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THE IMPACT OF TTIP

VOLUME 1: ECONOMIC EFFECTS ON THE TRANSATLANTIC PARTNERS, THIRD COUNTRIES AND THE GLOBAL TRADE ORDER

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Executive Summary

- The current plans to conclude a Transatlantic Trade and Investment Partnership (TTIP) raise a number of both economic and political questions. This policy brief deals with the potential economic effects for the transatlantic partners as well as for third parties.
- The empirical literature reveals clearly that TTIP will benefit the EU and the US. This holds particularly with respect to non-tariff barriers; their reduction promises the largest welfare effect. However, it requires some serious steps to overcome numerous obstacles, mainly in the realm of regulations and standards. One way to deal with such standards is to conclude mutual recognition agreements with strict labelling requirements, leading to more choices for consumers without abandoning domestic consumer protection preferences.
- Such a non-discriminatory open regulatory regime can be beneficial for the global trading order since the transatlantic partners have the chance to maintain their high standards without discriminating against third parties, as they are already used to these standards and do not have to adjust to new ones.
- Governments on both sides of the Atlantic will also confront many civil society lobbies concerned about the growth of corporate power and alleged diminution of regulatory prerogatives associated with this. Much will depend on the willingness of the transatlantic negotiating partners to overcome these obstacles.
- This will require concerted political will and focus, aspects that are scarce in beleaguered Western democracies still confronting the fallout of the worst financial crisis since the 1930s. Whether democratically elected leaders will be able to overcome key interest groups, and forge the cross-issues trade-offs in their full complexity, remains to be seen.

Introduction

In early 2013, the United States-European Union High Level Working Group on Jobs and Growth (hereafter HLWG, 2013) discussed the prospects of a Transatlantic Trade and Investment Partnership (TTIP) and "...reached the conclusion that a comprehensive agreement that addresses a broad range of bilateral trade and investment issues, including regulatory issues, and contributes to the development of global rules..." should be concluded (HLWG, 2013, 1). It argues that TTIP is in the mutual interest of both the United States (US) and the European Union (EU). Therefore, the final report contains far-reaching recommendations for enhancing market access, reducing regulatory and other non-tariff barriers, and establishing rules regarding shared global trade challenges and opportunities.

Their report has spurred hopes that the long-lasting efforts to liberalize transatlantic trade will finally succeed. It has been an outspoken objective especially of German politicians and its business community to bilaterally open trade with the US since the mid-1990s (Donges, Freytag and Zimmermann, 1997, 567). Indeed, the current literature shows that there are positive welfare effects to be expected on both sides of the Atlantic.

However, in contrast to the negotiations in the 1990s, at this time the scope of the envisaged agreement is beyond pure trade liberalization, making an agreement even harder to achieve. The reason for the growing complexity is the fragmentation of production processes observed in the last few decades. Since companies today are operating within global value chains (GVCs) or global production networks, they are affected by trade policy differently than in the 20th century. Thus, TTIP also encompasses regulatory aspects, which in relation to trade are best addressed as behind-the-border measures. Investment regulation and protection are additional issues. So it is fair to assume that the TTIP will address topics going beyond the current world trading rules and incentive structures as laid down in the World Trade Organisation's (WTO) agreements and member states' commitments.

Together with the fact that TTIP is negotiated between more than two partners, (since the EU consists of 28 countries) and its enormous economic importance – TTIP would comprise roughly 40 per cent of world gross domestic product (GDP) and 30 per cent of world trade – the scope (WTO+) leads to the view that TTIP is a so-called 'mega-regional', which will have an impact not only on trade and welfare in its member countries, but also may well affect third countries substantially. Therefore, it is warranted to also look at the potential effects on the rest of the world.

The remainder of this paper is organized as follows. After a thorough and brief theoretical review in section 2, section 3 deals with the potential effects of TTIP on the partner countries themselves as well as on third parties. In section 4, we discuss the overlap of TTIP with the second mega-regional the US is currently negotiating, the Trans-Pacific Partnership (TPP). Section 5 briefly analyses the mega-regionals' potential influence on the future development of the world trading order. Section 6 concludes.

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Theoretical Foundation

There is a long-standing debate on the effects of regional integration. Two related strands can be identified. The first discusses static and dynamic welfare effects of preferential trade agreements; the second their effects on the global trading order.

Let us start with a discussion of welfare effects. Following Jacob Viner's (1950) contribution to the theory of economic integration, the assessment of bilateral and regional free trade agreement is ambiguous when analyzed in a static setting. On the one hand there is trade creation, which is clearly positive. Trade which was prevented before integration due to trade barriers is now stimulated. Instead of relying on domestic producers, customers or producers down the value chain purchase goods produced in one of the members of the regional arrangement; the allocation of goods and actors is thereby improved.

On the other hand, we can observe trade diversion, meaning that after regional integration producers from third countries lose trade shares, since they are still facing trade barriers, which the producers within the customs union (CU) or free trade area (FTA) no longer face. This means that trade is diverted from the efficient third-country producer to the relatively inefficient CU or FTA producer. In addition to pure trade distortion, there may also be a redirection of foreign direct investments (FDI) from outside the CU or FTA into it in order to qualify for zero tariff barriers, so called tariff-jumping. Trade and – less so – investment diversion do not only affect third countries negatively, but are also a problem for the integrated area itself.

If the regional integration is not a CU but an FTA, there might also be trade deflection, implying that third country producers ship their exports into the FTA region via the country with the lowest trade barriers, and use the zero barriers within the FTA to carry the goods to the final destination. To prevent this trade deflection, FTAs have to rely on rules of origin, which are complicated and prone to further discrimination.

In addition to the static effects of mutual liberalization, which translates into increasing trade flows and higher GDP but do not lead to a different growth trajectory, there are potential dynamic effects of liberalization. Dynamic effects include productivity growth, expanded capital accumulation and increase of investments (Erixon and Bauer, 2010). Productivity gains from trade almost entirely stem from increasing import competition. Dynamic effects can be observed in the longer run and are probably more important than the static immediate gains.

Regional economic integration increases economic activity and employment since trade that was prevented before integration due to trade barriers is stimulated, e.g., by mutual recognition of product standards and regulations.

