The Transatlantic Trade and Investment Partnership and the Shifting Structure of Global Trade Policy

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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 that Free Trade Agreements (FTAs) are second-best alternatives to a dysfunctional multilateral system; while 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.[2]

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 GDP. The EU, for instance, considers its FTA in 2011 with South Korea to be a first-of-a-kind, 'new generation', '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 (CEPII 2010).

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 trade barriers other 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 has risen significantly for all countries involved, including the United States.

The European Union has just launched trade negotiations with Japan. Even if some observers seriously doubt whether this agreement will materialise, the potential benefits are sizeable and exceed any other bilateral trade agreement that 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 of these three initiatives 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. Agreements to reduce regulatory divergence, most probably by new horizontal rules and sectoral agreements like Mutual Recognition Agreements, will represent the biggest component of TTIP. Furthermore, it will involve an investment component to substitute current Bilateral Investment Treaties and to provide for new market access for investments. It will delve into other 'unfinished business' in trade policy, like openness in public procurement. And leaders on both sides claim that the agreement should serve as a platform for cooperating on discrete trade issues globally, such as competitive neutrality and state-owned enterprises.

However, TTIP and some of these ambitions are met with scepticism by some seasoned observers of trade policy – see, for example, Barfield (2013) and Langhammer (2013). Others, with less careful views, have also made sceptical contributions to the debate. Have

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[2] Bhagwati (2008) offers robust arguments against preferential trade agreements. My colleague Razeen Sally is also a notable sceptic of many FTAs, especially Asian FTAs – see Sally (2006 and 2007).

the EU and the United States not tried this before – and without success – complain some observers? Is this not just an attempt to create a 'Fortress Atlantic' as a defense 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 countries are rising to a position of economic power that could match the EU or the United States, the old Western powers take their business out of multilateral organisations to settle affairs bilaterally.

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

My answer to both questions is 'No'. Inarguably, 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 years, 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 that it is possible to determine the 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 United States, 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 instead 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.

Why TTIP?

The origin of TTIP, at least from the viewpoint of the European Union, is indicative of current trends in European cooperation. Leading voices in the European Commission have long been sceptical 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 prevent the EU from negotiation other, and better, trade agreements.

In Europe, TTIP was born out of initiatives taken by member states, especially Germany and Sweden, and the European Parliament.[3] 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 one argument in particular that has carried weight in Europe's process to favour a transatlantic trade initiative: the European Union needs higher economic growth. As a result, trade agreements that could deliver higher economic growth 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. 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 that the TTIP gain for the EU would be around 0.3–0.5 percent of GDP (the GDP gains are slightly smaller for the United States) – see Francois *et al.* (2013). Other estimates suggest that the potential gains may be larger (Felbermayr and Larch 2013) – and some trade economists in Europe have questioned the methodologies used in different studies.[4] Yet the 'official' estimate still suggests that TTIP will have a non-trivial impact on GDP in Europe: GDP should expand by approximately

[3] 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.

[4] 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).

120 billion euros, translating into a gain for the average four-person household of about 550 euros per year. It is rare 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 involved in negotiating TTIP.

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 on the margins. Hillary Clinton portrayed a transatlantic FTA as an 'economic NATO', but trade officials in the United States acknowledged 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.

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 effect 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 section will present my view. It is divided in two parts.

Firstly I will address the question of whether 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.

Firstly, neither the EU nor the United States 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 achieving 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 will also include a market access component. It is hoping to sign an Association Agreement with Ukraine and is negotiating an agreement aimed at opening up trade with Eurasia countries through its Eastern Partnership. It spearheaded Russia's entry into the WTO and wants to deepen its trade relations 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 continues. However, 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 that 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 US 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 United States no longer considers itself the hegemon of a global economic system and has fewer strategic goals associated with its trade policy. Like the European Union, the big shift in US trade policy over the past 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.

Secondly, 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 were to have strongly negative consequences on, for instance, EU trade with Asian countries – if trade diversion were to be sizeable – the net effect of an agreement would be close to negative. Such an agreement would be difficult to get accepted by many players that currently have vested interests in maintaining current relations with those Asian countries.

Furthermore, in today's world economy, the trade-liberalising agreement is not the tool that can be used to generate serious trade diversion. The effects of bilateral trade agreements on the actual geographical 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 United States 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, say, 3 percent to zero will have negligible effects.

A bilateral trade agreement between two low-tariff economies must be focused on effecting trade-preventing measures that have not been previously 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 made on a reciprocal and preferential basis: they tend to apply to other countries too. Let us look at the effect of TTIP on Sweden, for instance. A significant part, approximately two thirds, of the positive effect of TTIP on GDP will appear in the business services sector (one third of the estimated gains will come from the business services sector) – see National Board of Trade (2012). This sector has been comparatively closed in Sweden and the reforms likely to occur as a result 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 based on my observations rather than undisputed facts – is that TTIP is more likely to spur on new international trade deals than to deter them.

The short motivation for this view is based on politics. The most important factor in changing 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. An agreement like TTIP will make countries like China somewhat uncomfortable. 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. This kind of motivation probably played a part in China's decision to join the TISA negotiations.

Arguably, this is important to the vitality of the multilateral trading system and to chances to put new global trade liberalisation firmly on the agenda. Over 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 leadership by the United States, which considered this system to be critical to its overall strategic objective of spreading market-based capitalism. There were willing followers to the US leadership, but none other than the United States 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 changed somewhat. In the absence of political leadership and direction, the Doha Round got stuck because the political instinct of many countries was to favour the *status quo,* rather than new liberalisation, as long as there was no external pressure prompting 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 to greater foreign competition because they believe that 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.

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 to other countries that stand outside that bilateral agreement and, which is important, to 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 loosing current trade access – but it is about the fear of not having equally as good access to trade that will be liberalised in future. Consequently, if TTIP is the 'real thing', if it realises the promise of ushering the world into 21st century trade policy, the response from the larger emerging economies cannot be simply not to respond at all. The political and economic opportunity costs of the *status quo* have changed.

Concluding comments

It is impossible to say whether 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 US Congress, a US President with a party divided on trade, political bickering by some EU member states, etc. Other obstacles are about substance – and two in particular are critical. Firstly, the risk that cross-border data portability will be seriously curtailed by the EU's new data protection regulation – and that the EU-US Safe Harbour framework will be revoked. This risk has, of course, been amplified by the recent revelations of PRISM and accusations of large-scale US government surveillance of European data telecommunication. Secondly, that the EU cannot agree to change some of its policies derived from the precautionary principle, especially its policy on GMOs. Both of these issues need to be addressed if a deal is to be politically feasible. And the current trend in policy is one of ever greater distance between the EU and the United States.

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