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Pre-Hearing Brief on Methodological Questions Relating to the USITC Investigation Concerning the Proposed Trans-Atlantic Free Trade Agreement

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Public Citizen welcomes the opportunity to provide written comment on the U.S. International Trade Commission (USITC) investigation entitled "U.S.-EU Transatlantic Trade and Investment Partnership Agreement: Advice on the Probable Economic Effect of Providing Duty-Free Treatment for Imports" in advance of USITC's public hearing on June 5, 2013. Public Citizen is a national, nonprofit public interest organization with more than 300,000 members and supporters that champions citizen interests before Congress, the executive branch agencies and the courts. We have conducted extensive analysis on the economic impacts and implications of existing U.S. trade and investment agreements, the expansive model of trade and investment terms that the Obama administration has pursued in the Trans-Pacific Partnership "Free Trade" Agreement (FTA), and the likely impacts of the U.S.-EU Trans-Atlantic Free Trade Agreement (TAFTA) if it were to be based on such an approach.

While the U.S. Trade Representative (USTR) requested USITC to study the projected effect "of providing duty-free treatment for imports of products from all of the EU member states,"[1] the TAFTA negotiations will not focus primarily on tariffs, but on "regulatory and other non-tariff barriers," according to the joint U.S.-EU announcement of the intent to launch negotiations.[2] The decision to concentrate on "behind-the-border"[3] policies stems from the Parties' acknowledgement that tariffs between the United States and EU are "already quite low."[4]

With regard to non-tariff measures (NTMs), USTR requested that USITC "assume that any known U.S. nontariff barrier will not be applicable to such imports."[5] This USTR request asks the USITC to design a study based on a foreseeably implausible outcome of U.S.-EU negotiations: assuredly such negotiations will not result in the removal of *all* known U.S. NTMs. This is particularly true when one considers what USTR deems to be an NTM. Using USTR's annual National Trade Estimate Report on Foreign Trade Barriers as a guide,[6] removal of all NTMs would require both the United States and EU to abandon a vast swath of health, environmental, food and product safety, energy, financial, and other public interest safeguards that can be construed under USTR's broad notion to be "nontariff barriers." Even if this were politically feasible, which it is not, certainly such an unthinkable assault on essential protections for consumers, workers and the environment would not be the Obama administration's agenda.

Obviously, wholesale regulatory elimination is also wholly untenable. Even the European study widely used to claim projected economic gains from the prospective dismantling of NTMs under TAFTA[7] determined that 100 percent elimination of those regulatory measures would be far from feasible.[8] The study, conducted for the European Commission by ECORYS Nederland BV, states, "It is unlikely that all areas of regulatory divergence identified can actually be addressed. There are many reasons why this is the case: because this would require constitutional changes, unrealistic legal work, or unrealistic technical change; because there is a lack of sufficient economic benefit to support the effort; because the set of regulations is too broad; because of consumer preferences, language and geography; or because of political sensitivities."[9] As such, the study projects that, at most, 50 percent of all NTMs are within the realm of possibility to be "aligned or even dismantled,"[10] while acknowledging that it would be more "realistic" to expect 25 percent of NTMs to be eliminated or "converged" under a U.S.-EU deal.[11] To provide a realistic assessment of the likely impact of any agreement, USITC must base its analysis on the reality that neither Congress nor the U.S. public would permit the elimination of the vast majority of non-tariff measures that can be construed as "barriers."

Moreover, such elimination would likely impose significant costs on U.S. consumers, workers and the environment. In addition to the non-economic toll that would result from a degradation of health, safety, environmental, and other public interest standards, such regulatory weakening would also result in quantifiable monetary costs for U.S. consumers and the broader economy. For example, in the food sector, the ECORYS study lists "Grade A dairy safety…rules and inspection requirements" for milk and "a US ban on the import of uncooked meat products" in the case of "a health risk" as NTMs that could be slated for dismantling under the deal.[12] The elimination of such consumer protections would likely result in greater incidence of food-borne illness in the United States, which would not only increase the medical costs of affected consumers, but would reduce their productivity levels and number of days at work, spelling a negative impact on aggregate economic output.

