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Jacques Delors Centre

Policy Paper

Transatlantic Trade post-Trump[1]

Priorities for a Pragmatic Reset

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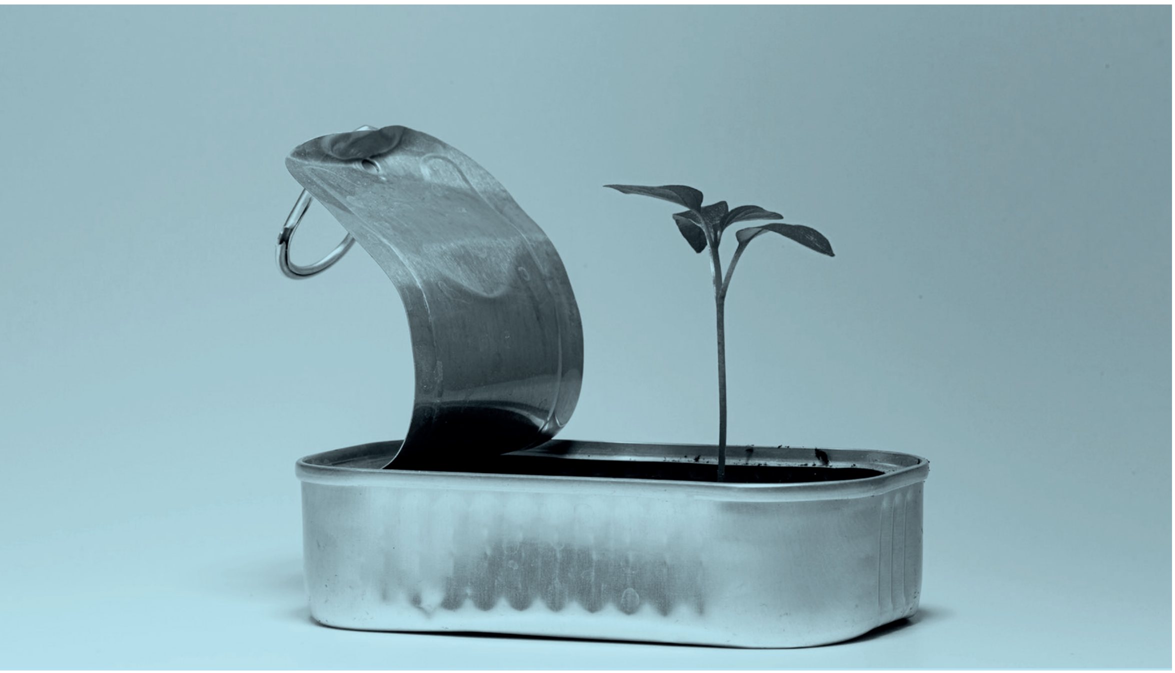
#TransatlanticRelations
#Trade
#BidenAdministration



After four turbulent years in trade relations, Europe has high expectations of the Biden administration. However, the room for big trade reforms is small and new grand-scale liberalization is neither economically necessary nor politically realistic. Accordingly, we propose a pragmatic agenda that focuses on ending ongoing trade conflicts and making progress on some WTO reforms as well as trade-adjacent issues such as climate change and supply-chain security.

1 This paper draws on insights from an expert workshop held in the fall of 2020 as part of a workshop series on the economics of European sovereignty co-organized by the Policy Planning Unit of the German Federal Foreign Office and the Jacques Delors Centre. However, the paper reflects neither the position of the Federal Foreign Office, nor of any individual participant, but rather solely the opinion of the authors.

