The Transatlantic Trade and Investment Partnership agreement – a global win-win solution?

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Since the summer of 2013 the EU Commission and the US Government have actively been negotiating a new trade and investment agreement – the Transatlantic Trade and Investment Partnership – or in short TTIP, to cover trade in most goods, some services and also incentivizing investments through further liberalization efforts across the Atlantic. The second round of negotiations will be concluded in December and further negotiations will continue into 2014.

According to independent research conducted at the London-based think tank Centre for Economic Policy Research (CEPR) the benefits of the agreement are expected to be substantial and in the order of €95 billion per year on the US side and €119 billion per year on the EU side. Most of the gains are expected to result as gains from trade and 80% of these gains should result alone from reducing non-tariff barriers (NTBs) such as 'bureaucracy and regulations', according to the independent CEPR study. For example, according to the CEPR study[1] that draws extensively on the prior study conducted by the consultancy Ecorys, 'NTBs can either increase the cost of doing business for firms, or they can restrict market access'.

Table 1: Key facts about the Transatlantic Trade and Investment Partnership (TTIP)

% of world	US	EU	TTIP (US+EU)	World
Population	4.5	7	11.5	
GDP	25	27	52	
Foreign trade (goods & services)	10	38	48	
- hereof trade with TTIP partner	21	19	-	
Expected annual gains according to CEPR study	€95 billion	€119 billion	€214 billion	€100 billion

Source: World Development Indicators from the World Bank and CEPR (2013)

In part the TTIP initiative is considered by observers and trade experts as a result of the breakdown of the Doha Round, which is the major contemporary WTO forum for trade negotiations across all member countries developed as developing, now counting 159 member countries in total. However, the negotiations that were initiated in Doha, Qatar broke down over the course of 2008 and are not expected to be resumed in any immediate future.

We can also view the agreement as an attempt to optimize the trade engine in times of crisis among the richest countries in the world and the increasing trend towards rising income disparities in the most highly developed parts of the world. From the extensive work on new trade theories by the Nobel prize winning economist Paul Krugman we have learned that trade among similar level income countries is much less likely to cater to the traditional divergent interests of the classical factors of production such as capital and labour.

In the new trade theories benefits from international trade may arise on both sides of the Atlantic by leading to a seemingly greater choice in the variety of goods that we encounter as consumers. Whereas in reality the total number of firms will go down in any given industry which leads to a reaping of greater scale economies and thereby potentially lower prices for consumers in both the EU and US. In the real world we often encounter this effect as happening through mergers and acquisitions among some of the traditional rivals in each industry. Competition authorities around the world and especially in the EU and US spend thousands of man hours each year to estimate the likely effects of these mergers and acquisitions on end-consumers and whether these agreements could lead to higher rather than lower prices for consumers in the longer term.

In this short article I address what I think are considered the most salient and important questions that have not been investigated yet in depth, as to the global welfare effects of the agreement with a focus on developing countries and from the perspective of EU firms and consumers.

For developing countries the overshadowing question is on the effects of the agreement on their agricultural exports and a few other traditional developing country export strongholds such as textiles, including also more recent growing developing country industries such as electronics and cars. Developing countries should be concerned in particular about the potential trade diversion that the agreement could lead to. In some sense the agreement can be perceived as a nearing between two of the largest regional trading blocs in the world, potentially resulting in what would be a free trade regional mega-merger.

This is somewhat into the future; however, the preferential aspect of the agreement already now can give rise to what the Canadian economist Jacob Viner conceived as a trade diverting effect of regional trading blocs. This may seem a less obvious argument today where traditional trade barriers such as tariffs are low. This argument could hold equally for non-tariff barriers such as standards even though standards work in a qualitatively different way and are more complex to incorporate into the standard international economic toolbox.

For example, if the US and EU through the agreement agree to a universal set of standards it can potentially lead to a discrimination against developing country producers that are not reckoned to meet the same standards. One proclaimed aim of the agreement is in fact for the TTIP to set global standards. Therefore the agreement is more important for global welfare than we would immediately think.

A possible solution to this problem of recognizing standards from third country producers exporting into the TTIP could be the EU's current trade regime with developing countries, the General System of Preferences (GSP). On an experimental basis the EU has started to develop an NTB-oriented extension to this regime called the GSP+ related with standards and in particular ethical conduct and practice in areas such as human rights, good governance and environment. These standards often aim at disciplining the behaviour of the Union's own multinational producers operating out of developing countries and for good reason.