In recent years however, trade (as a stylized and generalized concept) has changed and with it the perception of regional trade integration. Whereas 20th century trade implied that a good was produced in one country and afterwards shipped to another, 21st century trade is characterized by a deep fragmentation of production processes. Integration into GVCs is crucial for producers (e.g. Draper, Freytag and Fricke, 2014). Therefore, the simple logic of trade creation vs. trade diversion is no longer leading the debate. Instead one has to consider the new positions of closely integrated value chains after a regional integration process has taken place. Baldwin (2013) rightly argues that 21st century regionalism deals with disciplines facilitating the flows of goods and factors within global production networks or GVCs rather than with preferential market access. In this changing paradigm, the importance of dynamic effects increases.

The upshot of this view is that discrimination between insiders and outsiders of preferential trade agreements (PTAs) becomes very difficult and probably much less likely than in the 20th century trade setting. By the same token, new regionalism requires a broader range of measures, related to both tariffs and non-tariff barriers, in which the latter become increasingly important. In particular, the so-called behind-the-border-protectionism in the form of regulation, standards, subsidies and the like is highly relevant in the 21st century setting. According to Baldwin (2013, 7-13), a modern PTA encompasses unilateral reform measures by its partners (mainly relevant for developing countries), integration deeper than agreed upon in the WTO, such as further agreements on intellectual property rights, capital flows or competition policy, as well as integration beyond the current framework, including e.g. investment provisions and investment protection agreements.

In light of these new developments in international trade, the second aspect, namely the effects of regional integration on the global trade order, may also be judged differently today than in the past. Whereas in the past, regional integration (because of trade diversion) was rather seen as a stumbling block towards multilateral liberalization (Bhagwati and Panagariya, 1996), today it cannot be seen as so clear-cut. It very much depends on the scope and depth of the integration including standards, the size of the bloc itself, its openness toward third countries and the nature of investment regulation within it. In general, the judgment is more positive today than it was in the past (Baldwin and Seghezza, 2007). As concluded in the WTO World Trade Report 2011 (WTO, 2011), regional and multilateral approaches to trade cooperation are not incompatible. However, the task for governments is to ensure this complement of PTAs and the multilateral system, where the multilateral system minimizes negative effects from PTAs (WTO, 2011).

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TTIP in the USA and the EU: Overview of Potential Effects

The next step of this analysis is to assess the potential effects of TTIP on its partners as well as for third parties against the background of these theoretical considerations. For this purpose, we review the latest empirical investigations and simulations, which show in general that TTIP may well contribute to welfare gains in the US and the EU and can avoid welfare losses elsewhere, if properly concluded.

EU AND USA

GENERAL FACTS ON TRANSATLANTIC TRADE

To start with the extent and structure of transatlantic trade between the EU and US, the considerable magnitude of economic integration between both economies, together with relatively similar cost and production structures as well as the generally low tariffs and cross-border barriers to trade, are remarkable (Diekmann, 2013; Erixon and Bauer, 2010). Therefore, one can expect that (1) intra-industry trade and therefore greater specialization will be promoted through TTIP and (2) given low border barriers to trade, the main impacts will come from lowering regulatory barriers.

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The overall effects of a transatlantic trade deal are mainly determined by three characteristics: the enormous sizes of both economies, extensive intra-firm trade between them, and high levels of intra-industry trade. As the extent of trade and investments between both economies is already significantly high, it is by far the largest bilateral economic relationship in the world (Erixon and Bauer, 2010). Both economies together represent more than 40 per cent of world GDP. It can thus be expected that the elimination of trade barriers would have significant effects both on the involved economies as well on third countries. Main drivers of economic integration between the two economies are foreign affiliates, resulting in a considerably high degree of intra-firm trade. This is central for understanding the effects of an FTA since intra-firm trade represents about one third of total transatlantic trade; 50 per cent of all US foreign affiliates are located in Europe, while 75 per cent of all European affiliates are located in the US (Erixon and Bauer, 2010). This is especially obvious for the German automotive and chemicals industries for example, where over 75 percent of German exports are accounted for by intra-firm trade (Diekmann, 2013). In addition to that, the enormous extent of intra-industry trade is decisive; with for example motor vehicles, engines, machinery, medical instruments and television apparatus among the sectors recording the highest shares of intra-industry trade (Erixon and Bauer, 2010). These sectors record a Grubel-Lloyd-Index of 0.85¹, which underlines the significance of intra-industry trade (Erixon and Pehnelt, 2009).

These characteristics are central for understanding the effects of a transatlantic free trade area. However, effects differ depending on the details of the TTIP. Thus it appears reasonable to divide this analysis into two sections: border-barriers, and behind-the-border barriers. However, given that most calculations do not distinguish between different forms of non-tariff-barriers (NTBs), i. e. subsidies (including in

¹ | The Grubel-Lloyd Index indicates the extent of intra-industry trade in relation to total trade.

sensitive sectors, particularly agriculture), technical barriers to trade (TBT) such as standards, sanitary and phytosanitary measures (SPS), and other regulations (e.g. Intellectual Property Rights (IPR); investment) as behind-the-border-barriers, we stick to the traditional way to distinguish between tariffs and NTBs.

TRANSATLANTIC ZERO-TARIFF AGREEMENT

For most of the currently traded goods, applied tariffs in the EU and the US are rather low. However, sectoral differences and tariff peaks are evident. Both economies record significantly higher tariffs on agricultural products along with significant tariff peaks on products such as dairy, tobacco, beverages and certain types of textiles (see Table 1) (Erixon and Pehnelt, 2009). Fontagne, Gourdon and Jean (2013) estimate that the average tariff protection on EU goods imported by the US amounts to only 2.2 per cent, while US goods imported by the EU attract an average tariff duty of 3.3 per cent, both in ad valorem equivalent terms. Therefore, tariff liberalisation is rather unlikely to achieve significant economic gains for either the USA or the EU, with the exception of the removal of duties on a comparatively small number of sensitive products.

