nation, such regulatory duplication and discord will likely proliferate.

Perhaps most notably, the 2007 EU-US summit achieved an “Open Skies” agreement to further liberalize transatlantic civil aviation. But it also called for “deeper” – though not “full” – economic integration by 2015, to be advanced and monitored by a newly-created “Transatlantic Economic Council”. Leaders on both sides of the Atlantic thus seem to have realized the importance of speeding up the building of a fully integrated transatlantic economy.

However, the Transatlantic Economic Council is supposed to undertake a broad range of activities – preparing a work program, setting targets and deadlines, monitoring progress, and producing metrics and annual reports – and its level of organizational support is not spelled out in the summit documents. It will have two cabinet-level co-chairs, which is a good start. But it will require a permanent secretariat to fulfill its mission.

Other important challenges remain. In the document cited above, the Transatlantic Policy Network envisions “evolution toward an eventual Transatlantic Partnership Agreement embracing the economic, political, and strategic totality of the EU-US relationship.” Thus transatlantic economic integration, though important in itself, is not the end. As understood by Jean Monnet, economic integration must and will lead to political integration, since an integrated market requires common institutions producing common rules to govern it.

Removing trade and investment barriers and easing other regulatory burdens can create a more prosperous Atlantic free-trade area. But a fully integrated transatlantic economy will also require shared institutions, such as a unified competition policy, a common external tariff, a common commercial jurisdiction, and perhaps even joint monetary arrangements, such as a dollar-euro parity to reduce transactions costs as well as trade and investment uncertainty. Creation of these institutions will require deeper political arrangements accompanying the purely technical ones, for, in the end, there cannot be a fully functioning common market without a common polity to govern it. □

Prospects for Deeper Transatlantic Economic Integration

Costantino Pischedda

In the aftermath of the US-led invasion of Iraq, diplomatic relations between the United States and the European Union went through some of the most tense moments since the Second World War; only recently, with new governments in Germany and France, on the one hand, and a gradual attenuation of the Bush Administration’s unilateralist instincts on the other, have signs of a new, more cooperative, phase emerged. But the political tensions do not appear to have significantly affected the economic dimension of the transatlantic partnership. In fact, over the past few years, transatlantic economic integration has continued at a rapid pace measured in terms of trade–flows, and even more so in terms of foreign direct investment (FDI) and the operations of EU and US multinational corporations (MNCs) in each other’s home-territories.[1]

This is not to deny the rapidly increasing importance of China as an economic partner for both the US and the EU. The statistics, in fact, substantially support this popular perception: Over the past fifteen years, China-EU and China-US trade-flows have grown much faster than has transatlantic trade.[2] However, it is premature to fret about the end of the “supremacy” of the transatlantic relationship. In terms of FDI and the operations of MNCs (forms of economic integration less “superficial” than cross-border trade-flows), the transatlantic economic partnership appears much more solid and deep than do EU and US relations with China. The surge in FDI from and towards China over the last few years can mainly be explained by their very small initial values, and their

US National Economic Council Director Allan Hubbard (left) and European Commission Vice President Günter Verheugen (right), Co-Chairs the first meeting of the new Transatlantic Economic Council, November 9, 2007. Together, they will oversee the efforts to achieve transatlantic regulatory convergence.
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values today remain just a fraction of transatlantic FDI. During 1990-2005, FDI inflows to China increased almost 50 times, but are still less than 1% of US outbound FDI, while 50% goes to Europe.[3]

Pundits have pointed to some high-profile commercial disputes (e.g., over steel, and genetically modified organisms) as evidence that transatlantic economic relations are in jeopardy. In addition, the opposition of the US and some European governments to some high-profile foreign takeovers has been interpreted as the beginning of a new protectionist trend.[4] These are clearly not positive developments, but, again, excessive alarm about the health of the transatlantic partnership is not warranted. In fact, most of the recent commercial disputes between the US and the EU have been continuations of clashes initiated during the Clinton administration, and many have been resolved via bilateral agreement, rather than resorting to the WTO.[5] On the other hand, despite an increasing number of foreign acquisitions in Europe, most have taken place without any government interference, while US resistance to foreign acquisitions has largely reflected national security concerns, and has targeted mainly Chinese and Middle-Eastern firms.

Deeper transatlantic integration is not an alternative to multilateral trade-liberalization in any way. On the contrary, it is actually possible that a deeper transatlantic relationship would strengthen the WTO.

In sum, transatlantic economic relations continue to be healthy and strong. But what are the prospects for deeper integration in the future? During Germany's six-month presidency of the EU, German Chancellor Angela Merkel strongly supported the creation of a barrier-free transatlantic market. At first, the project appeared to focus on the establishment of a free-trade area, which later shifted to the removal of non-tariff barriers through harmonization and mutual recognition of regulations and standards.[6]

This initiative has a solid economic basis: A 2005 OECD study concluded that mutual removal of barriers to foreign competition would contribute much more to economic growth on both sides of the Atlantic than would further reductions in tariffs or FDI restrictions.[7] The strictest barriers apply to services (especially transport, telecommunications, electricity, and gas). Another study estimated similarly that regulatory harmonization in the automotive industry would reduce average production costs by 7%.[8]

Overall, Merkel's initiative has been well received in Washington and London[9], and strongly influenced the agenda of the last US-EU summit. In April the EU and US signed a "Framework for Advancing Transatlantic Economic Integration", with primary focus on eliminating regulatory barriers. Moreover, the parties agreed on so-called "Lighthouse Priority Projects", including 1) enhanced protection of intellectual-property rights; 2) development of common standards for trade-security; 3) mutual recognition of financial-market regulations; 4) improved cooperation regarding innovation policies and new technologies; and 5) the establishment of a regular dialogue on barriers to investment. A permanent high-level "Transatlantic Economic Council" was created to supervise the Lighthouse projects, set goals and deadlines, and produce progress reports.[10]

It is premature to fret about the end of the "supremacy" of the transatlantic relationship which appears much more solid and deep than do EU and US relations with China.