Even though economists like to think that multinational firms follow the highest standards when operating abroad, this is far from reality and it cannot be ignored that our producers feel they must follow the local institutions or rules of the game to survive in the tropics or Siberia. If the EU and the US allow, through the TTIP agreement, to leave a back door open for developing countries to be included in NTB aspects by agreeing to the same set of standards as TTIP producers, but by volition it could rule out a lot of potential trade diverting effects on developing countries. Furthermore, standards can create development in and by themselves simply by making growth inclusive to all and it is through this avenue that countries but perhaps not individuals become truly enriched.

For EU firms the most interesting aspect is the potential for more cross-Atlantic investment and related herewith the opening up for more rationalization of sourcing, production and marketing. Even though in business schools we teach about the global strategy of multinational firms, significant barriers still exist to the development of such truly global strategies. Often strategies are more regional than global in scope. The truth today is that while the EU firms have invested extensively in some parts of the world such as Eastern Europe and Asia, and the US has invested significantly especially in Latin America, most foreign direct investment (FDI) is still among the highest developed countries and in the EU most of the investment is in principle home market investment now that the Internal Market is a practical reality of doing business in Europe.

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This implies that there is a lot of scope for continued cross-investment over the Atlantic.

It is uncertain how much of this investment potential will be realized via more loose arrangements such as strategic alliances, collaborative ventures such as joint ventures or by establishing own subsidiaries via the greenfield or acquisition route. From an EU perspective in particular there could be the hope that the TTIP will help to trigger a greater spur or competition trigger on innovative efforts of firms and individuals in the EU, while also giving a wider room for collaborative ventures with the typically more innovation successful US firms.

At the same time should the EU also seek to maximize the gains from the agreement on their innovation prospects by opening up for more R&D intensive FDI from US firms. Exactly how this can be achieved through public policy and with the best results is one of the great research questions currently facing EU researchers specialized in innovation policy. For example, could regional policy efforts be better redirected at incentivizing R&D intensive forms of FDI, in particular centres of excellence, across Europe? Should Europe seek to copy the US venture capital model and could that give incentive for more R&D intensive investments from across the Atlantic? Will US takeovers of EU firms and vice-versa benefit the Union in terms of more R&D investment with us? These are salient questions that public policy-makers in the EU must consider.

The effect of more cross-Atlantic mergers and acquisitions is the large question with potential benefits for EU consumers. Will the TTIP pave the way for us benefiting more from the lower and competitive US prices? Or are these prices really a reflection of a different economic system inhabited by different institutions, fundamental values and beliefs?

For consumers, both price effects and the impact of negotiating and compromising on standards need to be taken into account. In the economic models that seek to capture with a single number the net-benefits of these types of agreements, often underlies extremely simplified assumptions about what happens when NTBs such as standards are removed.

The typical assumption is that taking away standards rather than adding them will be welfare enhancing. Here there is a need for advocacy for a combination of a quantitative and more qualitative approach to understand how institutions and preferences really affect the economic system. It cannot be assumed that these effects are always linear, eg. more is worse, less is better – it could be that the optimal standard is in the middle.

For example, the financial crisis has amply proven that standards in the financial sector are extremely important to uphold for the long-term benefit of consumers. Another important example is the food industry where China's experiences with wild capitalism unaccompanied by standards can lead to very inferior solutions in terms of food safety and security.

These gruelling lessons from the past must lead economics to look at its own assumptions more critically, since it might be suspected that our models in fact are wrong and that the standards, whether they pertain to the environment, food safety or labour rights, are in fact to the benefit of countries and that only those that seek them can expect to advance in terms of economic, social and human development.

Therefore the EU should not be lenient in negotiating standards with the US and needs to take a case-by-case approach.

A very positive effect of the TTIP might in fact result contrary to model predictions if the rule is followed that the highest standards should prevail. For example, if the US has higher standards for requirements to IT security as part and parcel of company policy those standards should prevail everywhere. Whereas the EU, with higher standards in terms of the requirements to energy efficiency of electrical goods and machinery including cars, those standards should take effect everywhere. In other words this is the opposite world of negotiating tariffs, the highest rather than lowest common denominator should prevail.

There may be a short-run adjustment cost but in the longer term the effects might be very beneficial. If cases are encountered where rules seem to be unjustified in common development goals such as a combination of pursuit of income, clean environment and human development, then of course policy-makers should seek to eradicate them. But only when based on common sense rather than simplified assumptions construed by economist to make models meet ends. If the developing countries through volition start to adopt the same set of standards that the TTIP could become exemplary off, eg. in setting the highest global standards, then the effect of the agreement on global welfare could greatly surpass any expectations that come out of the general equilibrium models. ■

1. CEPR, (2013), Page 16: 'Reducing Transatlantic Barriers to Trade and Investment – An Economic Assessment', Final Project Report by Joseph Francois, Miriam Manchin, Hanna Norberg, Olga Pindyuk and Patrick Tomberger, Centre for Economic Policy Research, London.