Table 1: EU and US tariffs by product groups (Most Favoured Nations applied duties in 2012)

EU tariffs by product groups		US tariffs by product groups	
Product groups	MFN applied duties (average, in %, for 2012)	Product groups	MFN applied duties (average, in %, for 2012)
<i>Dairy products</i>	52.9	<i>Dairy products</i>	19.9
<i>Sugars and confectionary</i>	32.1	<i>Sugars and confectionary</i>	14.4
<i>Animal products</i>	20.4	<i>Beverages & tobacco</i>	14.0
<i>Beverages & tobacco</i>	19.9	<i>Clothing</i>	11.6
<i>Cereals & preparations</i>	17.1	<i>Textiles</i>	7.9
<i>Fish & fish products</i>	11.8	<i>Oilseeds, fats & oils</i>	4.8
<i>Clothing</i>	11.5	<i>Fruit, vegetables, plants</i>	4.7
<i>Fruit, vegetables, plants</i>	10.7	<i>Cotton</i>	4.1
<i>Textiles</i>	6.6	<i>Leather, footwear, etc</i>	3.8
<i>Coffee, tea</i>	6.2	<i>Coffee, tea</i>	3.3
<i>Oilseeds, fats & oils</i>	5.6	<i>Cereals & preparations</i>	3.1
<i>Chemicals</i>	4.6	<i>Transport equipment</i>	3.1
<i>Other agricultural products</i>	4.3	<i>Chemicals</i>	2.8
<i>Transport equipment</i>	4.3	<i>Manufactures, n.e.s.</i>	2.4
<i>Leather, footwear, etc</i>	4.2	<i>Animal products</i>	2.2
<i>Petroleum</i>	2.8	<i>Minerals & metals</i>	1.7
<i>Electrical machinery</i>	2.8	<i>Electrical machinery</i>	1.7
<i>Manufactures, n.e.s.</i>	2.7	<i>Non-electrical machinery</i>	1.2
<i>Minerals & metals</i>	2.0	<i>Other agricultural products</i>	1.1
<i>Non-electrical machinery</i>	1.9	<i>Petroleum</i>	1.1
<i>Wood, paper, etc</i>	1.0	<i>Fish & fish products</i>	0.8
<i>Cotton</i>	0.0	<i>Wood, paper, etc</i>	0.5

Sources: WTO (2014a) and WTO (2014b).

For most of the currently traded goods, applied tariffs in the EU and the US are rather low. However, sectoral differences and tariff peaks are evident. Both economies record significantly higher tariffs on agricultural products along with significant tariff peaks on products such as dairy, tobacco, beverages and certain types of textiles.

Calculating the static bilateral trade creation effect in consequence of a tariff elimination between the EU and the USA, Erixon and Pehnelt (2009) find the following results, dependent on the price import elasticities of the EU and the US: When assuming a rather low price import elasticity, annual US exports to the EU27 could increase by 2.5 billion Euros (about 1.51 percent). Vice versa, the increase of EU exports to the US would amount to 4.7 billion Euros (about 1.95 percent). However, when assuming high price import elasticity, the results show an increase of US annual exports to the EU by 6.4 billion Euros (3.76 percent), while the EU would record an increase of its exports to the US by 11.7 billion Euros (4.89 percent). The estimated trade creation effect would therefore be between 7 and 18 billion Euros (12.5 billion Euros on average) (Erixon and Pehnelt, 2009). Furthermore, when looking at the sectoral level, the biggest trade creation would occur in the manufacturing sector (machinery/electrical), chemicals, steel and minerals.

By employing a (computable) general equilibrium model (CGE), Erixon and Bauer (2010) calculate both static and dynamic effects of a zero-tariff agreement. They estimate a static effect on GDP of 0.01 per cent for the EU and 0.15 percent for the US. More importantly, despite the marginal static gains, the dynamic gains, resulting from improved productivity and reduced trade costs, would be considerably higher. For the calculation of dynamic effects, two scenarios are applied which differ in the assumed increase in labor productivity (with one scenario assuming an increase by 2 per cent in goods sectors and the other an increase by 3.5 per cent in sectors with high levels of intra-industry trade and an increase of 2 per cent for other goods sectors) (Erixon and Bauer, 2010)². Those dynamic gains would account for 0.23-0.47 (first and second scenario) percent increase of GDP for the EU and 0.99-1.33 per cent increase of GDP for the US. Considering welfare gains, here measured as national income effects, the authors conclude for the static effect an increase of 3 billion USD for the EU and 4.5 billion USD for the US. For the dynamic gains however, they calculate 58.86 billion USD for the EU and 59-82 billion USD for the US. The change in exports would range between 7 per cent (static) and 18 per cent (dynamic) for the US and between 8 per cent (static) and 17 per cent (dynamic) for the EU.

Looking at the sectoral level, sectors gaining most from export creation comprise textiles, manufacturing and agriculture-related sectors for the EU. For the US, the agricultural sector benefits most from export creation, followed by textiles and manufacturing. Interestingly, the overall rise in exports in both economies is mainly induced by the machinery and chemicals sectors. For the EU, the motor vehicle industry is a substantial contributor to the potential export rise, for the US, the transport equipment sector is a substantial contributor (Erixon and Bauer, 2010). Evidently, sectors benefitting the most from a zero-tariff agreement are the ones accounting for major shares in transatlantic intra-firm and intra-industry trade. A zero-tariff agreement would thus benefit both export and import industries and would yield even further dynamic effects due to the substantive extent of intra-industry and intra-firm trade, which would even be more important than static trade creation effects (Erixon and Pehnelt, 2009).

However, as Felbermayr and Larch (2013a) show for the EU, the elimination of tariffs and subsequently decreasing consumer prices in the sales market would mainly benefit major corporations that already export into the US market. This reasoning is

² | Furthermore, both scenarios include the assumptions of full elimination of tariffs on goods and the reduction of trade facilitation costs by an amount equivalent to 3 per cent of the value of trade in non-commodity goods sectors.

likewise applicable for an elimination of tariffs in the EU market and the subsequent benefits for major US corporations. This stands in contrast to the elimination of NTBs which would mainly benefit small and medium-sized enterprises (see next section).

NON-TARIFF BARRIERS

In comparison to tariffs, NTBs have considerably different effects and consequently their reduction is important as well (Felbermayr and Larch, 2013a). Significantly high gains are to be expected through the elimination of non-tariff barriers and the harmonisation of standards that act as barriers to trade, investment and public procurement. Such NTBs comprise for example differing standards for environmental, health and consumer protection; diverging industry norms and standards; and regulations governing public procurement. A reduction and standardisation of such regulatory measures would reduce the costs of trade and investment significantly (Draper, Lacey and Ramkolowan, 2014).

