Transatlantic Free Trade Agreement and / or Exchange Rate Stabilisation

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Transatlantic free trade agreement (TFTA)

- 15% of total US-trade in goods & services is with EU
- EU-trade with US 13.8% of total EU-trade

→ Small trade relative to GDP U.S. + EU/World GDP → WHY?

- For example: Germany trades more with Switzerland + Belgium than with U.S.

TFTA

- Tariff barriers to trade EU-U.S. are low, fairly easy to reduce or even abandon
- But non-tariff barriers (NTB) are high, difficult to reduce
- Strong vested interest in NTB and product differentiation
- Strong mutual penetration of U.S. and EU with foreign direct investment (FDI)
- *Key reason for little trade and high fixed capital integration → volatile exchange rates*

TFTA impacts

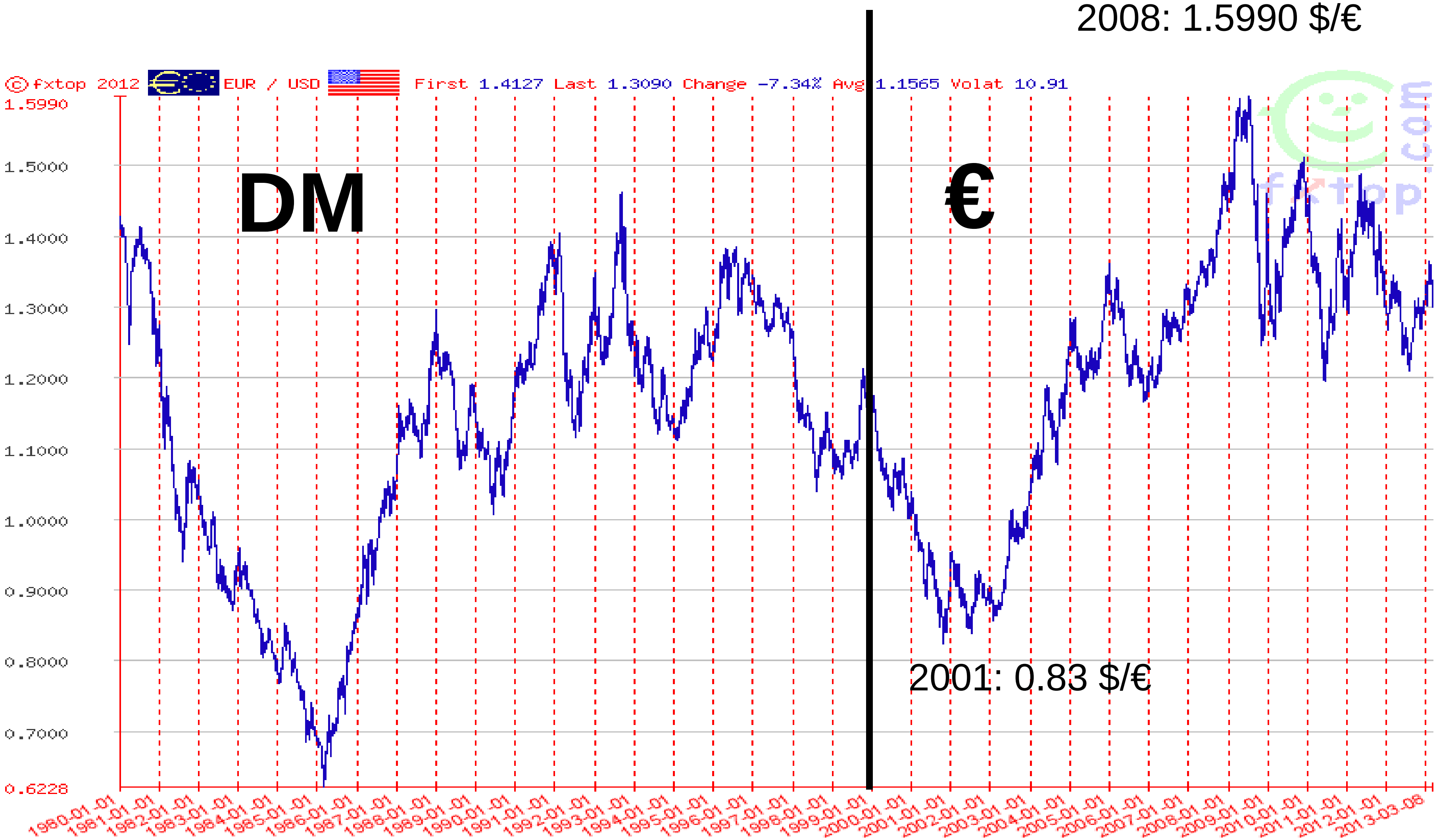
- Expected benefits of TFTA:
  - plus 0.5 to 1.0% of GDP increase in U.S. and EU
  - But: one time effect, distributed over several years
- No relevant effect on growth rate!
- But many controversies on NTBs
- Multilateral trade agreements with WTO more important than another bilateral agreement
- Exchange rate policy is a much more important issue – not only for trade

Chaotic exchange rates movements distort trade EU-U.S.