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Introduction

After four turbulent years in trade relations, Europe has high expectations for the Biden administration. Given the economic fallout of the COVID-19 pandemic, there is a strong desire to turn the page on the conflicts that flared up and festered under Trump. Against this backdrop, the European Union (EU) has already published an all-encompassing proposal for a new transatlantic agenda with the Biden administration.[2] The broad strategy still lacks details on trade but underlines that the EU wishes to harness transatlantic trade for its economic recovery, steer the global trade system back into calmer, more predictable waters, and find common ground on issues such as China and green trade. It is unlikely that these hopes will all be fulfilled. While the President-elect has been a proponent of free trade for much of his political career, on the campaign trail he promised a "foreign policy for the middle class", stressed domestic manufacturing, and drew close links between trade and national security. A return to the "old normal" is therefore unlikely.

In search of a new normal, this paper maps out a transatlantic trade agenda for the coming years. We argue, first, that such an agenda needs to be grounded in realistic expectations of what can be achieved. Political room for maneuver on trade is limited on both sides of the Atlantic and the macro-economic effect of resolving most of the issues on the table would be small. Going big on trade is thus neither realistic nor advisable, in terms of expending political capital.

A sober assessment nonetheless reveals several areas in which political progress in the next four years is possible. This includes ending the unproductive tariff spiral between the US and EU, alleviating some concerns about World Trade Organization (WTO) policies, and a constructive coordination of measures on trade resilience, carbon border adjustment and green trade. For all of these issues, sequencing will be key. As the saying goes, "nothing succeeds like success." Accordingly, the EU should focus on delivering quick wins, both bilaterally and in reforming the multilateral trade system. It can use these as stepping stones towards resolving more contentious long-term issues such as comprehensive WTO reform.

We start by introducing some general recommendations for a pragmatic transatlantic trade agenda in the coming years. We then move on to a more detailed discussion of EU and US interests in four areas that dominate the current European debate on trade policy: first, leveraging trade for the recovery; second, strengthening economic resilience; third, putting trade at the service of the green transition; and finally, reforming the multilateral trade system. In each area, we discuss European and US priorities and show where there is room for smaller short-term agreements, and where a longer-term strategy is needed.

2 European Commission, 2020.

1 General recommendations for a pragmatic transatlantic agenda on trade

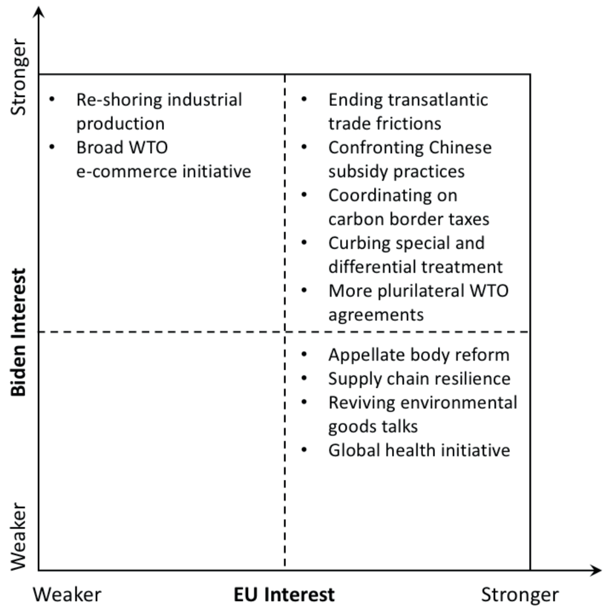
Three general recommendations should guide how the EU shapes its trade policy towards the incoming US administration.

First, EU strategy should start with a **realistic assessment of the macro-economic role of trade** in the current crisis. Much of the European policy debate currently centres on the idea that reducing uncertainty in the multilateral trade system and pushing ahead with new bi- and plurilateral agreements is important to counteract the economic repercussions of the coronavirus crisis.[3] However, as we discuss in more detail below, the economic gains of specific agreements are limited, take a long time to be realized and are unlikely to reach the sectors that currently suffer most from the pandemic. Trade policy is, thus, an ineffective tool for fostering growth in the short run. Therefore, from an economic point of view, there is no need to rush into new trade agreements. The EU should focus on maximizing the substantive gains from trade in related areas such as climate and supply chain resilience.

