Published on *The National Interest* (http://nationalinterest.org)

The Strange Politics of U.S.-EU Free Trade

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President Obama's announcement that the United States and the European Union will begin negotiating a bilateral agreement on trade and investment this year is significant. For all the growing importance of China and other emerging markets, the U.S. and EU are still the world's two largest economies, encompassing half of global economic activity. Transatlantic trade is roughly $700 billion per year, and U.S.-EU investment surpasses investment in and from Asia. Because of the size of these economies, and the enormous amount of trade and investment between them, a lowering of trade and investment barriers would have a sizeable impact on the global economy.

Robert Manning has [5]argued [5]in these spaces [5] that interest in a transatlantic deal may be due to ongoing low growth and austerity: lowering trade barriers between the world's two largest markets could stimulate economic growth without fiscal expenditure. But government austerity and low growth have historically been associated with trade protectionism, not liberalization. The 1930s, believed by some to be the most apt analogue for the present situation, was marked by tariff increases, currency wars, and restrictions on international investment. Why should it be different now? Because the current political situation facing the United States and the EU differs from ordinary trade politics in ways which may have far-reaching implications for international trade and investment regimes.

Standard accounts of trade politics often begin with reference to Mancur Olson's logic of collective action, whereby small groups with a common interest may be able to politically mobilize more effectively than large groups. Thus, policy often benefits the minority at the expense of the majority. Trade generates diffuse benefits for large numbers of consumers in the form of lower prices, but concentrates costs on a smaller numbers of producers who suffer from foreign competition. Consumers may find it difficult to overcome collective action problems and achieve political influence because the gains for each individual are relatively small despite being large for the group. Producers who would suffer from trade have strong incentives to act politically, because the average cost to each of them is much higher.

Therefore, the logic of collective action expects trade policy to be protectionist absent two conditions: A countervailing small group of comparatively advantaged producers that is able mobilize politically in favor of open trade for their goods or services, and an international negotiating process that allows states to grant reciprocal concessions: in other words, you liberalize your comparatively disadvantaged markets and I'll liberalize mine.

The trade deal that Washington and Brussels are negotiating inverts this dynamic. Because U.S.-EU trade is already relatively open, both the benefits and costs of further liberalization are diffuse. As a result, all of the major interests seem to be in support. As the *New York Times* noted [6], "there does not seem to be any broad-based political opposition to an EU-U.S. trade agreement, as there was to NAFTA [the North American Free Trade Agreement]." Since the costs to producers of mobilizing politically in opposition to greater openness may outweigh the gains, such a deal may even make typical redistribution via side payments unnecessary (as recently described [7] by Daniel Altman). As a result, the standard domestic political situation is inverted: the groups most likely to lobby the government will be those that benefit from trade, rather than those that suffer from it.

A U.S.-EU trade deal could also impact future international economic negotiations in atypical ways. Some, like Jagdish Bhagwati [8], are skeptical of bilateral trade agreements, believing that they lessen momentum for multilateral deals—such as the ongoing (and never-ending) Doha round run by the World Trade Organization (WTO)—which are more difficult to complete but result in greater global liberalization. Walter Russell Mead has recently made a similar argument [9] in response to the proposed U.S.-EU deal. But the Doha round of WTO talks is all but dead, as the politics remains intractable. And yet, perhaps ironically, a U.S.-EU bilateral deal could resuscitate WTO negotiations if it provides an impetus for antagonists in the Doha round to make further concessions rather than be locked out of trade arrangements. A Doha agreement that privileges U.S. and European interests may contradict its ostensible purpose as a "development round," but developing nations would not benefit from being excluded from preferential access to the world's largest markets either. So Bhagwati could be wrong: bilateral trade deals could actually provide momentum for completion of multilateral deals, at least in cases like this.

A U.S.-EU deal may simultaneously reverse important trends governing international investment. Most bilateral trade and investment treaties include investor-state dispute clauses (ISDs). Unlike traditional dispute settlement mechanisms, ISDs allow firms to sue states directly, usually within the context of an international arbitral board such as the International Centre for the Settlement of Investment Disputes [10] (ICSID). ISDs are controversial primarily because there is a widespread fear that multinational corporations with deep pockets will engage in litigious wars of attrition. Furthermore, when investors can sue states directly, governments no longer have

access to diplomatic tools to smooth over disputes. And, to the extent that the long-term viability of open goods and capital markets requires some flexibility to deal with domestic resistance, the removal of states as arbiters—of which investment disputes are worth pursuing and which are better left ignored—could have lasting negative implications for the political viability of economic openness.

While ISD clauses are widespread, they usually exist within the context of treaties between states characterized by economic asymmetries. For instance, of the more than 2000 bilateral investment treaties (BITs) worldwide, none exist between two advanced industrial countries. The United States generally embraces investor-state dispute clauses; both their model free-trade agreement (FTA) and BIT contain such language. However, it is far from certain that a US-EU treaty would include an ISD clause. Generally, advanced industrial countries have shown they are more interested in promoting legal regimes that protect "their" multinationals while they are less willing to cede jurisdiction over investment disputes in which they might be defendants. For instance, Australia has decided to drop ISD clauses [11] from its BITs and FTAs after it was sued by Philip Morris, who used an Australia-Hong Kong BIT to establish ICSID jurisdiction [12]. In an economic version of mutual deterrence, the economic strength of the US and EU provides incentives for both to avoid these clauses.

There is growing dissatisfaction with the costs of ISDs: India and South Africa recently announced broad reviews of such clauses. Thus, it is unlikely such clauses could persist if the U.S. and EU decide to not subject themselves to such extraterritorial juridical measures. A lasting legacy of a U.S.-EU agreement, then, could be the dismantling of foreign investor-led suits against states. Such a movement away from ISDs may actually prove beneficial to long run economic integration, since ISDs tend to create duplicated layers of juridical authority that generate confusion and make it harder for governments to intercede in investor-state disputes in ways that support for deep economic integration. Further, there is some evidence that states with ISDs tend not to pursue meaningful domestic legal reforms. If ISDs contribute to the persistence of partial economic reforms that ultimately impede broad-based growth, then removing them may spur economic development.

In sum, a U.S.-EU FTA may simultaneously reverse normal aspects of domestic trade politics, multilateral trade negotiations, and international investment law. Because of the centrality of the United States and EU in the international economic system, a treaty between the two will set the agenda for future bi- and multilateral economic treaties, and have significant ramifications for the global economy. Unlike the situation in previous periods of economic distress, the politics for getting a new trade deal appear to be favorable.

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Image: Wikimedia Commons/Danny Cornelissen [13].

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