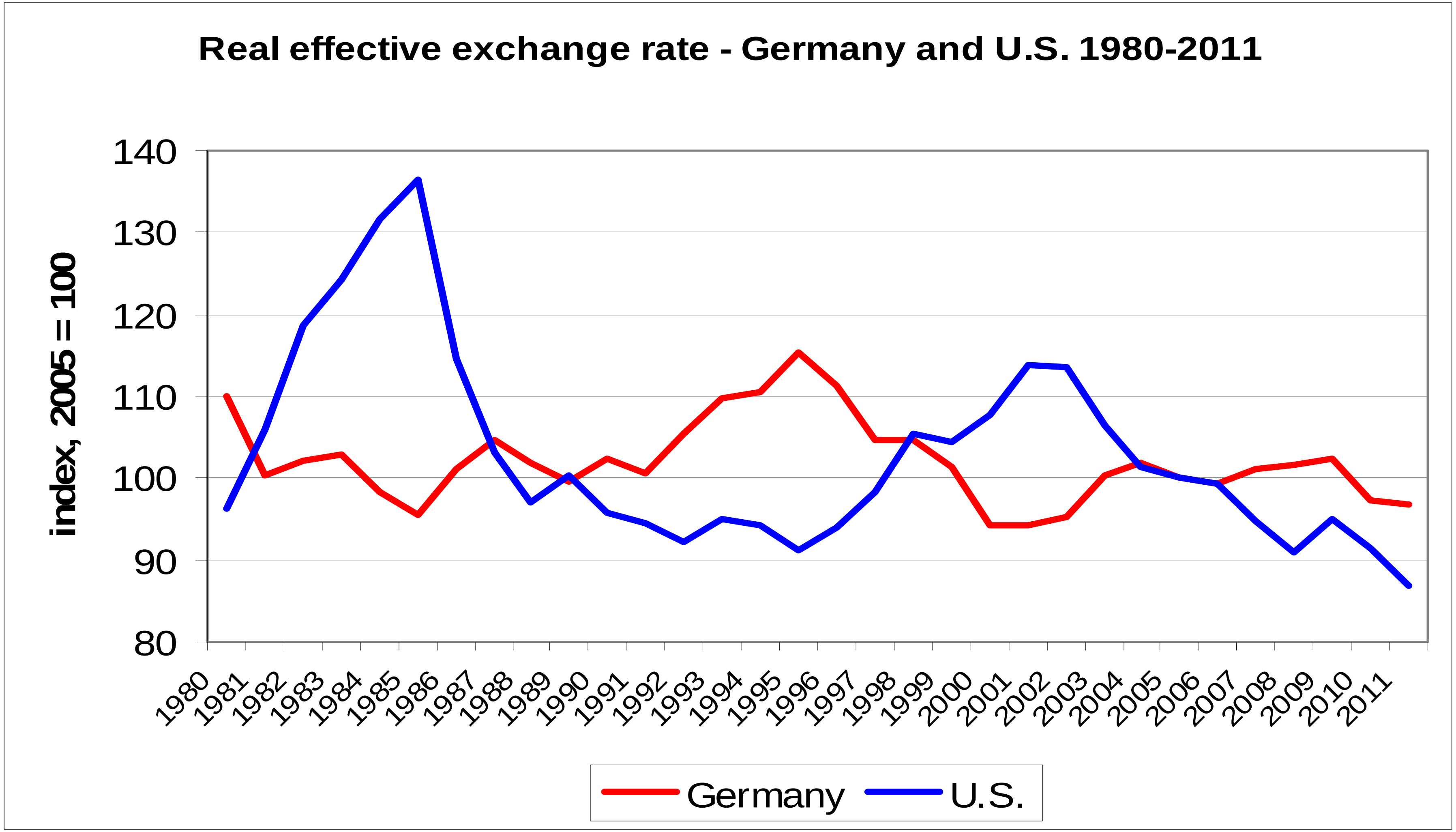
- Flexible exchange rate regime has led to XR bubbles, up to 150%
- No connection to fundamentals of the real economy
- Creates uncertainty for companies
- Companies can hedge only short term with forex futures etc.
- Companies push product differentiation and NTBs
- Many speculative short-term capital flows

