

Whither the Transatlantic Trade and Investment Partnership?

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1. Introduction

Failures in the World Trade Organisation's Doha Round have prompted countries to turn to preferential trade agreements. Every country with a stake in world trade is now negotiating bilateral free trade agreements – with occasional infusions of regional attempts to forge greater trade ties by reducing barriers to trade and investments, e.g. the Trans-Pacific Partnership (TPP). Some claim Free Trade Agreements to be second-best alternatives to a dysfunctional multilateral system; others see them through the eyes of Jacob Viner and consider them to be termites of the trading system, diverting trade and causing bureaucratic obstacles to trade through Rules of Origin regulations.¹ Yet regardless the side of the argument, the most outstanding feature of many FTAs is that they do not have impressive effects on growth in trade and Gross Domestic Product (GDP). The EU, for instance, considers its FTA with South Korea to be a first-of-a-kind, “deep and comprehensive” bilateral agreement with a medium-sized growth market – and at the time when it was ratified, EU representatives hailed it as an important trade agreement for the European post-crisis recovery. The estimates of the European Commission, however, suggested this FTA to boost GDP in Europe by no more than 0.08 percent.²

Yet some countries may now be about to enter a new era of preferential trade agreements – an era defined by larger preferential trade agreements with more sizeable effects on economic growth and that are premised on the ambition to usher global trade into the 21st Century by addressing other trade barriers than those covered by past WTO agreements. TPP is such an agreement – perhaps the most important trade negotiation that the United States is currently involved in. Now that Japan has joined the Trans-Pacific Partnership negotiations, the value of a TPP deal have gone up significantly for all involved countries, including the U.S.

1 Jagdish Bhagwati (2008) offers a robust view against preferential trade agreements. My colleague Razeen Sally is also a noted skeptic of many FTAs, especially Asian FTAs. See Sally (2006) and (2007).

2 CEPII (2010).

The European Union has just launched trade negotiations with Japan. Even if there are serious doubts by some observers that this agreement will materialise, the potential benefits are sizeable and exceed any other bilateral trade agreement the EU has signed with a third country. Yet more significantly, the EU and the United States have now started negotiations for a Transatlantic Trade and Investment Partnership (TTIP). If all these three initiatives would yield results, they will have a serious impact on trade and GDP.

The transatlantic initiative is premised on the idea that it will extend the scope of a Free Trade Agreement beyond the traditional components of eliminating most tariffs and free up some restrictions on trade in services. The biggest component of TTIP is agreements to reduce regulatory divergence, most probably by new horizontal rules and sectoral agreements like Mutual Recognition Agreements. Furthermore, it will involve an investment component to substitute current Bilateral Investment Treaties and provide for new market access for investments. It will delve into other “unfinished business” in trade policy, like openness in public procurement. And leaders of the both side claim the agreement should serve as platform for cooperating on pertinent trade issues globally, such as state-owned enterprises.

However, TTIP and some of these ambitions are met with scepticism from some seasoned observers of trade policy.³ Others, with less careful views, have also made contributions to the debate. Have the EU and the U.S. not tried this before – and without success – some have complained? Is this just not an attempt to create a “Fortress Atlantic” to defend against competition from rising Asia, especially China? Another attacking point is that this initiative is quite typical for the Western-centric approach to international economic cooperation: just as other many countries are getting up to a position of economic power that could match the EU or the U.S., the old Western powers take their business out of multilateral organisations to settle affairs bilaterally.

3 See e.g. Barfield (2013) and Langhammer (2013).

So, is the strange acronym of TTIP a code word for the death knell of the WTO and multilateral trade cooperation? Is this a trade agreement premised on defensive attitudes to world trade?

My answer to both questions is “No”. I think there are some problematic aspects associated with TTIP as well as with other large regional agreements that will need attention. It should also be acknowledged that neither TTIP nor TPP was born out of deep and genuine beliefs in the principles of free markets or the classical school of free trade. Like any other trade agreement in the past year, these initiatives build on conditional views of free trade and free competition, mixed up with soft mercantilism, a growing urgency for transatlantic trade leadership, and a pragmatic desire to support economic growth. There are supporters of TTIP that build their case on more defensive arguments, but to the extent it is possible to determine what sentiments that have guided leaders to launch TTIP, defensive motivations have not been one of them.

