DOLLAR & SENSE: THE BROOKINGS TRADE PODCAST

"How a US-EU trade agreement could improve the economy, increase jobs, and strengthen democracy"

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Episode Summary:

Sanjay Patnaik, director of the Center on Regulation and Markets at Brookings, discusses his new report on the benefits of a U.S.-EU free trade agreement, building on the Transatlantic Trade and Investment Partnership negotiated by the Obama administration but scuttled by President Trump.

DOLLAR: Hi, I'm David Dollar, host of the Brookings Trade podcast Dollar and Sense. Today, we're going to talk about the possibility of a free trade agreement between the United States and the European Union. My guest is Sanjay Patnaik, director of the Center on Regulation and Markets at Brookings. He's recently published an article arguing that a free trade agreement between Europe and the United States would have multiple benefits. He also points out that something along these lines had been negotiated during the Obama administration, but never completed under the name of the Transatlantic Trade and Investment Partnership. So, that's going to be our topic.

But before we begin, I want to tell you about a new podcast from Brookings called the Brookings Podcast on Economic Activity, featuring cutting edge economic policy research and the economists who create it. Here's more.

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DOLLAR: Okay, Sanjay. So let's get to Europe-U.S. free trade. Why don't we start with this TTIP agreement that was largely negotiated during the Obama administration, but then abandoned. You know, what is TTIP and what has been its fate so far?

PATNAIK: Thank you so much for having me. It's a pleasure to be here. So as you mentioned, TTIP is the Transatlantic Trade and Investment Partnership. It was a major proposed free trade agreement between the United States and the E.U., with negotiations ongoing between 2013 and 2016. The agreement would have been the largest free trade agreement ever implemented in the world. But the deal was scrapped by President Trump, who instead initiated a trade war with Europe, as we all know.

TTIP would have eliminated 98 to 100% of tariffs and 10 to 25% of non-tariff barriers to trade between the two blocks. And this included streamlining regulations and compliance procedures for many goods and services. By doing so, it would have increased the U.S. GDP an estimated 75 billion U.S. dollars, and the EU GDP an estimated 64 billion U.S. dollars.

Fifteen rounds of negotiations had been completed in 2016, with many provisions in advanced stages of negotiation, including a small and medium sized enterprise clause and a customs and trade facilitation clause. I believe that it would be a good time now for the Biden administration to revive talks with the EU and build on the progress made on Obama.

DOLLAR: Now, as an economist, I think of the U.S. and the EU both as pretty open economies. So, are the really highly protected sectors that would benefit a lot from free trade? I mean, the overall, you know, positive effects depends a lot on what's protected to start with. So, are there some examples of sectors where this would make a significant difference?

PATNAIK: That's a great question. And the short answer is yes. Although the U.S. has most favored nation status with the EU, the EU's average most favored nation applied tariff rate is about 5.2% across all sectors. But there are some sectors that are even more protected than others. For instance, EU tariff rates can climb up to 26% for fish and seafood, 22% for trucks, 14% for bicycles, 10% for passenger vehicles, 10% for processed wood products, and 6.5% for fertilizers and plastics. And this is all based on a U.S. Trade Representative report for 2020. These industries stand to benefit a lot from a free trade agreement, and it's also important to to see that some industries actually would see an increase in demand as a result of lower prices and would also benefit from that. Some examples of those are textiles, electronics, and metal products.

DOLLAR: Those are really important points. Averages can be deceptive, so when you hear the average tariff rate is 5%, that sounds relatively minor, pretty small distortion. But there are a lot of product lines where it's zero. And so to get to that average of five, as you say, there are some, you know, moderately significant tariffs out there. So, that that's actually quite interesting.

Let me turn to the issue of labor. I think one of the issues, one of the issues why trade has become controversial in the U.S. is its effect on employment and wages. In the case of a free trade agreement with the European Union, do we have estimates about what would happen to employment on wages on both sides of the Atlantic?

PATNAIK: Yes, and this is a very important point, because there's a lot of misinformation about trade and the impact on employment. People, unfortunately, often think that free trade is bad for American workers, but actually, in this case with the European Union, the opposite would be true. One reason is that the EU is a high wage economy and therefore on a level playing field with the U.S. A policy report on TTIP actually said that low-wage American workers would see their wages increase about 0.4% on average, and high-skilled American workers would see an increase of about 0.3%. And the effects could even be greater for sectors that stand to benefit the most from a free trade agreement, as I mentioned before.