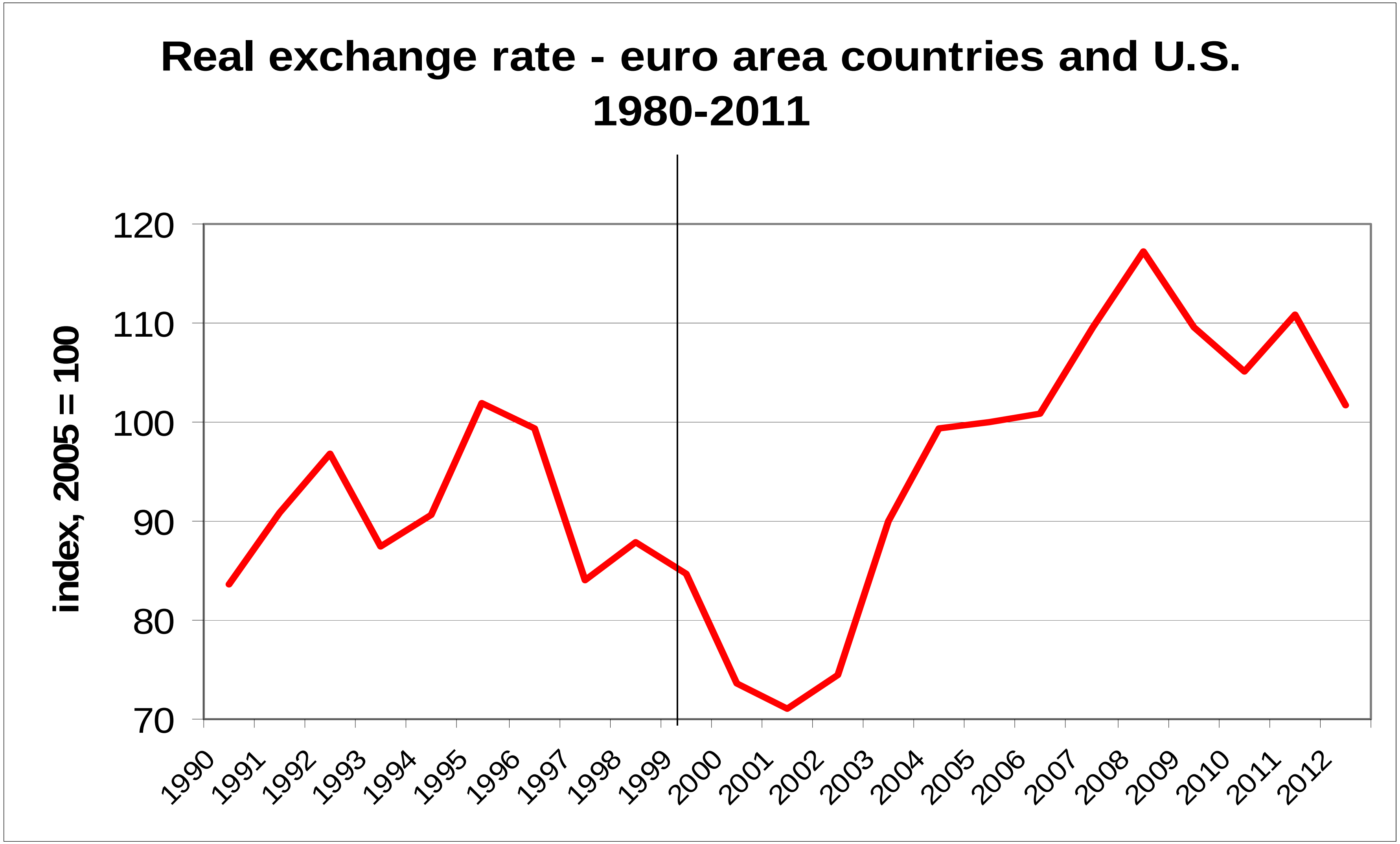
$/DM and $/€ 1980-2013 – XR bubbles

2008: 1.5990 $/€



1985: 0.3184 $/DM or 0.6229 $/€


Real effective exchange rate - Germany and U.S. 1980-2011
index, 2005 = 100
140
130
120
110
100
90
80
1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011
Germany
U.S.



Real exchange rate - euro area countries and U.S.
1980-2011
index, 2005 = 100
120
110
100
90
80
70
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012

Bottom line

1. A substantial TFTA will be difficult to achieve, with little macro effects, but strong uncertain sector effects
2. Less XR volatility would
   - remove trade distortions
   - strengthen transatlantic trade
   - stabilize business cycles in EU and U.S.
   - buttress price stability (oil and other commodity prices)
   - curb speculative capital flows
   - support macro stability in developing countries
3. Managing the €/$ exchange rate with floor and ceiling, and smoothing annual fluctuations (precursors Plaza- and Louvre Accords, Switzerland 2011)
4. Exchange rate management might impact monetary policy by Fed and ECB: less swings in policy interest rates, more use of counter-cyclical fiscal policy

Francois Hollande has made a good point for Europe (and the U.S.)!