Harmonisation of regulation is a double-edged sword. On the one hand, it reduces transaction costs and removes barriers to transatlantic trade. Thus it increases welfare within the TTIP negotiating partner countries. At the same time, it gives third country enterprises security and enables them to concentrate on one standard, so as long the standard is not prohibitive. On the other hand, ex-ante harmonization reduces the benefits of regulatory competition for the best solution. Once a standard is agreed upon, it will be rather difficult to change it even when it becomes obvious that it misses its objective. Therefore, a mutual recognition agreement (MRA) for rules and regulation would be better (Felbermayr and Larch, 2013b), such as used in the EU's single market, where the country-of-origin-principle holds. Such an MRA would include strict labelling requirements for sensitive products (see below). The downside is its trade diverting potential for third countries. An open MRA, which allows foreign competitors to choose between both standards on both sides of the Atlantic could help with solving this problem. The key to this are conformity assessment procedures; They are essential if a third party exporter meets the standard in one of the TTIP countries that is covered by an MRA, then the product concerned should be considered acceptable in all TTIP countries.

As ECORYS (2009) and Fontagne, Gourdon and Jean (2013) show, the ad valorem equivalent protection arising from diverging regulatory norms between the US and the EU is significantly higher than the comparably low tariff rates. Ad valorem equivalent protection then ranged between 19 per cent and 73 per cent across the agriculture, manufacturing and services sectors (ECORYS, 2009 and Fontagne, Gourdon and Jean, 2013). The earlier ECORYS (2009) study suggests that the reduction of non-tariff measures produces modest improvements in national income and real wages for the US and the EU, while changes to total exports are more substantial. In an "ambitious" scenario, where 50 per cent of non-tariff measures and regulatory divergences are eliminated, real income increases by 0.3 per cent and 0.7 per cent in the long run for the US and the EU respectively. In a "limited" scenario (where 25 per cent of non-tariff measures and regulatory divergence is eliminated), real income increases by 0.1 per cent for the US and by 0.3 per cent for the EU in the long-term. In the long-term, total exports by the US increase by 6.1 per cent and 2.7 per cent in the ambitious and limited scenarios respectively, while EU exports increase by 2.1 per cent and 0.9 per cent respectively. More recently, a study com-

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missioned by the EU effectively updating and using a similar methodology to that of ECORYS (2009), produced similarly modest results.³

Non-discrimination of third countries: an open mutual recognition agreement (MRA) allows foreign competitors to choose between standards on both sides of the Atlantic. The key to this is conformity assessment procedures; essentially if a third party exporter meets the standard in one of the TTIP countries that is covered by an MRA, then the product concerned should be considered acceptable in all TTIP countries.

Fontagne, Gourdon and Jean (2013), using a different CGE modelling technique and an alternative estimation of non-tariff measures, find that a 25 per cent reduction in non-tariff measures coupled with a full reduction in tariff duties produces a 0.3 per cent increase in the GDP of both the EU and the USA over the long-run. The volume of total exports increases more significantly in the long-run, by roughly 10 per cent for the USA and by approximately 8 per cent for extra-EU exports. In contrast to these studies, Felbermayr, Heid and Lehwald (2013), for the Bertelsmann Institute, use a gravitational econometric model approach to estimate the size of protection from non-tariff measures and find that the implementation of the TTIP may produce substantially larger economic gains. They find that tariff liberalisation results in a real per capita income increase of 0.27 per cent for the EU (unweighted mean) and 0.8 per cent for the USA. The impact is much larger under a deep liberalisation scenario, with the full reduction of non-tariff measures. Under this scenario real per capita income increases by 13 per cent for the USA and 5 per cent for the EU. However the vast difference in estimated impacts between this study and those noted previously (including the study commissioned by the EU) has resulted in the EU suggesting that the Bertelsmann Institute's study is based on an untested methodology "that departs from the standard approach used so far in other similar studies" and that some of the results produced are "unreasonable and inconsistent" and "unrealistically high" (European Commission, 2013a).

Regardless of one's view on modelling techniques and associated results, it is clear that reduction of non-tariff measures and regulatory differences will play a much more significant role in unlocking economic gains for both the USA and the EU than a reduction in traditional tariff duties.

However, NTBs induce a wide range of costs for companies aiming to export into the respective region, including variable production costs for processing the necessary adaptations for the foreign market access or costs within the product development process. These market access costs are of high importance for the exporting industry and companies. Hereby, a firm's size is decisive for its ability to bear the costs. Hence, small and medium-sized enterprises (SMEs) would especially benefit from a harmonization or mutual recognition of NTBs by gaining initial market access that might have been too expensive in the presence of standard adaptation costs. For major corporations however, lower market access costs are also convenient but would not change their export behaviors in a comparable way to SMEs (Felbermayr and Larch, 2013a).

According to Diekman (2013), elimination or a decrease of NTBs between the EU and the US might be facilitated by the fact that they are already deeply intertwined regions in terms of investments, enterprise linkages and extensive value chains with a relatively high cultural proximity. However, a complete harmonization of standards might fail in the light of highly sensitive sectors on both sides of the Atlantic which are the tripping stone of transatlantic negotiations. An MRA could be the solution to that problem.

3 | See Francois et al. (2013). This study also takes into account the potential impact of "regulatory spill-overs", distinguishing between regulatory spill-overs (trade costs for third countries exporting to the EU or the USA fall as regulations are harmonized) and indirect spillovers (third countries begin to adopt the standards and regulations set by the EU and the USA through the TTIP).

SENSITIVE SECTORS

Several issues are key challenges for the transatlantic negotiations.

One of the main issue and tripping stones is the agricultural sector and its farm subsidies. With two of the biggest providers of farm subsidies being involved in the trade negotiations, a bilateral commitment on farm subsidies would be substantial and may function as precedent for a multilateral agreement (Schott and Cimino, 2013).