The conclusion of this paper is that countries outside the EU and the U.S., especially the larger emerging economies, should fear TTIP failure rather than TTIP success. A failed effort would not only imply less market openness but probably also less willingness on the part of the two giants of the world economy to exercise leadership for the world trading system. The alternative to TTIP is not renewed efforts to negotiate new multilateral agreements. It follows, therefore, that my view on TTIP is that it is neither an attempt at a transatlantic fortress nor an exclusive, old-club arrangement that will undermine the World Trade Organisation. If it works well, TTIP is rather one of few feasible strategies to breathe new life into international trade cooperation and advance the agenda for freer trade elsewhere. It is a trade agreement that principally should be feared by those forces that wish to prevent or deter liberalising trade reforms.

2. Why TTIP?

The origin of TTIP, at least from the viewpoint of the European Union, is indicative of current trends of European cooperation. Leading voices in the European Commission have for long been a sceptic of transatlantic trade agreement. The Commission’s Trade Directorate nodded in this direction under the leadership of Leon Brittan – but most of the time the Commission’s view has been that a transatlantic Free Trade Agreement would erode the multilateral system and deny the EU from negotiation other, and better, trade agreements.

In Europe, TTIP was rather born out of initiatives taken by member states, especially Germany and Sweden, and the European Parliament.⁴ And they, along with other participants, managed to persuade a reluctant Commission that TTIP would make economic sense and that it would not have damaging consequences on the multilateral system.

There is particularly one argument that has carried weight in Europe’s process to favour a transatlantic trade initiative: the European Union is in need of higher economic growth.

4 Germany has championed the idea of a transatlantic free trade agreement for several years. Under Germany’s EU Presidency in 2007 it flouted the idea of starting such negotiations – and as part of that strategy initialled the Transatlantic Economic Council.

Consequently, trade agreements that could deliver higher economic have been given a new hearing as the economic crisis in Europe has worsened. Few would deny that TTIP has the capacity to deliver a sizeable contribution to GDP in Europe. The gains from this FTA would be bigger than from other FTAs for the reason that it involves two large economies. Estimates from a study commissioned by the European Commission suggest the TTIP gain for the EU to be in the tune of 0.3-0.5 percent of GDP (the GDP gains are slightly smaller for the U.S.)⁵ Other estimates suggest the potential gains to be larger⁶ – and there has been a debate among some trade economists in Europe about the methodologies used in different studies.⁷ Yet the “official” estimate still suggest that TTIP will have a non-negligible impact on GDP in Europe: GDP will expand by approximately 120 billion euro, translating into a gain for the average four-person household of about 550 euro per year. It does not happen very often that the results of policy achievements by EU institutions are of that calibre. Consequently, even under the conservative assumptions used in the Commission-led study, TTIP will make a contribution to economic growth and jobs in the EU that is high enough to motivate the effort.

The economic case for TTIP is not the only argument used by leaders of the European Union, or the United States. But it is the most important one. Other sentiments may have some influence too, but only at the margin. Hillary Clinton portrayed a transatlantic FTA as an “economic Nato”, but trade officials in the United States acknowledged already at an early stage in the consideration of TTIP that the agreement would be won or lost for its effects on jobs and growth. Even if other arguments have not carried the same political weight, it does not follow that they are less important analytically.

3. The “sequential strategy”: offensive or defensive?

Arguably, one of the most interesting aspects of TTIP is its potential effect on global trade – or global efforts to negotiate new trade agreements. Is this effective positive or negative – or to put it differently: is it more or less likely to prompt new and international efforts to liberalise trade and improve trade rules against discriminatory government action? This chapter will present my view. It is divided in two parts.