In financial services, the study names the Sarbanes-Oxley Act of 2002 as an NTM on the target list of EU businesses and officials.[13] The Act created enhanced accounting and anti-fraud standards to prevent a recurrence of the Enron, WorldCom, and other corporate accounting scandals that destroyed billions of dollars of U.S. investments. Similarly, EU government officials have been calling for TAFTA to be used to weaken provisions of the Volcker Rule.[14] The Rule, which the EU apparently views as an NTM, happens to sit at the center of Wall Street reforms enacted to rein in the excessive risk-taking that led to the Great Recession. The dissolution of such critical financial reregulation would heighten the risk of more accounting scandals or another financial crisis, threatening dire impacts on the real economy. **In calculating the prospective economic impacts of NTM convergence or elimination, USITC should incorporate risk-adjusted estimates of such economic costs alongside any estimated economic gains so as to produce a projection of the *net* impact of the deal.**

USITC should also incorporate into its analysis of TAFTA's net impact the large *social* costs associated with the degradation of NTMs created to ensure food safety, financial stability, climate security, Internet freedom, access to medicines and other public interest goals. A study by the U.N. Conference on Trade and Development (UNCTAD) states, "Focusing only on the protection effects of [NTMs] is likely to cause the social benefits they might provide to be disregarded. This is important from a policy point of view, since the optimal liberalization policy for [NTMs] will often not – unlike for tariffs – be their elimination but rather their rationalization to the social-utility maximizing level; in other words, the desirable policy prescription is to minimize their cost-benefit ratio."[15] USITC should seek to quantify social costs that would result from NTM dismantling, whether through willingness-to-pay or other appropriate methods, adding the sums to the economic costs discussed above to tabulate a projected net impact of the U.S.-EU deal.

While the ECORYS study ignores such social costs, it uses gravity regressions and a computable general equilibrium (CGE) model to project relatively small economic gains[16] from the convergence or elimination of NTMs. This approach, riddled with assumptions that could significantly skew the results, should not be replicated in the USITC investigation. The aforementioned UNCTAD study, entitled "Non-Tariff Barriers in Computable General Equilibrium Modeling," argues correctly, "ongoing liberalization policy efforts to eliminate the restrictive effects of [NTMs] are proceeding with little economic analysis…It should therefore be no surprise that the modeling of [NTMs] using general equilibrium modeling techniques is still in its early stages…The study of [NTMs] creates sizeable challenges for an empirical exercise that relies on vast and globally coherent data sets, and very often on strong assumptions. This means that ex ante we know relatively little about the costs and benefits of [NTMs]."[17]

The UNCTAD study tested the usage of differing assumptions in a CGE model to estimate the economic effects of NTM removal and found that a change in the assumptions produced not just a change in the magnitude of those effects, but also a change in the direction of the effects – from positive to negative.[18] That is, under certain assumptions, NTM removal produced a net negative economic effect for some countries, without even taking into account the social costs cited above. Given the inchoate state of CGE modeling for NTMs and the manifold assumptions required, USITC should seek alternatives to a CGE model in investigating the likely economic effects of the U.S.-EU deal. **If USITC, despite the risk of reaching the wrong conclusions, does proceed with a CGE model, USITC should straightforwardly convey the uncertainty accompanying the model by testing economic impacts of NTM removal under scenarios of altered or abandoned assumptions. In this case, USITC should report the entire range of results, including any changes in magnitude or direction of the projected economic effects.**

One alternative to relying on a CGE model would be to search for and extrapolate from relevant empirical evidence on the impacts of NTM convergence or removal. One historical scenario that seems relevant to draw from is the regulatory convergence of European countries that occurred during the formation of the European Union. USITC should conduct a literature review of studies that assess the impacts of such prior attempts at regulatory convergence, summarizing the nature and extent of any resulting economic effects. **Some studies indeed indicate that regulatory convergence within the EU has yielded little or no significant efficiency gains,[19] calling into question the magnitude of any economic benefits that can be expected from TAFTA and suggesting that the aforementioned economic and social costs of the deal may well trump any gains.** Such findings based on historical evidence should feature prominently in USITC's assessment of TAFTA's cost-benefit ratio.

ENDNOTES

[1] Letter from Acting U.S. Trade Representative Demetrios Marantis to USITC Chairman Irving Williamson, Office of the U.S. Trade Representative, March 25, 2013. Available at: http://www.usitc.gov/research_and_analysis/ongoing/documents/request_letter_USTR_US-EU_PEE.pdf.

[2] "Statement from United States President Barack Obama, European Council President Herman Van Rompuy and European Commission President José Manuel Barroso," The White House, Feb. 13, 2013. Available at: http://www.ustr.gov/about-us/press-office/press-releases/2013/february/statement-US-EU-Presidents.