However, a challenge for resolving problems in agricultural market access and regulation are the differences in the determination of SPS measures. This is particularly obvious with regard to the WTO trade disputes over the European Union's prohibition of imports of growth hormone-treated meats and approval process for biotechnology products like genetically modified organisms (GMOs). In order to solve these problems, the US suggested a "science-based approach" which should rely on the findings of the European Food Safety Authority (EFSA) which conducts scientific assessments of product risks and safety. In recognition of the challenges of differing SPS approaches, the HLWG report suggests an "SPS-plus" approach, seeking "to build on key principles of the WTO SPS Agreement, including requirements that SPS measures be based on science and on international standards or scientific risk assessments, applied only to the extent necessary to protect human, animal, or plant life or health," as well as "establishing a mechanism for improved dialogue and cooperation on addressing bilateral SPS issues" (HLWG 2013). This mechanism should ensure increased transparency and timely notification and focus on implementing "sound science" rulings (Schott and Cimino, 2013).

Also for services, liberalization of trade and investments would require extensive work for harmonizing regulatory policies for the different services sectors (finance, insurance, and telecommunications). According to the HLWG report, the EU and the US aim at negotiating market access in services which matches the "highest level of liberalization captured in existing FTAs" (HLWG 2013). However, a harmonization of the approaches of scheduling services commitments is indispensable. For the EU, the inclusion of the negative list approach⁴ is a challenge. Still, a compromise was reached in ongoing negotiations on the Trade in Services Agreement (TISA), which foresees a "hybrid framework" combining a negative list approach for national treatment disciplines and a positive list approach for market access commitments. Especially the harmonization of regulatory policies for financial services is challenging in the light of the ongoing management of the European financial crisis (Schott and Cimino, 2013).

While the HLWG final report 2013 (HLWG, 2013) states that both the EU and the US are investigating and exploring opportunities for addressing a "limited number of significant Intellectual Property Rights (IPR) issues of interest to either side" (HLWG, 2013), there are still substantive gaps between the EU and the US positions concerning IPR. One major aspect is the differing view on the protection of geographical indications (GI). This debate is additionally affected by developments at the multilateral level comprising two major issues between the EU and the US: the creation of a multilateral register for wines and spirits and the extension of the higher level of

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⁴ | The negative list approach implies a comprehensive inclusion of all services sectors, unless it is otherwise specified in the list of reservations. Discriminatory measures affecting all included sectors are to be liberalized unless specific measures are set out in the list of reservations. The negative list approach is contrary to the positive list approach which implies a voluntary inclusion of services sectors.

protection of wine and spirits to all products. While the EU aims at a system of notification and registration of GIs which is legally binding with an extension of product coverage beyond wine and spirits, the US supports a non-binding, voluntary registration of GI solely for wine and spirits (Schott and Cimino, 2013).

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A further sensitive area includes aspects of international climate change regimes, global carbon markets and energy efficiency. In particular, an ongoing dispute over airplane emissions reflects the regulatory divergences between the US and EU on climate change policies. TTIP should build on efforts for a global aviation emissions regulation (through/like has been introduced by the International Civil Aviation Organization) to resolve climate change issues (Schott and Cimino, 2013).

Although being an expressed goal of the US and EU negotiations, improved access to government procurement remains critical. The EU in particular presses for even more open access to local- and state-level procurement. As the European Commission states, the relative restrictedness of US government procurement markets is one of the primary barriers to trade and investment with the US (European Commission, 2011).

AGREEMENT ON TRADE IN SERVICES

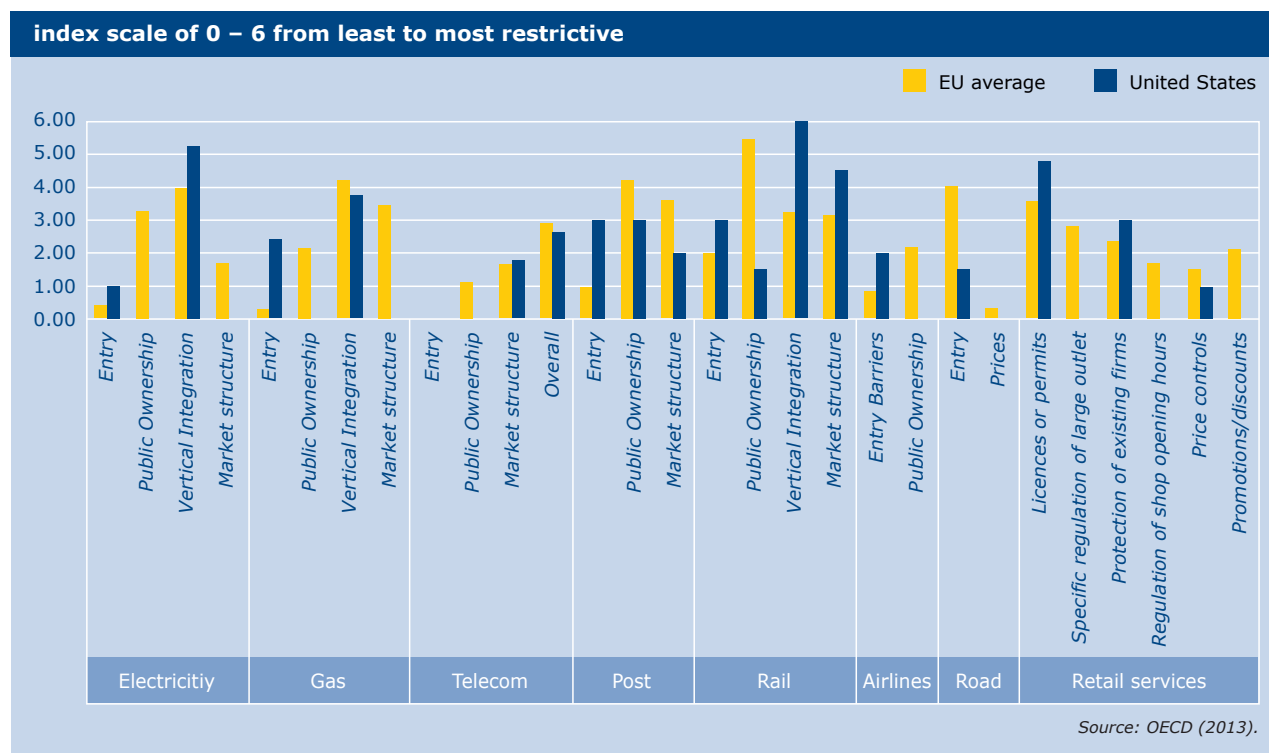
Services represent a large portion of the transatlantic economy. In 2012, 28.9 per cent of all EU services imports came from the US, while 26.3 per cent of all EU services exports were destined for the US (European Commission, 2013b). For the US, the EU is the main destination for services exports. In 2010, 31.8 per cent of all US services exports were destined for the EU (WTO, 2013).