"The EU's strategy should start with a realistic assessment of the macro-economic role of trade in the current crisis."

Second, the EU should be transparent about the fact that the **political room for manoeuvre is small** on both sides of the Atlantic. Lately, the EU has had its own difficulties with bringing comprehensive trade agreements across the finish line, and recent experience with the Comprehensive Economic and Trade Agreement (CETA) and EU-Mercosur agreement has not increased Member States' appetite for grand bargains. Equally important, the US—and especially the Democratic Party—remain deeply divided on the merits of trade liberalization. Given the manifold domestic issues the country faces, striking new trade deals or engaging in grand-scale reforms of the multilateral trade system will not be a priority for the incoming administration.[4] Although Biden's management of transatlantic trade relations will be less erratic and protectionist than his predecessor's, any significant alterations to trade relations will require extensive time and effort.

Figure 1: Overview of EU and US interests



[3] European Commission, 2020.
[4] Pew Research, 2020.

Despite all these caveats, substantive movement is possible. Figure 1 summarizes the positions of the European Commission and a future Biden administration on key issues. It shows that while some interests will continue to diverge, there is also overlap on important issues (upper right quadrant). Making progress in these areas will go a long way not just in delivering policy goals but also in showing that the rule-based trade system is still able to produce substantive shared gains. However, to tap this potential, sequencing will be key. Nothing is as convincing as success and the EU should **focus on delivering quick wins,** both bilaterally and in reforming the multilateral system, and use them as stepping stones to work towards common positions on more all-embracing reforms and agreements. The remainder of this paper discusses EU and US interests on key issues in more detail and describes possible quick wins, thornier areas where more efforts are needed, and issues where little progress is to be expected.

2 Four priorities for transatlantic trade relations

2.1 Priority 1: Leveraging trade for the recovery

In recent months, economic recovery has become a focal point of the European trade policy debate. With coronavirus infection rates once again spiking all over Europe, some of the more optimistic economic forecasts based on the strong rebound during the summer now seem out of reach. The Commission currently estimates EU growth will drop by about 7.4% in 2020 and the full recovery will not come until well into 2022.[5] Consequently, the role that trade could play in boosting growth has become crucial for the EU.

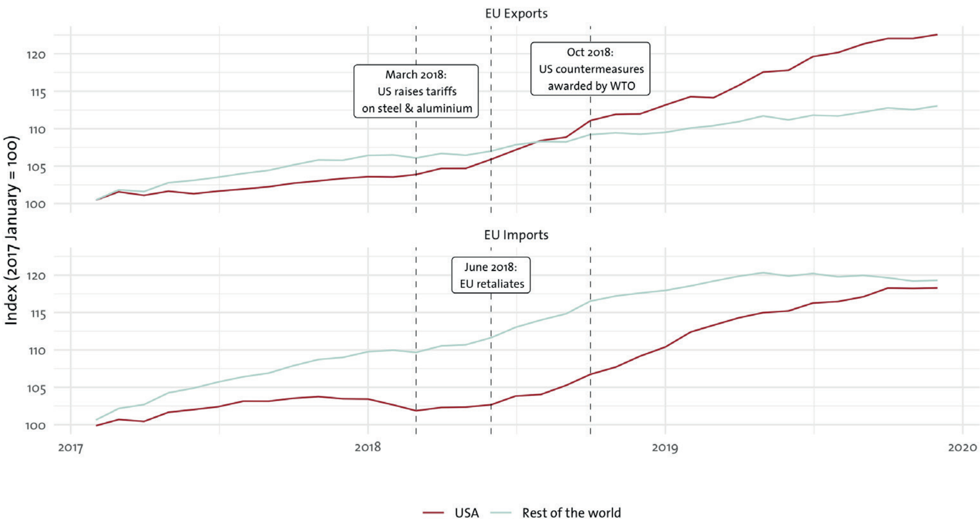
To promote this, a key priority of the EU is **to reduce uncertainty for European exporters by easing bilateral trade tensions** with the US. Trade conflicts between the US and EU have been on the rise ever since the introduction of new American import tariffs on steel and aluminium in 2018. The EU responded with retaliatory measures. Tensions further increased when the US leveraged a WTO ruling on European aircraft giant Airbus subsidies to slap more than €6 billion in countervailing measures on European agricultural products at the end of 2019. In November 2020, the EU followed suit by using a similar WTO ruling on US subsidies for rival manufacturer Boeing to introduce €4 billion in tariffs on US exports ranging from tractors to ketchup and cheddar cheese.

