SCHWARTZ CENTER FOR
ECONOMIC POLICY ANALYSIS
THE NEW SCHOOL

POLICYNOTE

TTIP – A GOOD DEAL?

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INTRODUCTION

Since mid-2013, the United States and the European Union have been negotiating a so-called free trade agreement, by now labeled "Transatlantic trade and investment partnership" or TTIP in short. We suggest here that TTIP is a bad deal. First, the projected economic gains amount to not more than a rounding error. Over ten or more years, these come to roughly one hundred to one hundred fifty billion US dollars, which implies that the US were to grow 0.05 per cent per year faster than otherwise.[1] Second, none of these studies account for social, environmental or economic adjustment costs. Economic adjustment costs, for example, arise due to changes in employment patterns. As the labor force reorients itself, temporary unemployment, related social insurance, lost tax revenue and retraining costs will eat into the presumed long term gains. Third, available documents—of which there are few, because negotiations unfold under a quite impenetrable cloak of secrecy—suggest that TTIP is intended to be a "living agreement," which could permanently bias the legislative process in favor of multinational corporations.

FOREIGN INVESTOR PROTECTION

Two separate provisions serve this purpose, the investor-state-dispute-settlement mechanism and a regulatory cooperation council. An investor-state-dispute-settlement mechanism of this sort allows foreign investors to file a complaint of unfair treatment by the host government, and see the case refereed in secret by an extra-judicial and ad hoc arbitration panel.[2]

These mechanisms have been part of trade pacts for decades, and have—justly—received a lot of bad press. High profile cases include the Swedish energy company Vattenfall suing the German government for about $3.7bn over its decision to phase out nuclear reactors post-Fukushima. German energy companies cannot pursue this route: investment arbitration establishes inequality before the law. It does then pay, potentially, to have some foreign ownership. For example, Lithuanian investors, owning two per cent of a Ukrainian company, convinced the International Center for Settlement of Investment Disputes (ICSID) in Washington, DC, to hear a complaint against the Ukrainian government.

Historically, such investor protection was designed to buffer against expropriation. Developed countries sought to blunt the threat of populist nationalization in developing countries. (About two thirds of cases are brought against developing country governments.) Nowadays, arbitration clauses include provisions against indirect expropriation. Companies and arbitrators interpret these clauses to mean possibly anything that undermines "legitimate expectations" on profitability. On these grounds, Philip Morris is suing Uruguay and Australia over cigarette packaging laws. If your pack of cigarettes must be plain, and show terrifying pictures, your profits could suffer. And if your government wants to protect public health, it first must pay off foreign investors! Not surprisingly, several countries—South Africa, Indonesia, and Australia among them—will not sign further investor protection clauses, and let existing onces expire when possible.

Why would TTIP need investor protection? Is the French government plotting to nationalize McDonald's subsidiaries? Probably not. But societies do occasionally want to implement laws and regulations in the public interest that potentially weaken profitability in particular sectors. They should obviously maintain that right, and exercise it without the sword of arbitration swinging over their heads. Further, there is no evidence that investor protection increases FDI flows. Especially between two such juggernauts, the US and EU, with well developed legal systems, investor protection cannot be expected to trigger a flurry of FDI activity—whereas one might expect a flurry of requests for compensation! In Europe, fiery public opposition to arbitration—in the UK with regard to the national health system, in Germany over the Vattenfall case—has pushed Juncker, the incoming EU commission's president, to question whether it can (or should) be included in TTIP. In the US, there is no public debate of the issue—but a strong desire by political and business elites to maintain investor arbitration as the gold standard of corporate protection.

REGULATORY COHERENCE

The provisions on regulatory coherence introduce truly novel aspects. A council would be formed, and dialed in directly to the legislative and regulatory discourse in Brussels and Washington. According to a leaked position paper, the council would be staffed by regulators, but consider input from private sector stakeholders.[3] In other words, such a council would institutionalize a foot in the door for business lobbyists. Investment arbitration and a regulatory

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council together can be expected to lead to what is called regulatory chill, and de facto hinder regulators from pursuing the public's interest.

Achieving regulatory coherence is a cornerstone of TTIP. The simple reason for this emphasis is that traditional trade barriers between the US and EU are already very low: trade weighted average tariffs are less than five per cent. Thus, the remaining impediments to trade are so-called non-tariff barriers. Based on an extraordinarily expansive definition, TTIP appears to identify essentially any legal or regulatory divergence between the EU and US as a barrier to trade. (More on that further below.) To realize some degree of regulatory coherence, one must look back as well as towards the future.