However, some services sectors in both economies are still considerably restricted. For both the US and the EU, the share of output of services which were characterized by 'a substantial level of protection' according to the OECD's Product Market Regulation Index⁵, represents 20 per cent of GDP (Messerlin and van der Marel, 2009). A product market regulation index which was higher than average was recorded by the following sectors: electricity, renting machinery, distribution, business services, transport and storage, and financial services. However, the US services sectors are generally more open than the EU's (Messerlin and van der Marel, 2009). Graph 1 illustrates the different types of regulation for selected services. An assessment and subsequent rearranging of certain product market regulations (where appropriate) would yield significant direct and indirect effects, as well as static and dynamic gains. This is of special relevance since most of the highly regulated sectors are 'backbone services' which reveal an overall and general importance for the whole economy. Through major inter-sectoral linkages, the improved productivity and efficiency in the course of market liberalisation would yield substantial overall economic effects (Erixon and Brandt, 2011). Moreover, Draper, Lacey and Ramkolowan (2014) state that the most systemically important gains are likely to be made in areas such as financial services (insurance and banking), professional services, education services, telecommunications services, express delivery and e-commerce (Draper, Lacey and Ramkolowan, 2014). These sectors are all crucial to the operation of GVCs.

5 | The index comprises a set of indicators which measure the degree to which policies promote or inhibit competition. The indicators reflect regulations in the areas of state control of business enterprises, legal and administrative barriers to entrepreneurship and barriers to international trade and investment. A higher value indicates higher regulations (Conway, Janod and Nicoletti, 2005)

6 | Data for the following EU countries is not available: Bulgaria, Croatia, Latvia, Lithuania, Luxembourg, Malta, Poland, Romania and Cyprus.

Graph 1: OECD Product Market Regulation Index 2008 for EU average⁶ and the United States



Messerlin and van der Marel (2009) point out the importance of a bilateral services agreement that could potentially become a plurilateral agreement. It would only need eight more countries to join the agreement in order to reach a critical mass of 80 per cent of world trade. Those countries would include Japan, China, India, Brazil, Russia, Canada, Korea and Mexico. This may enforce a multilateralisation of services agreements, complementing the TISA which is the most significant development for trade negotiations at the plurilateral level and may have wide implications for the multi-lateral trading system. TISA negotiations cover almost 70 per cent of world services trade, and include major trading partners, such as Canada, the EU, Japan, the Republic of Korea and the United States. With China expressing an interest to join recently, further dynamics may be induced to this project (Marchetti and Roy, 2013). However, Marchetti and Roy (2013) note that the TISA negotiations are not likely, as currently constructed, to deliver new market access gains in services since the parties have effectively agreed only to bind their best market access levels as offered through their own PTAs. A TTIP that goes further offers the possibility of deeper liberalization at the multilateral level.

EFFECTS ON THIRD COUNTRIES

EFFECTS OF A ZERO-TARIFF AGREEMENT

Since the tariff level is already considerably low for most manufactured goods, trade diverting effects from extra-transatlantic to the transatlantic are not so likely (Felbermayr and Larch, 2013a; Erixon and Pehnelt, 2009). Moreover, remaining tariff peaks of the EU and the US are mainly in labor-intensive consumer goods and some goods which are mainly exported by developing and emerging economies. Hence, there is a rather small potential of transatlantic trade to be substitutable to these goods categories (Erixon and Pehnelt, 2009). Rollo et al (2013) highlight that “there is practically

no similarity between, on the one hand, the structure at HS 6 Digit level (around 5000 product categories) of the non-fuel exports of the LIC (low income countries) to the EU and US, and on the other hand, the exports of the EU to the US, and of the US to the EU”.

Furthermore, Baldwin (2014), notes that if complementarities are high, as is the case with African Caribbean Pacific (ACP) – EU and ACP – USA trade, then if the TTIP results in trade expansion for the member states it is likely that this would suck in imports from the ACP in order to supply expanding production plants in the signatory states. This implies increased traditional exports, particularly of resources, and therefore intensification of current comparative advantage patterns. Depending on one’s view of comparative advantage this could be good (more exports, more foreign exchange, more jobs etc) or bad (lock-in effect, marginalization from global value chains, etc).

Selected ACP countries within specific product categories may nevertheless face substantial preference erosion and increased competition (resulting in trade diversion) from countries participating in mega-regional agreements. Rollo et al (2013) note that low-income country product exports such as textiles, clothing and footwear, and specific agricultural products such as fish, bananas and sugar, face preference erosion in both the EU and US markets with the implementation of the TTIP. So while it is reasonably clear that the overall effects of the TTIP on low-income countries is likely to be small, certain developing countries are likely to face significantly higher levels of competition in a specific set of products.

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Thorstensen and Ferraz (2013) conduct a simulation of the impact of both TTIP and TPP as two mega-regional agreements on the Brazilian, Russian, Indian, Chinese and South African (BRICS) economies. Different scenarios of the impact of the elimination of tariff and non-tariff barriers amongst the TTIP and TPP member states on the BRICS economies are considered for three sectors: agriculture, industry and services. For the scenario of a full liberalization of tariff barriers between the EU and the US, they find a decrease in both exports and imports for all BRICS countries, with Brazil (export decline of 0.17 per cent, import decline of 0.16 per cent); India (export and import decline of 0.14 per cent) and China (export decline of 0.14 per cent and import decline of 0.12 per cent) as the most affected countries. In another scenario, which assumes again a full liberalization of tariff barriers between the EU and the US but now with an additional partial liberalization (50 per cent) of NTBs, Thorstensen and Ferraz (2013) conclude that exports and imports of the BRICS are again negatively affected, with Brazil recording highest losses (both exports and imports decrease by 1.61 per cent). The disadvantages are even bigger when assuming a full liberalization of tariff and non-tariff barriers between the EU and the US, as simulated in a third scenario in the study. Brazil would record a decline in exports and imports by 3.35 per cent; India, China and South Africa by 2 per cent and Russia by 1.7 per cent.