It is important to note that the overall macro-economic effects of these conflicts remain small. Compared to total trade between the EU and the US the share of goods affected by additional tariffs has remained very low.[6] Moreover, data shows that despite the conflicts, overall exports into the US have outpaced European shipments to the rest of the world in recent years (see Figure 2).[7] Moreover, while trade tensions with the US did lead to a notable increase in overall uncertainty for European exporters, recent research shows that the effect that such insecurities have on actual output and investment is much lower than suggested by the

[5] European Commission, 2020.
[6] Bundesbank, 2020.
[7] European Commission, 2019.

strong reactions on stock markets.[8] However, these conflicts do entail significant and unproductive costs for the affected sectors and, accordingly, should be curtailed.

Figure 2: Development of trade-weighted tariffs between the EU and the US



Own calculations based on Eurostat (2020)

Reducing bilateral trade tensions is an area where European interests jibe with the Biden administration. On the campaign trail, Joe Biden has shown willingness to rebuild cooperative trade relations with the EU and end what a close adviser called Trump's "artificial trade wars" with allies.[9] Critically, given that Trump's justification for the tariffs was based on national security grounds (Section 232 of the Trade Expansion Act of 1962), the incoming president would be able to revoke the import duties even in the now-likely case of a divided government. After four years of mutual tariff spirals, the EU should, therefore, seek to negotiate a general bilateral understanding on lifting the recent tariffs and countervailing measures on both sides of the Atlantic. This should also include a settlement of the protracted Boeing-Airbus dispute. Here, the EU should leverage the fresh start under Biden to find an agreement based on a common acknowledgement that both sides have a legitimate interest in producing long-range aircrafts and that this requires some form of public support. Beyond reducing uncertainty, some European policymakers argue that the EU should use the crisis as an opportunity to **push ahead with bilateral trade agreements,** including a new attempt at negotiating a comprehensive transatlantic trade deal.[10] By opening up foreign markets and reducing trade costs, the argument goes, such agreements can boost the output of Europe's export industries and add sorely needed revenues and growth for European firms.[11] However, arguments that portray trade deals as a tool for boosting growth as part of overall recovery efforts should be taken with caution.

On the one hand, the economic case for using trade as a recovery instrument is far from clear-cut. First, the economic gains of new trade deals take time to come through. Most contemporary trade models assume that benefits from trade arise mainly through dynamic effects such as a reallocation of resources from less to

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8 Davis, 2019.
9 Financial Times, 2020.
10 Handelsblatt, 2020; Tagesspiegel, 2020.
11 Financial Times, 2020.

more productive firms and increased innovation due to more competition.[12] This requires capital and workers to be shifted between sectors and firms. Trade gains, therefore, do not occur overnight and often involve substantial adjustment costs. Moreover, the economic benefits from individual agreements are modest. WTO-bound tariffs have been declining over recent decades and, today, often do not differ that much from preferential trade agreements. Most gains from new deals, therefore, occur through the reduction of non-tariff trade barriers, which makes their welfare effects much more indirect. To take the example of the failed Transatlantic Trade and Investment Partnership (TTIP), the Commission estimated a long-run increase of about 0.5% of GDP over the course of 10 years.[13] These are, of course, non-trivial effects, but they do not amount to the boost needed in a deep crisis. Moreover, the hardest hit sectors (such as services) and countries (mostly tourism-dependent Southern European countries) will see few benefits from such agreements, certainly in the near-term.