First I will address the question if TTIP is a defensive strategy for the European Union – or to rephrase the question: is TTIP an attempt to avoid new competition from rising economic powers? The answer to this question does not only have to rely on individual judgment: facts and analytical circumstances also play a role. The answer to the second question is much more based on judgement – and that question is: will TTIP help or hurt efforts to negotiate new international (potentially multilateral) trade deals?

There are two arguments against the thesis that TTIP is a defensive trade strategy.

5 Francois et al (2013).

6 See e.g. Felbermayr & Larch (2013).

7 The Commission recently felt compelled to issue an “explanatory statement” regarding the estimates from the study it commissioned, partly to respond to claims that this study had underestimated potential gains. See European Commission (2013).



First, neither the EU nor the U.S. is solely focused at their transatlantic initiative. They are both pursuing trade agendas outside the Atlantic hemisphere. The EU, for instance, is negotiating free trade agreements with India, Japan, Malaysia, Singapore, Thailand, and Vietnam. It is close to finishing an agreement with Canada and wants to improve its bilateral trade accord with Mexico, the first Nafta country it signed an FTA with. It has a programme for trade deals in Latin America, and has just gone through a process of signing off a negotiated deal with Andean states. It is negotiating a trade agreement with Mercosur. That negotiation has stalled – but that is not surprising given the overall course of trade and economic policy taken by some of the Mercosur members.

Furthermore, the EU is still trying to get countries in Africa to agree to Economic Partnership Agreements that would improve on the one-way market access that exists through past agreement on preferences. It wants to have an agreement with the Gulf countries in the Gulf Cooperation Council. It is now going through a process of getting a mandate to negotiate a bilateral investment agreement with China – an agreement that also will include a market access component. It is hoping to sign an Association Agreement with Ukraine and negotiates agreement with the effect of opening up trade with Eurasia countries through its Eastern Partnership. It spearheaded Russia's entry into the WTO and wants to deepen its trade relation with its large Eastern neighbour. It is one of the leaders behind the revision of the Information Technology Agreement (ITA) and the new attempt at negotiating a plurilateral Trade in Services Agreement (TISA).

The list could continue. But the gist of my point should be obvious: this is not a trade agenda for an entity that wants to build a fortress or shield itself against rising economic powers. Many of these current initiatives may not lead to results, or not to the desired result, but no one should doubt that there is a grander strategy guiding the EU which is based on liberalising trade with the vast part of the world economy.

Trade politics in the United States displays greater uneasiness about new trade deals, but redrawn ideological battle lines in the U.S. Congress should not conflate the fact that the United States is pushing for several new trade deals, including TPP and some new plurilateral agreements. The U.S. no longer considers itself the hegemon of a global economic system and have fewer strategic goals associated with the trade policy. Like the European Union, the big shift in U.S. trade policy in the recent decade is that it no longer accepts trade agreements with only a small degree of reciprocity. It now demands trade agreements with two-way trade liberalisation, especially those agreements that involve the large emerging economies that represent a big part of future demand and trade growth.

Second, if you want to lower your exposure to trade with some economies, the natural strategy is not to liberalise trade with other economies. In today's world economy, it is politically impossible to negotiate trade agreements that would seriously hurt other important trade. If TTIP would have strongly negative consequences on, say, EU trade with Asian countries – if trade diversion would be sizeable – the net effect of an agreement would be close to negative. Such

an agreement would be difficult to get accepted by many actors that today have vested interests in maintaining current relations with those Asian countries.

Furthermore, in today's world economy, trade-liberalising agreements is not the tool that can be used to generate serious trade diversion. The effects of bilateral trade agreements on the actual geographic structures of trade or commercial integration are small because the preferential effects of tariff reductions are mostly negligible and because reforms in other trade policies do not generate much diversion. This is especially true when two low-tariff economies like the EU and the U.S. agree on mutual trade openings. Real trade diversion tends to be a factor of the size of an initial tariff and it therefore follows that the diverting effect of a tariff reduction from 3 percent to zero will have negligible effects.

