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It's Time for Free Trade With Europe

By FRANCES G. BURWELL November 13, 2012

If President Barack Obama had run for re-election in Europe, he would have been overwhelmingly re-elected—in seven major countries, fewer than 10 percent would have voted for Mitt Romney. In Germany, 93 percent would have voted for Barack Obama—roughly the same percentage of African-Americans who voted for the president. Yet, many Europeans have expressed concerns about President Obama's foreign policy and particularly his lack of attention to Europe. At a conference in Europe this weekend, leading foreign policy analysts and politicians expressed dismay—but not surprise—that the president's first post-election foreign trip would be to Asia.

Instead, European leaders have turned to economics as the basis of a renewed partnership with the United States—a choice that might seem futile given the state of the eurozone and the U.S. mountains of debt and deficit. Nevertheless, several European leaders—including German Chancellor Angela Merkel and U.K. Prime Minister David Cameron—have proposed creating a single transatlantic market by reducing barriers to trade and investment across the Atlantic. This idea makes a great deal of sense. The United States and Europe remain each other's largest economic partner, with their daily trade of $3.6 billion, making this the largest commercial relationship in the world. The amount of investment currently held by the EU in the United States and vice versa totals about $3 trillion, contributing to the creation of 14 million jobs on both sides of the Atlantic. Perhaps most important in these trying economic times, removing at least most of the remaining barriers to trade across the Atlantic could lead to .3 to .7 percent growth in GDP per year; not a small number considering today's anemic growth rates, and something that U.S. and European leaders—and their economically strained publics—would dearly appreciate.

Negotiating such a pact will not be easy. The details will be enormously complicated and some businesses must give up protections that they have long enjoyed. But such an agreement would reduce costs for most businesses and consumers in the huge transatlantic market. Cars made in the United States would be cheaper to export to Europe and vice versa. Consumers would pay for only one safety test on electrical goods because U.S. and European governments would recognize the validity of tests done by the other. Large transatlantic companies would no longer pay duties on goods shipped between U.S. and European facilities and so might have more funds available for investment. Unlike other U.S. trade pacts, our workers and firms would be competing with a region with labor and environmental standards that are at least the equal of our own, if not even tougher.

European leaders have called on President Obama to launch negotiations to reduce barriers to transatlantic trade and investment. Even as he gets on the plane to Asia, he should remember the strength of the United States-EU market, despite the eurozone crisis. His immediate priority in the second term must be the creation of economic growth and jobs. For this "Pacific president," creating a stronger economic partnership with Europe is the best way to build a stronger American economy.

This article is taken from US News & World Report on 13th November, 2012. It is about a pact proposing a reduction of trade barriers which is the removal of tariffs and subsidies between the United States and Europe. It refers to a cut on taxes of imported goods and on assistance of domestic products. Therefore, both countries will allow the goods and services from each other to move freely.

The article shows that consumers only need to pay for test done in one country and companies do not need to pay duties on trading goods because the administrative barriers between two countries will be eliminated. Also, labor and environmental standards are similar so goods can easily be traded between two countries. This can lead to a reduction in costs of most producers and consumers and cheaper exports. Plus, it is believed that the elimination of protectionism can create jobs and an increase in GDP per capita which is helpful to solve the debt and deficit of United States and Europe.

Two diagrams about the removal of tariffs (fig.1) and subsidies (fig.2), will be used to analyse the issue above.