On the other hand, reaching all-encompassing new trade deals is politically fraught. In the EU, their merits are increasingly questioned and the fate of the CETA and Mercosur agreements has cast serious doubt on the Union's very ability to implement its "deep and comprehensive" free trade agenda. Given that tariffs across the Atlantic are already low, any agreement between the US and the EU would need to focus on regulatory convergence. The TTIP negotiations revealed that preferences about the right product and service standards often diverge substantially and in many cases are rooted in legitimate national differences over the proper level of precaution. There is little to suggest that this has changed in recent years.

Moreover, in the US, Biden's base is deeply divided on trade.[14] He pursued a deliberately "big tent" approach during the 2020 campaign, relying on progressive activists as his core base, but also wooing suburban conservatives. This leaves the President-elect with no clear-cut constituency when it comes to trade. His "buy American, make it in America, innovate in America" statements suggest he may retain some of Trump's policies and, indeed, he has echoed Trump's demands on bringing manufacturing jobs home ('reshoring'). Similarly, his recent nomination of Congresswoman Katherine Tai as US trade representative is widely seen as pointing towards a more labor- and environment-focused trade agenda. At the same time, Biden will also be under pressure from more centrist elements of the Democratic Party to pursue a more liberalizing approach. As with the Trump administration, the relative influence of different camps will ebb and flow over time.

Regardless of the direction Biden wishes to take, the myriad veto points within the US system will limit his autonomy in pursuing his trade agenda. Most notably, Trade Promotion Authority, which is an impermanent power granted to the US president to broker trade deals, expires on July 1, 2021. Its renewal will be critical for any larger-scale trade agreements, and it seems likely that some Republicans and progressive Democrats will oppose an extension. Finally, the odds of a comprehensive transatlantic trade deal are reduced by the fact that much of Biden's political capital will need to be spent at home. Surveys show that Americans are much more concerned with domestic issues than foreign policy or international trade. Indeed, the President-elect has already pledged that he will

"Myriad veto points within the US system will limit Biden's autonomy in pursuing his trade agenda."

[12] Melitz and Trefler 2012; Feenstra 2018.
[13] European Commission, 2017.
[14] New York Times, 2020.

not enter any new trade agreements before he has made “major investments at home and in our workers”. [15, 16]

The EU should, therefore, be realistic about the benefits it can possibly derive from trade. It should seek to ease the tensions of recent years and strive for limited sectoral liberalization and regulatory convergence, especially in areas such as telecommunications in which transatlantic standards would help to balance the regulatory influence of China. However, the grand trade initiatives that some European policy-makers are dreaming of would require investing a great deal of political capital without delivering significant economic gains in the foreseeable future.

Quick wins to prioritize:
Reducing US import tariffs on steel and aluminum; ending Airbus-Boeing WTO dispute and lifting countervailing measures in the EU and the US

Possible long-term policies to pursue:
Limited bilateral tariff reductions in specific sectors; regulatory convergence in less controversial areas

Shelved for now:
Reaching a deep and comprehensive transatlantic trade agreement

2.2 Priority 2: Strengthening trade defense and supply chain resilience

A second priority of EU trade policy is a broad push for more economic sovereignty. The general aim is to strengthen the EU’s ability to pursue its economic interests free of external coercion, fend off the distortive effects that foreign subsidies have on the competitiveness of European firms, and make key supply chains more resilient to economic shocks and political influence. In trade policy, this strategy is taking shape in two areas.

First, the EU aims to strengthen its trade defense toolbox. There is a growing perception amongst European policymakers that the EU’s current instruments are too slow, too weak, and too limited in scope to grapple with the growing weaponization of trade by others. To remedy these shortcomings, a new European foreign investment screening mechanism became fully operational in October 2020. The agenda also includes new rules on foreign subsidies enabling the EU to seek redress against state-backed firms selling into the single market. Further defensive instruments are likely to follow.