The first crucial question therefore is how to deal with the truly vast number of laws and regulations currently in place. It is probably not practical to negotiate all of these individually, which leaves the parties to either take them as they are—and achieve no backward looking regulatory coherence—or cut across all of them through mutual recognition, or recognition of equivalence. What the latter would imply is not entirely clear. However, it appears that different regulations would remain in place, and would be accepted on both sides. It is not difficult to see that such an arrangement would prescribe a race to the bottom, as firms in compliance with the more expensive set of regulations have a cost disadvantage.

The next question then is how to deliver forward looking regulatory coherence. A council of sorts might serve this purpose. Quite sensibly, it might allow regulators and stakeholders—business, unions, consumer groups—to pro-actively debate the relevant issues, to avoid duplication, etc. However, quite worryingly, the tone of available documents suggests that regulatory coherence has only one goal: to increase transatlantic trade. [4]

And that is the eight hundred pound gorilla in the room. Regulations serve a variety of purposes. Chief among these is the desire to address market failures. A market fails, for example, when economic actions by firms or households produce a cost to society that the individual units do not have to account for. In the jargon, not all costs of the transaction are internalized, so that a negative externality exists. In a nutshell, many regulations are designed to redress externalities. The regulation then produces social benefits. One could try to carefully weigh the benefits to society against the costs to firms (or households).

The proposed regulatory council indeed seeks to make such cost-benefit analysis mandatory for new regulations. Ideally, regulators and stakeholders could have an informed debate on the basis of such analyses. However, with limited capacities on regulator's side and limitless financial firepower of business lobby groups, mandatory impact assessments, as they are called, are more likely to stifle debate and add to regulatory chill. In this sense, regulatory coherence contributes to TTIP's overriding goal of increasing transatlantic trade only if it reduces firm costs. (Obviously, harmonization could in principle mean to apply the highest regulatory standard. That, however, would increase firm costs on one side of the Atlantic, and result in reduced trade.) The implicit emphasis of TTIP is therefore to deregulate, and to only recognize the costs of regulations, rather than both costs and benefits.

NON-TARIFF BARRIERS AND ECONOMIC MODELS

Efforts to quantify the economic impact of TTIP mirror this emphasis.[5] The studies consider non-tariff barriers and regulations as trade costs, and therefore "bad." Reduction of costs leads to increases in transatlantic trade flows. All models, in one way or another, assume that unemployment is not a problem. In consequence, higher trade flows lead to higher incomes. Whether these income increases come with higher social, environmental or economic costs due to the removal of beneficial regulations is simply not addressed. Similarly, that such income increases actually materialize over the next ten to twenty years is a feature of the models—whether it would be a feature of real world development is quite uncertain. Short run socio-economic adjustment costs are not considered, and therefore cannot be weighed against the presumed long run benefits.

For the sake of the argument, let us take these biases built into the models as given. Then, the model-projected benefits hinge to a large degree on the magnitude of non-tariff barrier reductions. The larger the existing trade costs, and the larger the portion that is removed with implementation of TTIP, the larger is the calculated gain in incomes. So, how high are EU-US non-tariff barriers?

Traditionally, non-tariff barriers are considered to be all international trade policy measures excluding tariffs, plus a variety

Table 1: Main Findings of Four Studies on the Economic Effects of TTIP

	Ecorys (2009)*	CEPII (2013)	CEPR (2013)	Bertelsmann/ifo (2013)
EU GDP	0.35 - 0.72	0.0 - 0.5	0.02 - 0.48	0.52 - 1.31++
US GDP	0.14 - 0.31	0.0 - 0.5	0.01 - 0.39	0.35 - 4.82++

Notes: *Findings for ambitious and limited scenarios only; +Reference scenario only; ++Own calculation of GDP changes based on BMWT/ifo (2013, Tables A.II.5 and A.II.6), aggregated to GDP-weighted EU-27 level. Source: adapted from Table 1, page 4, Raza et.al. (2014) and the above studies. See text for further details.

of "natural" factors, such as language, culture, historical ties as well as the use of different currencies. All of these are unobservable, and hence must be estimated.[6] The studies on these trade costs—on which the reports on TTIP build—suggest that trade policy-related non-tariff barriers between advanced countries are about four per cent. To provide an estimate specifically relating to TTIP, Ecorys[7] expanded the traditional definition of trade costs to include "… behind-the-border measures flowing from domestic laws, regulations and practices" (Berden et.al. 2009, p. xiii), and asked business on both sides of the Atlantic to answer the following question:

> "Consider exporting to the US (EU), keeping in mind your domestic market. If 0 represents a completely 'free trade' environment, and 100 represents an entirely closed market due to NTMs, what value between 0 – 100 would you use to describe the overall level of restrictiveness of the US (EU) market to your export product (service) in this sector?"
> Ecorys (2009, p10)

Clearly, the question is geared to assess business perceptions on trade restrictions, rather than estimate actual trade costs. Unsurprisingly, the resulting indexes suggest that non-tariff barriers are indeed up to four times as high as in the standard literature. Of these restrictions, Ecorys argues, on the basis of interviews with sector experts, twenty five to fifty per cent might be actionable, meaning realistically removable. It is difficult to compare these numbers, as they are based on such different methodologies. However, the bottom line is that Ecorys claims that TTIP can reduce trade costs by roughly four to eight per cent—at least as much as or more than the sum total of traditionally estimated non-tariff barriers. This inflation introduces a further upward bias into model results.

IS A ROUNDING ERROR WORTH THE TROUBLE?

Despite all of this, the projected benefits are paltry, at best. The median estimates—depending on models and scenarios—for both EU and US barely get to a half per cent additional growth over ten (or more) years. (See Table 1, which shows the long run or "steady state" effect.) That translates to less than 0.05 per cent additional growth per year. If the US economy grows on average two per cent per year, it would grow 2.05 per cent per year with TTIP. TTIP is projected to produce positive GDP effects on the order of a rounding error—without counting adjustment costs in the short and medium run, and without counting the social, economic and environmental costs to society from the removal of regulations. For Europe, a back-of-the-envelope calculation of economic adjustment costs suggests TTIP could cost between €30bn and €60bn.[8] These have to be compared to long run economic gains of roughly €60bn to €130bn—in other words, fifty percent or more of the upwardly biased estimate of gains are eroded over the medium run.

To summarize, we might compare TTIP to a 'traditional' trade agreement. In a traditional trade agreement, the parties commit to reduce tariffs. According to the textbook view, a tariff shields a certain set of firms from competition, and thus provides a benefit to these. The tariff presents a cost to society, since prices will be higher than otherwise. In this sense, the gains—lower prices—from a traditional trade agreement are diffuse, whereas the loss—increased competition—from the agreement is concentrated. TTIP flips this on its head. Benefits of current regulations are diffuse, and costs concentrated. As TTIP seeks to reduce regulations through the practice of regulatory coherence, an agreement would likely provide significant gains to specific firms, on the back of the general public interest. For that reason, it is an extraordinarily bad deal.

ENDNOTES

1 As Public Citizen's TAFTA factsheet outlines, this amounts to a few "cents per person per day," see http://www.citizen.org/documents/TAFTA-economic-factsheet.pdf, accessed 12/17/14.

2 For further discussions of investor-state-dispute settlement mechanisms, see Eberhardt (2014) and UNCTAD (2013).

3 See Corporate Europe Obvservatory, "Regulation – none of our business?" http://corporateeurope.org/trade/2013/12/regulation-none-our-business, accessed 11/13/14.

4 See O'Brien (2014) for a discussion of these issues, and the 'tone' in available documents.

5 See Berden et.al. (2009), which is the "Ecorys study," CEPR (2013), which is the CEPR study, Fontagne et.al. (2013), which is the "CEPII study," and Felbermayr et.al. (2013a), which is the "Bertelsmann study," as well as our extensive discussion of the underlying models in Raza et.al. (2014). It should be briefly noted that Ecorys and CEPR employs the same model (and author); CEPII features a very similar model; and all these three use the same set of non-tariff barrier estimates from Ecorys.

6 In principle, the incidence of non-tariff barriers is observable (though data is sparse). However, the relevant issue is the restrictiveness of existing barriers; that is, their tariff equivalent.

7 See Anderson and van Wincoop (2004) for a much-cited study in the academic literature. Berden et.al. (2009) represents the Ecorys study. Anderson, one of the authors of the 2004 paper, acted as a consultant for Ecorys's report.

8 This calculation adds costs of unemployment insurance, loss of tax revenue due to higher unemployment, expenditure on "trade adjustment assistance," and loss of tariff revenue, which feeds into the EU Commission's budget, and is based on estimates of temporary job losses. See Table 5, page 18, and related discussion in Raza et.al. (2014).

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