A bilateral trade agreement between two low-tariff economies will have to be focused at effecting trade-preventing measures that previously have not been addressed in trade agreements. If such changes can be effected they do not divert existing trade to a significant degree. Moreover, some of the changes in market access cannot be done on a reciprocal and preferential basis: they will rather apply to other countries, too. Take for instance the effect of TTIP on Sweden. A significant part of the positive effect on GDP of TTIP will appear in the business services sector (one third of the estimated gains will be come from the business services sector).⁸ This sector has been comparatively closed in Sweden and the reforms likely to occur as a consequence of TTIP will in most instances apply to other countries, too. Changing the rules for commercial presence in, for instance, financial services will mostly be done on a multilateral basis.

Let us now turn to the second question: will TTIP help or hurt efforts to negotiate international (possibly multilateral) trade deals? My view – which is built on my observations rather than undisputed facts – is that TTIP is more likely to spur than to deter new international trade deals.

The short motivation for this view is based on politics. The most important factor to change the political conditions for new international trade agreements is that many larger emerging markets become more open to trade liberalisation, especially countries like China and India. They are now far too big, and far too important for actual changes in trade flows generated by a trade agreement, to be allowed terms of an agreement that would mean little or no liberalisation for them. A country like China will feel somewhat uncomfortable by an agreement like TTIP. They will fear that they are getting side-lined in discussions over the structure of future trade agreements. They will feel compelled to accept trade agreements that they previously could neglect or even block. An example of such a motivation is likely to have been at play when China decided to join the TISA negotiations.

Arguably, this is important for the vitality of the multilateral trading system and for the chances to knock new global trade liberalisation onto the agenda. In the past 15 years, the multilateral trading system has been a leaderless system with no clear direction that has unified the key members. The system itself benefited for several decades from the leadership

⁸ National Board of Trade (2012).

by the United States, which considered this system to be critical for its overall strategic objective of spreading market-based capitalism. There were willing followers to the U.S. leadership, but none other than the U.S. had the requisite economic, political and institutional capacity to underwrite the system. Yet since the collapse of the Cold War, American leadership has withered away, and its general position on trade liberalisation has somewhat changed. Absent political leadership and direction, the Doha Round got stuck because the political instinct of many countries was to favour status quo rather than new liberalisation as long as there is no external pressure that prompts them to revisit that position.

Like many other things in economic life, trade liberalisation tends to be driven by two motives: profits and fear. Countries agree to open up for greater foreign competition because they believe it will boost their economy or because they fear that other countries will go ahead without them if they stubbornly resist liberalisation. Despite all the success of a trade-oriented model of growth, many countries have grown to think that they will not stand to benefit much from new trade liberalisation, or that the political cost of liberalisation is too high to stomach.

4 TTIP may partly change this. It is a big initiative. And if the two biggest economies of the world go for a bilateral agreement, it means that there is a risk for other countries that stand outside that bilateral agreement and, which is important, other efforts to liberalise trade. That risk is mostly about not having a voice in the design of the trade reforms that are likely to serve as benchmarks in future international agreements. It is far less about losing current trade access – but it is about the fear of not having as good access to trade that will be liberalised in future. Consequently, if TTIP is the ‘real thing’, if it achieves the promise of ushering the world into 21st Century trade policy, the response from the larger emerging economies cannot be no response at all. The political and economic opportunity costs of status quo have changed.

4. Concluding comment

It is impossible to say if TTIP will deliver on its ambitions. There are several obstacles that stand in the way of success. Some of the obstacles are political: a bipartisan U.S. Congress, a U.S. President with a party divided on trade, political bickering by some EU member states, et cetera. Other obstacles are about substance – and especially two are criti-

cal. First, the risk that cross-border data portability will be seriously curtailed by the EU's new data protection regulation – and that the EU-U.S. Safe Harbour framework will be revoked. This risk has of course been amplified by the recent revelations of PRISM and accusations of large-scale U.S. government surveillance of European data telecommunication. Second, that the EU cannot agree to change some of its policies derived from the precautionary principle, especially its policy on GMOs. Both these issues need to be addressed if a deal should be politically feasible. And the current trend of policy is one of ever greater distance between the EU and the U.S.

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