Second, the EU wants to increase the resilience of European supply chains. Given the temporary disruption of some production networks during the early phase of the COVID crisis, the Commission has identified key sectors — such as pharmaceuticals, electric batteries, aerospace and digital — where it plans to reduce supply chain risks through a combination of strategic stockpiling, diversification and re-shoring.[17] The plan is still hazy with rather ill-defined end goals. Early

[15] Pew Research Center, 2020.
[16] New York Times, 2020.
[17] Carl et al., 2020.

assessments show that while there are specific goods where EU dependency on, say, China is risky,[18] it is not generally over-dependent on global supply chains, and any re-shoring of production would often lead to less and not more diversification.[19] Nonetheless, the issue will remain a defining feature of the European trade agenda.

While defensive measures and steps to increase supply chain resilience are taken unilaterally, the EU is keen to seek greater transatlantic coordination on the issue. Indeed, the fact that EU attitudes and policies towards Chinese trade practices are hardening means a partial convergence of transatlantic positions on the issue. Nonetheless, the topic remains thorny.[20] Under Trump, Europe has become increasingly wary about the rise of uncoordinated US export bans directed at the People's Republic. The fact that more and more US producers are barred from using Chinese products or providing inputs to Chinese firms causes problems not just for those European firms that produce in the US and export to China. It also hurts firms located in the single market, especially in advanced technology, that remain deeply integrated in both US and Chinese supply chains.[21]

"The Biden administration is likely to seek more transatlantic cooperation when it comes to confronting Chinese trade practices."

This issue is unlikely to disappear. Biden made a point of criticizing Trump's handling of the trade war, but he has also adopted a distinctly confrontational stance towards China with no hint at any cuts in export controls on technology products. Moreover, his economic plans include targeted reshoring as well as closing "supply chain vulnerabilities across a range of critical products," including "energy and grid resilience technologies, semiconductors, key electronics and related technologies, telecommunications infrastructure, and key raw materials."[22] However, the Biden administration is likely to seek more transatlantic cooperation when it comes to confronting Chinese trade practices. On the campaign trail, the President-elect stressed that he plans to pursue the strengthening of US supply chains ¬-jointly with American allies. This appears feasible. Indeed, the Commission has already floated the idea of a bilateral trade and technology council, creating a space to coordinate transatlantic approaches to Chinese technology and commercial practices. Moreover, to address the thorny issue of secondary sanctions, the EU should consider adopting its own extraterritorial mechanisms to sanction breaches of environmental, data protection, tax and anti-corruption laws. On the one hand, this would facilitate coordination with the US. On the other hand, it could also serve as a deterrent when the EU is threatened by US extraterritorial sanctions.

In general, the Biden administration is likely to double down on Trump's efforts to confront what it too perceives as unfair Chinese trade practices. While re-shoring significant parts of industrial production is an unrealistic goal, the EU's stance vis-à-vis China has also hardened in recent years. The EU should thus approach the incoming Biden administration, enter into a substantive dialogue on China, and strive to formulate a common transatlantic agenda on confronting unfair trade practices.

[18] Redeker and Stahl, 2020.
[19] Guinea and Forsthuber, 2020.
[20] Lowe, S., 2020.
[21] Redeker and Stahl, 2020.
[22] Biden campaign 2020.