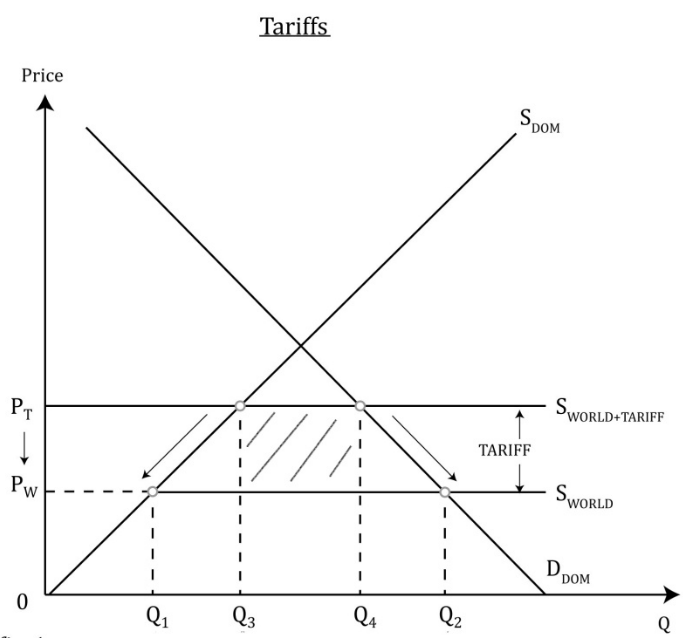

fig. 1

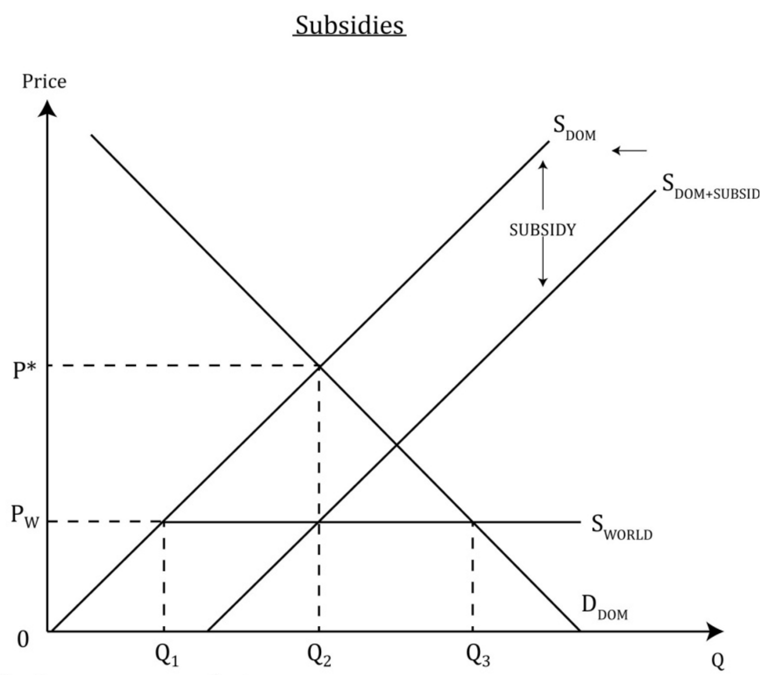

fig. 2

In fig.1, the demand of domestic producers decreases from Q_3 to Q_1 but consumers can purchase more goods and services, from Q_4 to Q_2, at a lower price, from P_T to P_W. In addition, the shaded are shows the loss of government revenue due to the removal of tariffs.

In fig.2, the removal of subsidies raises domestic producers' cost of production so the domestic supply curve shifts back to S_{DOM}. Domestic producers are worse off as consumers spend more on cheaper imports, lower the domestic consumption from Q_2 to Q_1.

The impact of such a pact can be evaluated in terms of the advantages and disadvantages of the removals of tariffs and subsidies in both short run and long run.

In the short run, trade creation that occurs between two countries can make good use of the comparative advantages of Europe and US, because they can specialize in producing particular goods and services in lower opportunity costs. Their total outputs will increase because of the potential economies of scale.

In the long run, more competition will encourage firms to develop improved and cheaper products as well as better efficiency. Not only the consumer welfare can be maximized, but American and European governments can also reduce their deficit with the removal of subsidies and injections in circular flow of income due to exports. As the increase of export and foreign investment from Europe, which is one of the components in aggregate demand, the economic growth of US can be increased as well.

On the other hand, in the short run, US domestic producers especially agricultural farmers, which play a part in economic growth of US but are not competitive in international trade due to the inelastic demand and supply of commodity, are worse off because cheaper imports lead to a lower demand of their goods and services. This can lead to an increase of domestic unemployment rate and so greater government spending on unemployment welfare is needed.

An increase in government expenditure and leakages in circular flow of income due to larger consumption in imports, can make US government suffer in a greater deficit in the long run. Furthermore, with the removal of tariffs, tax revenue of government will be lower. The logic follows that austerity will need to be implemented which can lead to a decrease of living standard of the society. Also, due to the reduction of consumer spending on domestic goods and services, as well as the fall of investments of local businesses, economic growth will be slower instead.

However, from my point of view, the reduction of trade barriers is needed. Not only because of the above advantages, but also because the alliance of two largest economic partners can give a greater pressure on China about trade imbalances. China is the biggest exporter to US and Europe but the currency of China is arguably undervalued and its labor cost keeps increasing which are disadvantages to both countries. American and European then need to pay higher prices for Chinese goods and services. Plus with the big hit of global financial crisis, it is believed that the United States and Europe will be willing to lower their prices of goods and services for exports, in order to boost their economies back, so a win-win situation can be occurred as a result.