What is really interesting is that an economic report by the Atlantic Council estimated that TTIP would have added about 740,000 new American jobs. And also, when we look at Europe, different reports put job gains in Europe at about 400,000. And in the United States, these job gains would have been distributed across regions in the U.S., with almost all 50 states benefiting, depending on different industries, for instance, the South and Midwest, especially in the vehicle exports producing jobs. And then on the West Coast, a lot of the services industries. But actually overall, it would have been beneficial for employment in the United States.

DOLLAR: So, that's very interesting and quite a contrast with the effects of protectionism that we usually estimate. You mentioned that President Trump abandoned the TTIP and instead launched a trade war against Europe. And among other things, he put tariffs on steel and aluminum products, imports into the United States. Do we have estimates about the employment effects of that protectionist approach?

PATNAIK: Mm hmm, yes, we do. And the effects were largely as expected, namely detrimental to the job market in the United States. What is really important to keep in mind is while trade wars might protect a few jobs in one sector where the tariffs are levied, they often cost significantly more job losses in related sectors. For example, when we look at Trump's tariffs on aluminum and steel, these tariffs did produce more American jobs in aluminum and steel production, about 26,000. But at the same time, the tariffs cost the U.S. about 430,000 jobs in sectors using iron, steel, and aluminum. And that means, all in all, Trump's tariffs cost the U.S. about 400,000 jobs.

This is pretty easy to explain from an economist perspective, right? Because these tariffs made European steel and aluminum more expensive and that gave U.S. producers an advantage. But at the same time, because of the price increase across the board for steel and aluminum, any companies that used steel and aluminum will have to pay higher prices and usually pass that on to customers and that reduced demand for these products. And those are, for instance, appliance makers, other kind of like manufacturers that use those product.

DOLLAR: One of the issues that's arisen recently in U.S.-EU trade concerns energy. Europe's obviously got something of an energy crisis looming with Russia cutting off or restricting supplies of gas and with what's happened with the price of petroleum and supplies of petroleum. So, how would this kind of agreement affect energy trade? Could it help with this immediate crisis that we have?

PATNAIK: It could actually have helped, because during the negotiations for TTIP, energy and especially natural gas and renewable energy would have been included. That means it would have been streamlined, exports from the United States to Europe would have been made easier because there are still some regulations in place that make it a bit more difficult than if we had a free trade agreement in place. And in addition to that, renewable energy production, renewable energy sectors, would also have been more integrated across the Atlantic, and obviously that would have really helped in the current crisis.

DOLLAR: One of the things you point out in your publication concerns the issue of inflation. You know, our U.S. Federal Reserve is now on a path of rising interest rates in order to constrain demand. We we do have a pretty serious inflation problem in the United States, and actually they have a pretty serious problem in Europe as well. In the case of

Europe, I think a lot of it starts with Russia's invasion of Ukraine driving up energy and food prices, but it seems to be becoming more generalized. And in the U.S., we definitely have pretty generalized inflation. So, you know, how can this kind of free trade agreement help us with the whole effort to control inflation?

PATNAIK: This is a very important aspect of free trade agreements. While, as you pointed out, interest rate increases by the Fed are aimed at reducing overall demand for products and services, thereby cooling the economy, free trade agreements actually can help bring down prices through the supply side while increasing economic growth. And so this is a very different mechanism. It works through the supply side. And when we look at the current state of inflation, part of the inflation problem that we see both in the U.S. and the EU can be attributed to bottlenecks in supply chains, and we've seen that, especially after the pandemic.

And by easing barriers to trade, a free trade agreement firstly can actually reduce the cost of products directly, but it would also increase the supply of goods and services, bringing down costs further.

And so this is really, and a lot of economists agree on that—Secretary Yellen mentioned it earlier—that free trade is one of the more permanent structural changes that can be done to have a beneficial effect on the consumer price index in the long term.

DOLLAR: Yeah, I think that makes a lot of sense. I often think of free trade as one of the best remedies for monopoly and generally, general and market concentration. And, you know, when we talk about trying to create more competitive markets, so in many ways the easiest thing is to liberalize trade.

PATNAIK: Exactly. You increase the competition, right, and then companies get more efficient and consumers have more choice and the prices are lower.