EFFECTS OF A REDUCTION OR ELIMINATION OF NON-TARIFF BARRIERS

A reduction of non-tariff barriers can affect third countries in a number of ways, depending on the extent of the reduction and the initial divergence of regulations. In case of a partial alignment of regulations, standards and other non-tariff measures, countries outside of the agreement face two scenarios: It is either possible that non-member countries which struggle to comply with the existing or new requirements might be damaged since they face a loss in their relative competitiveness. Or countries and existing exporters are able to maintain the standards and regulations set by the EU and the US and may be able to withstand competitive pressures from members of the regional agreement (Draper, Lacey and Ramkolowan, 2014; Felbermayr and Larch, 2013b).

However, a differing effect occurs in case standards that are mutually recognized or harmonized between the US and the EU. Countries outside of the mega-regional agreement will then face two competing effects: Where requirements, standards and regulations are made stricter, non-member states will face higher compliance and trade costs across all markets implementing the common framework, potentially implying greater competition from exporters within the mega-regional (Draper, Lacey and Ramkolowan, 2014). If a third country manages to meet the standards in either one of the economies with an admission to sell its products to the foreign market, it could be automatically qualified to export to the other partner economy as well. Hence, in the case of a harmonization of standards between the EU and the US, third countries may gain if they manage to meet the standard requirements and can export to both of the economies (Felbermayr and Larch, 2013b). Therefore, the harmonization and mutual appreciation of standards is not discriminating if third countries are able to utilize them as well. A transparent definition and certification system of mutual EU-US standards would therefore be preferable (Felbermayr and Larch, 2013). Following the scenario of harmonized standards, another (yet optimistic) feature is the expectation that common transatlantic standards could gain worldwide acceptance which would subsequently lead to a general improvement of product standards worldwide, enforcing consumer and environmental protection (Felbermayr and Larch, 2013). This in turn would yield a general growth stimulus in the areas of competition, labor and environmental policies (Diekman, 2013).

It is clear that the reduction of non-tariff measures between members of mega-regional agreements can be both beneficial and harmful to non-member countries. The extent to which changes in non-tariff measures are beneficial for non-member states is dependent on both the level of stringency of the new measures implemented by the mega-regional agreement and the degree to which harmonisation of these non-tariff measures and regulatory standards across members of the mega-regional agreement occurs.

The increasing focus on regulatory standards and non-tariff measures also brings into focus the fact that modern FTAs offer substantially less “preferential” tariff access than in the past. As Baldwin (2013) summarizes, only a small and shrinking percentage of global bilateral trade flows are eligible for preferences, a significant and growing proportion of trade flows have zero most favoured nations (MFN) tariffs (implying that no duty preference can be provided) and less than 2 per cent of World imports enjoy preferences of over 10 per cent.

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TTIP and TPP: Complement, Substitute or No Overlap?

Since the US is negotiating two mega-regionals simultaneously, it is reasonable to take a brief look at these parallel developments. It is clear that TPP negotiations are well-advanced, with some observers expecting them to wrap up in this year.⁷ By contrast the TTIP was only officially launched at the G8 summit in the United Kingdom in June 2013. Furthermore, there is an unofficial understanding that the USA first wants to conclude TPP negotiations before commencing TTIP negotiations in earnest, although agenda structuring in respect of the TTIP is proceeding. Both negotiations are driven by the professed goal of achieving “high-standard agreements”. As TPP negotiations have progressed, a consensus seems to have emerged as to what this language means, namely „a landmark, 21st-century trade agreement, setting a new standard for global trade and incorporating next-generation issues“. The TPP negotiations are taking place across twenty-nine chapters and as a single undertaking.

The 29 negotiating groups are focusing on achieving different legal texts and negotiating outcomes on, inter alia, the following areas: competition, cooperation and capacity building, cross-border services, customs, e-commerce, environment, financial services, government procurement, intellectual property, investment, labor, legal issues, market access for goods, rules of origin, sanitary and phytosanitary standards (SPS), technical barriers to trade (TBT), telecommunications, temporary entry, textiles and apparel, and trade remedies (USTR, 2013). Draper, Lacey and Ramkolowan (2014) note that in terms of international treaty commitments in areas that have thus far eluded multilateral trade rules, the TPP seems to harbour the prospect of a new textual template that will set the tone in both the TTIP, as well as – further down the road – future trade and investment agreements. These new areas include the following: regulatory coherence, state-owned enterprises, government procurement, competition, investment, e-commerce, environment, and labour.

Thus, it seems that there is much overlap with respect to both scope and depth of the negotiations in both planned mega-regionals. This surely makes sense, if the logic of the negotiations is coherent. If it is accepted to reduce barriers to trade across the Pacific with the help of certain tools, it seems plausible to use the same – if adjusted – tools to reduce trade barriers across the Atlantic. One may even go a step further and analyse what has been achieved. Schott and Cimino (2013) suggest that the transatlantic negotiation partners take the two regional agreements they have signed with Korea, namely KORUS and KOREU as benchmark and transfer the respective core of these agreements to TTIP; noting that work has to be done regarding different regulatory approaches with respect to IPRs, SPS and the environment, as discussed above.

This recommendation is based on the fact that within the TPP negotiations, six countries have already concluded PTAs with the US: Singapore, Australia, Chile, Peru, Mexico and Canada and therefore largely accept the US negotiating “template”. Clearly the overlap between TPP and TTIP is substantial. Of course there are special needs and interests which will have to be considered in the transatlantic case and are not relevant in the Korean cases or regarding TPP, such as the fear of French moviemakers or German fears regarding data privacy in the wake of the Edward Snowden saga.

The overlap between TPP and TTIP is substantial, although there are special needs and interests which will have to be considered in the transatlantic case and are not relevant in the TPP, such as the fear of French moviemakers or German fears regarding data privacy in the wake of the Edward Snowden saga.

⁷ | Private conversation with Deborah Elms, Bali Trade and Development Symposium, December 4th, 2013.