A possible objection to the establishment of a common transatlantic market is that it could weaken the multilateral system centered around the WTO, which has promoted uninterrupted growth of trade over the past sixty years. However, deeper transatlantic integration is not an alternative to multilateral trade-liberalization in any way. The institution of the European single market does not appear to have damaged the multilateral system, and Merkel's proposal aims to gradually eliminate behind-the-border regulatory barriers, which have thus far been dealt with only marginally in WTO negotiations. It is also actually possible that a deeper transatlantic relationship would strengthen the WTO. In fact, the ensuing realignment of US and EU interests could enhance their influence in multilateral negotiations, and they are both traditionally strong WTO supporters. Finally, given the enormous EU and US economies, setting common standards for the telecommunications, finance, and automotive industries could generate strong pressure towards global standards, a clear WTO goal.

However, the political feasibility of this project remains open to debate. The limited results achieved in more than ten years of dialogue aimed at enhancing transatlantic regulatory cooperation are testament to the difficulty of this challenge.[11] As World Bank economist Bernard Hoekman pointed out, most barriers in the transatlantic economy are in particularly sensitive sectors (e.g., communications, transport, and privacy protection), in which cultural and national-security concerns are important, as are protectionist interests.[12] Moreover, achieving regulatory harmonization in the services sector presents especially serious hurdles because the economic actors that would benefit most from it are mainly small and medium-size firms, which thus face collective-action problems in organizing to exercise political pressure.[13] The widespread US perception of Europe as a stagnant or even declining power is another obstacle.

However, the prospects for deeper transatlantic integration are now better than they have been in the recent past. The unilateralist tendencies in US foreign policy seem to have faded, while the EU economies have recently shown signs of more dynamism (in part due to successful structural reforms). In addition, competitive pressure from China and India could reinforce incentives for the creation of a common transatlantic market, just as incentives for the establishment of the single European market were once reinforced by US and Japanese competitive pressures.[14]

The high-profile transatlantic initiative launched by Angela Merkel seems to have introduced an ingredient missing until recently – strong political will. The April US-EU framework agreement represents a bold move in the right direction, but continuous high-level support on both sides of the Atlantic will be necessary to implement its agenda and to overcome the inevitable challenges ahead. □

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[1] Daniels S. Hamilton and Joseph P. Quinlan, *Transatlantic Economy 2005: Annual Survey of Jobs, Trade and Investment between the United States and Europe*, 2006, Washington: Brookings Institution.

[2] Jens van Scherpenberg, Integrating the Atlantic Economic Area, Stiftung Wissenschaft und Politik (SWP) Research Paper, October 2006, Berlin.

[3] US Department of Commerce, Bureau of Economic Analysis, *Balance of Payments and Direct Investment Position Data*; available at www.bea.gov. This gap is much wider if one considers FDI from China towards Europe and the United States, because the Chinese government started encouraging local firms to invest abroad only in 2001 (Edward M. Graham and David M. Marchick, *US National Security and Foreign Direct Investment*, 2006, pp. 100-101, Washington: Institute for International Economics).

[4] Jens van Sherpenberg, *Economic Nationalism on the Rise: Foreign Direct Investment in the USA after the Dubai Fiasco*, SWP Comments 10, March 2006, Berlin; also "Buy, Buy, Buy: Europe's businesses are changing hands at a record rate," *The Economist*, 8 February 2007.

[5] Bruce Stokes, "Trade Negotiations," pp. 39-59 in D. Andrews, M.A. Pollock, G.C. Shaffer, and H. Wallace (eds.), *The New Transatlantic Agenda and the Future of Transatlantic Economic Governance*, 2005, Florence: European University Institute.

[6] Compare Bernard Benoit, "Germany Eyes Free-Trade Zone to Rival China," *The Financial Times*, 15 September 2006, with "Interview with Angela Merkel," *The Financial Times*, 2 January 2007.

[7] OECD, "The Benefits of Liberalising Product Markets and Reducing Barriers to International Trade and Investment: The Case of the United States and European Union," Economics Department Working Paper 432, June 2005, Paris.

[8] Daniel Hamilton and Joseph Quinlan, *Frankfurter Allgemeine Zeitung*, 30 November 2006.

[9] "US Expresses Support for Transatlantic Free Trade Zone," *Financial Times*, 20 September 2006.

[10] The text of the agreement is available at www.whitehouse.gov/news/releases/2007/04/20070430-4.html (accessed 8 August 2007).

[11] Jens van Scherpenberg (note 2 above), pp. 9-12.

[12] Bernand Hoekman, *Transatlantic Cooperation to Open Services Markets: Supporting Multilateralism,* paper presented at the conference "Sleeping Giant: The Transatlantic Services Market," 6 February 2007, Washington.

[13] Ibid. Large multinational corporations in the services sector can overcome some of the costs associated with regulatory differences between the US and the EU by hiring personnel with professional certificates issued by local authorities.

[14] Gabor Steingart went so far as to argue that a transatlantic common market could play a political-economic role similar to the political-military role played by NATO: strengthening transatlantic cohesion and enhancing EU and US leverage in the rest of the world. Idem., *World War for Wealth: The Global Grab for Power and Prosperity*, Munich: Piper Verlag, 2006.