Quick wins to prioritize:
Starting transatlantic dialogue forums on common positions for foreign investment screening, counteracting foreign subsidies and supply chain diversification

Possible long-term policies to pursue:
Formulating a common agenda on confronting Chinese trade practices

Shelved for now:
Re-shoring significant parts of EU or US production

2.3 Priority 3: Putting trade policy at the service of the green transition

A key priority for the EU is to strengthen the link between trade policy and the green transition. First, this includes some instrument for effecting carbon border adjustment. To meet the climate targets under the landmark 2015 Paris Agreement, the EU will need to tighten its Emission Trading System (ETS). To make sure that European businesses are not undercut by imports from countries with low or zero prices on emissions, some form of carbon border adjustment is necessary.[23] In essence, this would amount to some form of EU import tariff that matches the difference between the EU carbon price and that of the exporting country. Critically, such measures would also reduce incentives for businesses to transfer production to countries with laxer emission constraints and thereby decrease the opportunity costs of climate action in third countries. For the EU, it is therefore an important tool to spur global climate action. In addition to levying such tariffs, the EU also plans to tinge its trade agreements in a deeper shade of green. The new Commission has pledged to include adherence to the Paris Agreement within all its trade deals, turning the voluntary targets into binding commitments. This is in line with a more general trend as the EU has been beefing up environmental rules and safeguards in many of its recent trade agreements.

However, the devil in both carbon border adjustment and greener trade agreements lies in the detailed implementation. Enacting a carbon border tax (CBT) requires not just assessing the total carbon footprint of imported goods but also determining at what point in the supply chain these emissions were created.[24] Even if an initial tax focuses on a small number of energy intensive goods, the process is immensely complex and prone to retaliatory measures from aggrieved trading partners as well as WTO complaints. Coordinating efforts with other allies – especially the US – will therefore be key. Similarly, the greening of preferential trade agreements (PTAs) has been met with criticism, from both environmental groups that point out that under current rules violating environmental provisions in EU trade deals has precious little consequence,[25] and from trading partners that see such measures largely as cheap excuses for protecting European producers from foreign competition. Arriving at broadly accepted and binding green trade norms is therefore likely to be challenging – to say the least.

[23] Lamy, Pons and Leturq, 2020.
[24] Ravikumar, 2020.
[25] Grain, 2020.

Still, with the new administration there is room for productive cooperation. Joe Biden has a relatively ambitious climate plan and wants to tie it into his trade policy. During the campaign, the President-elect called for a global ban on fossil-fuel subsidies and, like the EU, floated the idea of using trade deals to set binding commitments on reducing carbon emissions. Especially when it comes to the latter, Trump's frequent use of "national security" concerns with respect to trade – enabling the White House to by-pass Congress – could now be leveraged by the Biden administration in pursuit of these ambitions. Moreover, many Democrats are open to the idea of spurring US climate action by imposing a carbon tax at home and new climate tariffs at the country's external borders. Transatlantic cooperation in this area will need stamina as any coordination on carbon border adjustment would first require the US to introduce a domestic carbon tax.[26]

Putting trade at the service of the green transition ranks among the foremost goals of the current European Commission. While Biden's environmental agenda has remained vague and is subject to domestic constraints, there should be room for cooperation. In the event that a CBT becomes a US priority, both sides should make sure their carbon border adjustment schemes are mutually compatible, and in line with WTO law. Both sides should also coordinate on including environmental standards and a commitment to the Paris Agreement in future trade deals.

Possible long-term policies to pursue:
Making sure that EU and US pursue compatible regimes in carbon border adjustment; work towards common norms for climate targets in FTAs

2.4 Priority 4: Making headway on WTO reforms and initiatives

Finally, when it comes to a new transatlantic agenda on revitalizing the WTO, prioritization will be key. Here, a central focus is restoring the organization's **dispute settlement system.** The system remains key to resolving trade conflicts in a rules-based manner but has effectively been put out of business by the US's long-standing refusal to appoint new judges to its Appellate Body (AB). Though the EU, along with other countries, has recently established an alternative appeals system and doubled down on urging the incoming administration to end the blockade, the conflict remains difficult to resolve. American misgivings about the AB long predate Trump and are rooted in a bipartisan view that the body oversteps its authority by de facto establishing a body of binding precedent (and, of course, a string of serious US defeats at its hands). While Biden is generally expected to take a more constructive stance on AB reform, he has remained largely silent on his concrete plans and has not yet committed to any of the reform proposals currently floated in the WTO and amongst trade experts.[27] The EU should again signal its willingness to clarify certain aspects of the AB's workings and renew its invitation to the US to rejoin the international dispute settlement system.

