *Washington und Brüssel arbeiten am "Transatlantischen Wirtschaftsraum"*. 28.8.1995, Munich.
- United Nations, *Monthly Bulletin of Statistics*. New York, various issues.
- UNCTAD (1988), *UNCTAD Handbook 1987 – Supplement*. New York.
- UNCTAD (1994), *UNCTAD Handbook 1993*. New York.
- United States Trade Representative (USTR) (1994), *1994 National Trade Estimate Report on Foreign Trade Barriers*. Washington. D.C.

US Department of Commerce, Survey of Current Business. Washington, D.C, various issues.

World Trade Organization (WTO) (1995a), Regionalism and the World Trading System. Geneva.

World Trade Organization (WTO) (1995b), Trade Policy Review – European Union – Report by the Secretariat. Geneva.



Appendix Table – Import Market Penetration Ratios in the EU, US/Canada and Japan 1980/81-1990/91 (in per cent)<sup>a</sup>

	EU			US + Canada			Japan		
	80/81	85/86	90/91	80/81	85/86	90/91	80/81	85/86	90/91
All goods	17.3	14.9	15.0	9.1	10.9	12.3	13.1	9.3	9.5
Primary products	44.2	34.0	28.9	25.1	14.1	16.4	65.6	52.8	51.4
Manufactures	11.5	11.4	13.2	6.5	10.4	11.8	5.0	4.6	6.3
Agriculture	20.2	17.5	13.7	8.0	9.5	8.3	31.2	25.8	26.9
Coal, petroleum, natural gas	63.5	51.9	51.3	37.8	16.4	23.0	97.2	95.2	96.8
Other mining and quarrying	93.0	83.5	80.9	56.5	29.6	30.8	92.1	90.1	90.7
Rubber	7.0	6.5	9.9	7.0	9.0	10.2	2.1	2.0	3.6
Chemicals	9.5	9.5	10.9	4.3	5.9	6.3	6.1	6.5	6.8
Clothing	23.9	22.9	29.4	18.6	33.4	42.0	12.8	15.3	27.3
Wood products, paper and printing	14.2	11.9	12.1	1.6	2.8	3.0	4.5	3.6	5.2
Food, beverages and tobacco	4.9	3.8	4.0	3.3	3.3	3.1	4.5	3.6	5.7
Textiles	12.6	10.5	13.4	4.7	7.9	8.0	4.5	4.8	6.6
Petroleum and coal products	9.8	13.0	8.6	5.0	7.9	7.4	8.9	10.3	13.1
Non-metallic mineral products	3.4	2.9	4.3	4.1	6.6	7.4	0.9	1.4	2.6
Ferrous and non-ferrous metals	9.9	6.8	7.2	5.0	6.1	5.3	4.5	3.9	5.0
Transport equipment	11.3	9.4	13.4	10.0	12.9	13.3	2.6	2.4	3.9
Machinery and other manufactured goods	19.8	23.4	25.9	11.4	19.6	24.9	5.1	4.6	6.7

<sup>a</sup>Imports as per cent of domestic supply (domestic production plus imports minus exports).

Source: UNCTAD Handbook 1993; New York 1994. - UNCTAD Handbook 1987 Supplement.