Mega-Agreements and the World Trading Order

Bilateral trade agreements can have significant implications for the world trading order. However, the impact depends on the type of initiative, since different kinds have different effects on multilateral negotiations. Most of the existing PTAs, which are typically between two small countries (south-south) or between one big and one small (center-periphery) are not of significant economic importance (not much tariff liberalization; not far beyond WTO commitments) with no significant effect for the multilateral trading order.

However, as TTIP would be an agreement between the biggest advanced economies, it would definitely yield some significant systemic effects (Erixon and Pehnelt, 2009). Furthermore, from a comparative perspective, in the long-term the establishment and implementation of a comprehensive TPP may be more significant than the TTIP if it leads to the establishment of an Asia-Pacific Economic Cooperation (APEC)-wide agreement. Such an agreement could see the establishment of one of the largest PTAs incorporating China, Japan and the US along with a number of fast growing Asian and Pacific countries. The EU would notably be excluded from it.

As the foregoing analysis of the effects on third countries has shown, the traditional fears regarding the economic impacts of PTAs no longer seem justified. This view is supported when assessing their impact on the world trading order. As shown by Baldwin and Seghezza (2007), modern PTAs act as building blocks of multilateralism, rather than stumbling blocks to further multilateral initiatives. Given that the mega-regionals comprise many countries and go beyond the WTO agenda, and given that the firms in the partner countries of these agreements are well-integrated into GVCs, one can expect that the liberalization efforts of these agreements will spur further efforts elsewhere and translate into better multilateral disciplines. In sum, we expect that TTIP will not contradict further post-Bali efforts of the WTO, and may well promote further negotiating action in Geneva – something that has been in short supply in recent years.



Yet there is room for some concern, which has its origins in the evolving geopolitical order centered on the relative decline of the US, and the relative rise of China. These concerns mostly center on the TPP, since the Asia-Pacific is the arena where the emerging international economic order is being most sharply engaged. Already China and other East Asian countries are engaging in PTA negotiations, under the Regional Cooperation for Asia and the Pacific (RCEP), that exclude the US. If the TPP negotiations ultimately fail or do not live up to expectations, it is likely that two regional blocs, one US-centered and the other China-centered, with differing rules and incentive structures, will emerge in the Asia-Pacific region. This would likely increase tensions in the region; a region already characterised by sharply escalating economic and political disputes such as over claims to sovereignty over the Senkaku/Diayou islands in the East China sea. In other words PTAs could then be seen to reinforce political and security allegiances, which would take them from the economic into the geopolitical realm. On the other hand, China's current leadership could decide

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to use the TPP negotiations as an external prop to domestic economic reforms, thereby choosing to engage with it rather than confront it. This strategy has significant backing in China, particularly in the circles of reformers (Draper, 2013). Consequently the dark geopolitical scenario need not unfold if all parties remain focused on the economic content of the TPP, rather than its obvious geopolitical content.

By contrast, failure to conclude the TTIP would not represent a major economic setback for the EU, although the TTIP would certainly provide an important external prop to much needed microeconomic reforms at the national level thereby buttressing dynamic gains. But this is where the impact would be primarily felt, rather than at the geopolitical level. However, over the medium term failure to cement those dynamic gains would diminish the EU's relative global economic position in the future, and undermine its global influence accordingly. In the context of a rising China, and Asia beyond that, this is an outcome that EU foreign policy elites would be correct to fear.

Conclusions



The envisaged TTIP is a promising political undertaking, which may benefit both its partners as well as third countries. However, it requires some serious steps to overcome numerous obstacles, mainly in the realm of regulations and standards. One way to deal with such standards is to conclude MRAs with strict labelling requirements, leading to more choices for consumers without abandoning domestic consumer protection preferences. It can be expected that Europeans who dislike GMOs will not purchase them. In order to not divert trade and to not disadvantage third country producers, these mutually recognized standards should also be open for them. In other words, they can choose which standard to follow.

Such a non-discriminatory open regulatory regime can be beneficial for the global trading order since the transatlantic partners have the chance to maintain their high standards without discriminating against third parties, since they are already used to these standards and do not have to adjust to a new one.

However, the path towards the TTIP contains some 'sacred cows' that may have to be slaughtered, such as the European dislike of GMOs and US insistence on complete freedom of data flows. Governments on both sides of the Atlantic will also confront many civil society lobbies concerned about the growth of corporate power and alleged diminution of regulatory prerogatives associated with this. So much depends on the willingness of the transatlantic negotiating partners to overcome the obstacles. This will require concerted political will and focus, substances that are scarce in beleaguered Western democracies still confronting the fallout of the worst financial crisis since the 1930s. Whether democratically elected leaders will be able to overcome key interest groups, and forge the cross-issues trade-offs in their full complexity, remains to be seen.

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Acronyms

ACP	Africa, Caribbean and Pacific Group of States
APEC	Asia-Pacific Economic Cooperation
BRICS	Brazil, Russia, India, China and South Africa
CGE	Computable General Equilibrium Model
CU	Customs Union
EFSA	European Food Safety Authority
EU	European Commission
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GI	Geographical Identification
GMO	Genetically Modified Organism
GVC	Global Value Chains
HLWG	EU-US High Level Working Group on Jobs and Growth
IPR	Intellectual Property Rights
KOREU	European Union – South Korea Free Trade Agreement
KORUS	United States – South Korea Free Trade Agreement
MRA	Mutual Recognition Agreement
NTB	Non-Tariff Barriers
OECD	Organisation of Economic Cooperation and Development
PTA	Preferential Trade Agreement
RCEP	Regional Cooperation for Asia and the Pacific
SME	Small and Medium-sized Enterprise
SPS	Sanitary and Phytosanitary Measures
TBT	Technical Barriers to Trade
TISA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
US	United States
USTR	United States Trade Representative

Biographies

Dr. Matthias Bauer studied economics at the Friedrich Schiller University Jena (Germany) and business administration at the University of Hull (UK). He worked as a Ph.D. student at the graduate programme “Foundations of Global Financial Markets – Stability and Change” and was Research Affiliate at the European Center for International Political Economy, Brussels. Mr. Bauer is the Coordinator of International Economic Policy in the Political Dialogue and Analysis team of KAS, which is part of the European and International Cooperation department. His areas of research include the Social Market Economy, European fiscal policy, capital market policy and international trade policy.

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