DOLLAR: Another interesting aspect of the TTIP negotiation was that it was making an effort to harmonize regulations between the U.S. and the EU. You know, regulations can make a big difference for the actual, practical implementation of international trade. You know, especially with more sophisticated products, with certain types of food, you know, pharmaceuticals. And there are lots of examples where regulations obviously are important for regulating the market, but they can become an impediment to trade. So, what was TTIP going to do with this issue of harmonization? And can you give us some some good concrete examples of where harmonization could make a positive difference?

PATNAIK: And you're exactly right that streamlining regulations is one huge benefit that comes with free trade agreements, and particularly TTIP. It is often overlooked how costly and inefficient different regulations across countries can be, especially for multinational companies, and as a consequence for customers.

One of the most visible examples that has been in the news recently has been baby formula, right? Before this year, you could not import baby formula to the U.S. largely because of regulatory differences, even though European formula usually has a higher quality standard than American formula. And so when the supply of baby formula dropped in the U.S. because one of the plants shut down, we still couldn't import European formula until President Biden actually specifically allowed it.

And this is representative of many other products that have to require— comply with market regulations and a different set of regulations in Europe and the U.S. Financial services is another example, intellectual property rights. And so these regulations could all be streamlined.

In addition to the regulations themselves, the U.S. and the EU have different systems to enforce regulations, and the new free trade agreement could streamline these regulatory compliance regimes, including testing and inspection, for instance. And so this would really reduce costs for companies significantly and integrate the markets much more closely.

And when we look back at the negotiations, what is very interesting is that there has been significant progress on the way in these negotiations to streamline regulations. And that is actually no small feat when you consider that the regulatory systems are quite different across the Atlantic and they are based on different preferences, societal values. But there the negotiators have made really good progress.

DOLLAR: So there's a lot of good arguments for this, pursuing the free trade agreement between the U.S. and the European Union. Politically, do you have a sense of kind of what are the logjams? What's what's holding this up? Why why aren't we doing this?

PATNAIK: I think that's a very interesting and very critical question. I think what we have seen, I would say in the last couple of years is unfortunately on the far left and the far right, an aversion to free trade agreements and to free trade. And so that is definitely something that plays a role in the current debate, which is surprising because the majority of the business community is behind free trade. And as we see, it has clear benefits to customers. I mean, if we look at history and the benefits that the American consumer has reaped from trade, it is significant in terms of increased purchasing power, increased choice, lower prices of everyday products.

And so oftentimes, I think the debate is colored by ideological debates and not really grounded in evidence. For instance, to give you an example, oftentimes trade is being accused of causing a lot of job losses. But when we look at major job losses in manufacturing in the United States over the last couple of years, about 85% of those job losses are due to automation and not trade. And so I think it's really important for experts to push that narrative and show, show the evidence how how good trade deals can be, especially when they're made between democratic allies such as the EU and the U.S..

DOLLAR: Yeah, general opinion surveys in the U.S. also continue to show pretty strong support for trade, which is a little bit surprising. So, it may be this classic kind of case where the interest groups that benefit from protectionism, you know, whether it's particular tariffs or certain regulatory features that work to protect domestic markets, the special interests that benefit, you know, have a very powerful incentive to oppose liberalization.

And all the rest of have what I would think of, each person has as a modest incentive to have free trade because the numbers you cited are significant, but, you know, they're not going to make an overwhelming difference for individual finances for someone who benefits a little bit from from greater access. So, it's that political economy problem of the special interests have a lot at stake, the minority, and then the majority of people have a little bit at stake and it's hard to organize.

But it is disappointing that, you mentioned the extremes, but it seems to me both political parties now have really backed away from free trade.

PATNAIK: I think that's the surprising part, right? Because, I mean, traditionally, Republicans have been always pro-free trade and that has completely shifted under President Trump. And the Democrats have always had a mixed bag. Right? More centrist Democrats like Biden and Obama and Clinton had been pro-free trade. But the left flank was always more opposed because of labor, because of the labor unions behind it. And I do agree with you. I think I mean, trade is one of those classic examples where you see rent seeking taking place. Right? Aluminum and steel tariffs is a perfect example. It's a smaller group of producers trying to influence policy to their benefit, to the detriment of basically the rest of the economy. And in this case, they were successful.