"The EU should renew its invitation to the US to rejoin the international dispute settlement system."

Still, making meaningful progress here will require time and effort. To maximize the chances of success, the EU should first of all focus on rebuilding general confidence in the WTO's capacity to deliver via some quick transatlantic wins in

[26] There is some support for such a policy among lawmakers; Pacrell, 2019.
[27] WTO, 2019.

the multilateral arena. In the immediate future, this would include convincing the US to drop its blockade of the proposed new Director General, Ngozi Okonjo-Iweala. In addition, the EU and the US should team up to get the ongoing negotiations on fishing subsidies across the finish line, and to revive the plurilateral talks on reducing custom duties on environmentally friendly goods that began under Obama. Transatlantic trust can also benefit from further developing a common agenda on disciplining subsidies usage under WTO rules. Both the EU and the US remain deeply dissatisfied with the fact that the current rules are "insufficient to tackle market and trade distorting subsidization existing in certain jurisdictions",[28] namely China. Together with Japan, the EU and the US has proposed adding new classes of subsidies within the agreement's coverage, such as the investments of state-directed banks, unlimited guarantees or subsidies to sectors in overcapacity.[29] While real reforms hinge on Chinese support and are thus unlikely in the near future, cooperating beyond the envisioned bilateral trade and technology council and teaming up at WTO-level as well will go a long way to rebuild transatlantic confidence.

Besides delivering some quick wins, restoring the basic functioning of the WTO will also require putting some of the more far-reaching and divisive issues on the back burner. For example, the EU has long championed the wider use of plurilateral agreements under WTO rules. Plurilaterals make it easier for a subset of member states to go ahead with new deals, without having to wait for everyone else's consent. While useful in theory, the necessary institutional reforms would require a lot of political capital. So far, although generally supportive, US administrations have shown little interest in prioritising the issue and this is unlikely to change under Biden. Similarly, both the EU and the US should avoid getting bogged down in the attempt to establish all-embracing WTO rules on digital trade. While the Commission has repeatedly emphasized the overlap in EU and US interests on digital services, data protection remains a massive roadblock between the two sides, especially after the European Court of Justice struck down the transatlantic Privacy Shield agreement. For the foreseeable future, considerable divergence in regulatory regimes on privacy on both sides of the Atlantic will, therefore, remain difficult to overcome.

Quick wins to prioritize:
Finish negotiations on fisheries subsidies; make progress on global health initiative; revive negotiations on Environmental Goods Agreement

Possible long-term policies to pursue:
Reform of the Appellate Body; pushing for a joint initiative on subsidies

Shelved for now:
Broad WTO e-commerce initiative covering privacy and transfers of personal data; establish new rules for plurilaterals

[28] European Commission, 2020.
[29] Lowe, 2020.

Conclusion

Despite continued transatlantic differences on trade policy, the incoming Biden administration opens the door to progress on important issues. To tap its full potential, the EU should be realistic about its expectations on trade. New grand-scale liberalization is neither economically necessary for immediate relief in the middle of the COVID-crisis nor politically realistic. Instead, the EU should focus on ending the trade conflicts and making progress on some WTO reforms as well as trade-adjunct issues such as climate change and supply-chain security. In doing so, some quick wins such as removing the tariffs introduced during the Trump years, establishing new forums for trade defense coordination and bringing pending WTO initiatives across the finish line should be prioritized. Potential successes can then be used to fuel progress on more complex issues such as important WTO reforms, coordinating on carbon border adjustment or formulating a transatlantic agenda on Chinese trade practices.

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