[3] "Final Report," High Level Working Group on Jobs and Growth, Feb. 11, 2013. Available at: http://www.ustr.gov/sites/default/files/02132013%20FINAL%20HLWG%20REPORT.pdf.

[4] "Obama Administration Notifies Congress of Intent to Negotiate Transatlantic Trade and Investment Partnership," Office of the United States Trade Representative, March 20, 2013. Available at: http://www.ustr.gov/about-us/press-office/press-releases/2013/march/administration-notifies-congress-ttip.

[5] Letter from Acting U.S. Trade Representative Demetrios Marantis to USITC Chairman Irving Williamson, Office of the U.S. Trade Representative, March 25, 2013. Available at: http://www.usitc.gov/research_and_analysis/ongoing/documents/request_letter_USTR_US-EU_PEE.pdf.

[6] *See* Office of the United States Trade Representative, "2013 National Trade Estimate Report on Foreign Trade Barriers," USTR report, March 2013. Available at: http://www.ustr.gov/sites/default/files/2013%20NTE.pdf.

[7] *See*, for example, this report funded by the U.S. Chamber of Commerce, which cites the ECORYS study's projections for a GDP increase under the deal as a reason to initiate negotiations. John Morrall III, "Determining Compatible Regulatory Regimes between the U.S. and the EU, U.S. Chamber of Commerce report, at i. Available at: http://www.uschamber.com/sites/default/files/international/files/USTR-2012-0001-%20US%20Chamber-%20BusinessEurope%20FRN%20US%20EU%20High%20Level%20Working%20Group.pdf.

[8] Dr. Koen G. Berden, et al, "Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis," ECORYS Nederland BV, Dec. 11, 2009. Available at: http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc_145613.pdf. [Hereinafter "ECORYS report."]

[9] ECORYS report, at xxxvi.

[10] ECORYS report, at xxxvi.

[11] ECORYS report, at xiii.

[12] ECORYS report, at 80.

[13] ECORYS report, at 120.

[14] Howard Schneider, "After Buoyant Debut, U.S.-E.U. Trade Talks Face a Growing List of Issues," *The Washington Post*, May 13, 2013. Available at: http://www.washingtonpost.com/business/economy/after-buoyant-debut-us-eu-trade-talks-face-a-growing-list-of-issues/2013/05/13/c85bb6c0-bc05-11e2-9b09-1638acc3942e_story.html

[15] Marco Fugazza and Jean-Christophe Maur, "Non-Tariff Barriers in Computable General Equilibrium Modeling," U.N. Conference on Trade and Development, Policy Issues in International Trade and Commodities: Study Series No. 38, 2008, at 4. Available at: http://unctad.org/en/Docs/itcdtab39_en.pdf. [Hereinafter "UNCTAD report."]

[16] U.S. household gains are estimated at as little as an additional 0.07 percent of income annually under what the study calls the "realistic" scenario (eliminating 25 percent of all non-tariff barriers) and not including the study's assumption of long-term capital adjustments. Even if assuming the less realistic, "ambitious" scenario in which fully 50 percent of all non-tariff barriers are eliminated (100 percent of the barriers that the study considers to be within the realm of possibility for alignment or dismantling) and allowing for the assumption of long-term capital adjustments, each household would only see an additional 0.3 percent of income. According to the study, this idealized scenario would produce for the average U.S. household "an additional one-time payment of €6.400 ($8.300) over a working lifetime at present value." The more realistic scenario would thus produce an additional one-time payment of less than $1,900. Assuming a household of two income earners and a "working lifetime" of 40 years, the study projects that the total gains of a U.S.-EU deal range from $103 per person per year (41 cents per working day) under a scenario of sweeping deregulation to $23 per person per year (9 cents per working day) under a more realistic scenario. ECORYS report, at xvii and xx.

[17] UNCTAD report, at 1.

[18] UNCTAD report, at 11.

[19] *See*, for example, Barbara Casu and Philip Molyneux, "A Comparative Study of Efficiency in European Banking," *Applied Economics*, 35: 17, Nov. 2003. Available at: http://fic.wharton.upenn.edu/fic/papers/00/0017.pdf. The authors study the extent to which banking efficiency has improved in Europe as a result of the convergence of banking regulations in the formation of the EU's Single Internal Market. They conclude (on page 21 of the linked version) that it is only "possible to detect a slight improvement in the average efficiency scores," while "the efficiency gap among countries grew even wider."