DOLLAR: It's interesting what you say about the kind of classic positions of the two parties, but it is the case if you look at the last 50, 60 years, most of the free trade progress has come under Democratic presidents—FDR, John Kennedy, Bill Clinton, President Obama tried to negotiate both Atlantic and Pacific agreements. So so it is interesting, you you do make some progress under Democratic presidents that, you know, that's been the trend. But we we seem to have a stumbling block now about making progress right now.

PATNAIK: I mean, I do hope that maybe President Biden will reconsider and become more active in that sphere in the next two years. I have seen some restart of negotiations, at least, on the regulatory side, with the EU trying to harmonize more regulations. And I think there are some negotiations underway on this, at least as of last year. And so it is my hope I agree with you. I think what we have seen is that the more moderate Democratic presidents have been very successful in implementing those trade agreements, or at least trying to. And those have benefited the American consumer on average.

DOLLAR: The last topic I want to take up with you, Sanjay, concerns democracy, but Biden administration talks a lot about strengthening ties with democratic allies. And I think they've done quite a bit in the security realm, particularly around coordinating with Europe on the Russian invasion of Ukraine, strengthening NATO. I mean, you know, I think there's some real substance to the effort to strengthen U.S. ties with various democratic allies. But none of that's in the economic realm. I think what, I feel like what's what's missing is the economic realm, and I'd like to give you a chance to talk a little bit about, you know, how could this kind of free trade agreement support that larger agenda of cementing our relations with democratic allies?

PATNAIK: Thank you for raising this very important point. I think it has become clearer than ever, especially due to the Ukraine war, that the world is in a renewed struggle between democratic countries and authoritarian regimes. This is essentially a zero sum game, since autocratic regimes are fundamentally incompatible with the democratic values and freedoms we cherish in the U.S. and the EU. And importantly, autocratic regimes have increasingly become unreliable economic partners, as Europe is clearly seeing now with Russia and the natural gas crisis.

It is therefore quite unwise, I think, to be dependent on such countries economically in the medium and long term, especially as national security and economic interests are often tied together. And so a free trade agreement between the U.S. and the EU will really deepen our economic ties and integrate our economic and policymaking systems much more closely with each other. And in my view, this is indispensable in an era where autocratic regimes are increasingly aligning with each other and exerting the power globally.

The Free Trade Agreement would particularly send a strong message, I think, that the largest and most powerful economic bloc, which that agreement would represent, is built on democratic principles and individual liberties. And importantly, it would also make the regulations that we implement within that free trade agreement the global standard bearer. And that means other countries would probably follow those regulations, so we would have a lot of leverage on the world stage.

And so I think in the medium to long term, it would really strengthen our alliance and make both our economies much more resilient to external shocks, especially from autocratic regimes.

DOLLAR: I'm curious then, what would you do about our economic relations with China?

PATNAIK: Oh, that's a that's a big, big question. I do think, and that's actually another piece that I'm currently working on, I do think it would be wise for the U.S. and for for Europe to to start untangling the, the very close interdependence we've built with China over the last 15 to 20 years, because we have seen what happens if there is a conflict. In the case of Russia, right? I mean, look at Germany, look at Austria. Those two countries were highly dependent on Russian gas and now they are scrambling to maintain their economies because of the conflict. And suddenly this has become a bargaining chip.

And so I think when we talk about autocratic regimes, the risk of a conflict undermining the economic relations and potentially supply chain disruptions is always there. We have seen it in the past with oil producing countries, and China is no different. It is an autocratic regime and there is increased tension across a variety of issues, which makes it more dangerous, I think, for Western countries to be dependent on China to the extent that we currently are.

DOLLAR: I'm David Dollar, and I've been talking to my colleague Sanjay Patnaik about the possibility of a U.S.-Europe free trade agreement that would have important economic implications, help us deal with this inflationary environment, and also could be a key piece in the current geostrategic conflict that we see between democracies and authoritarians. So thank you very much, Sanjay, for sharing your research with us.

PATNAIK: Thank you so much for having me.

DOLLAR: Thank you all for listening. We release new episodes of Dollar and Sense every other week. So, if you haven't already, follow us wherever you get your podcasts and stay tuned. It's made possible by support from producer Fred Dews, audio engineer Colin Cruickshank, and other Brookings colleagues. If you have questions about the show or episode suggestions, you can email us at podcasts at Brookings dot edu. Dollar and Sense is part of the Brookings Podcast Network. Find more Brookings podcasts on our website, Brookings dot edu slash Podcasts.

Until next time, I'm David Dollar and this has been Dollar and Sense.