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Potential impacts of the Transatlantic Trade and Investment Partnership (TTIP) on developing and emerging economies

Study by the Ifo Institute, Munich, and the Institute for Applied Economic Research (IAW), Tübingen

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1. Background

- Easy *access to international markets* is crucial for the future prosperity of Germany and Europe. An open, reliable, well-regulated partnership between the EU and the U.S. can lend significant impetus to world trade and help to make it sustainable.
- On the one hand, TTIP will incorporate a *classic free trade agreement*. On the other hand, the two sides also want the Partnership to make a contribution to the rules of world trade for the 21st century, especially in the area of *regulatory cooperation*.
- TTIP would have a direct impact on about 45 per cent of global value added and 30 per cent of world trade. According to the latest estimates, Germany's *real per capita income* will grow by between 1.0 per cent and 3.5 per cent in the long term as a result of TTIP.
- But *impacts on third countries* must also be expected. Excluding energy resources, the EU imports more from developing countries than the U.S., Canada, Japan and China combined. But the United States, too, is an important market for developing countries. For 30 per cent of third countries, trade with TTIP countries accounts for more than 50 per cent of export turnover.
- The negotiating mandate of the EU Commission repeatedly highlights *sustainable development* as a major goal of the contracting parties and states that the Commission is committed, in principle, to making TTIP development-friendly. It is envisaged to monitor sustainability, not least from a development perspective, based on regular dialogue with other stakeholders, including civil society.
- The present study looks at whether and how TTIP could become the basis for an equitable and revised multilateral world trading system. The factors that are needed for this should be taken into account in the negotiations.

2. Development challenges

- Third countries may benefit economically from TTIP because the income and production gains generated in TTIP countries will result in *increased demand* for export goods from third countries (raw materials, semi-finished products, services, tourism). Additional exports mean higher incomes for the third countries in question.
- However, bilateral agreements also lead to *trade diversion*. Suppliers from TTIP countries enjoy better price competitiveness because of lower internal trade costs in the Partnership countries. This may be to the detriment of suppliers from third countries, who may lose market share in the EU and the U.S. Sometimes this effect may outweigh the first effect.

- Many developing countries export goods that are subject to high tariffs in the TTIP countries (such as textiles, shoes, and processed foods). While they are usually eligible for tariff-free access thanks to unilateral EU and U.S. trade facilitation measures (generalized systems of preferences, Everything But Arms initiative, etc.), these preferences will be eroded by the elimination of tariffs in EU-U.S. trade, which may result in developing countries losing market share in TTIP countries (*preference erosion*). This effect may make it more difficult for them to gain a foothold in high-value added activities along industrial production chains.
- *Regulatory cooperation*, too, might mean benefits for developing countries because they would only need to meet one reliable standard in both trade areas. The costs of customizing their export products to markets would drop. However, regulatory cooperation within the Partnership might also result in disadvantages for developing countries. Standards that work excellently for the EU and the U.S. do not necessarily work for poor countries too. That is why, under TTIP, care must be taken to ensure that transatlantic regulatory cooperation will take developing countries' interests into account in an equitable manner.

3. Findings from expert interviews

- Representatives of business associations felt that the *trade diversion effects* would be negligible. Civil society representatives were more skeptical.
- Experts emphasized that TTIP might result in discrimination in international *value chains* and highlighted the need for defining rules of origin that reflect the needs of developing countries.
- Civil society representatives noted that TTIP might result in high *sustainability standards* that some developing countries may find hard to meet.
- The majority of experts felt that the *investment protection regulations* of TTIP would not necessarily result in negative effects for developing countries.
- Experts emphasized that developing countries should increasingly raise their voices in the *WTO* and make use of the mechanisms provided under *WTO* rules in order to counter discriminatory effects. On the other hand, some experts pointed out that TTIP might reduce the significance of the *WTO*.

4. Findings from quantitative studies

- All the studies examined arrive at the conclusion that TTIP will generate positive income effects for the EU and the U.S. Real incomes worldwide would rise as well. This means that TTIP is *not a zero-sum game*.
- Negative trade diversion effects and positive income effects must be offset against each other in the model calculations. Based on the assumption that there are no spillover effects (reduced trade costs for third countries), microeconomic studies – which are best suited for assessing impacts on developing countries – showed small *negative effects on real income for 42 to 80 per cent of third countries*. With spillover effects, that figure is lower, varying between 3 and 40 per cent.
- These *welfare losses are not dramatic*. On a cumulative basis, over a period of ten to twelve years, they are equal to less than one per cent of per capita incomes. Based on an annual trend growth rate of about 4 per cent, this would translate into growth losses of barely more than one fortieth.
- Macroeconomic studies, which refrain from modeling sector details and value chains, report higher negative effects on developing countries. According to these studies, individual TTIP outsiders would be headed for long-term losses in real income of up to approximately 2 per cent if TTIP changes the comparative advantage structure and if there are no spillover effects. But even this is a small figure if seen in relation to annual trend growth rates of 4 per cent.
- TTIP would slightly reduce the relative significance of third countries in the foreign trade of the EU and of the U.S. Many developing countries would instead increase their trade with *East Asia* (raw materials) and *other OECD countries* (industrial goods).

5. Findings from case studies

- More than 90 per cent of all exports from **Bangladesh** are textiles. Two thirds of them go to TTIP countries. Eliminating tariffs on textiles within the TTIP area would result in trade diversion to the detriment of Bangladesh. If one takes into account increased demand from the EU and the U.S. for textiles as a result of enhanced incomes, most of the diversion effect will be offset, meaning that Bangladesh's per capita income would hardly change at all.
- In **Brazil**, exports only account for about 13 per cent of GDP. One third of these exports go to TTIP countries – mainly raw materials (oil, iron ore), agricultural commodities (soy, fruit) and airplanes. Trade diversion must be expected for agricultural

goods (for instance fruit juice) but not for raw materials. Most simulation results say that Brazil will experience low losses in real income.

- Exports account for about 55 per cent of **Côte d'Ivoire's** GDP. About half of its exports go to TTIP countries, mainly cocoa beans and cocoa products. No trade diversion effects are to be expected for non-processed goods, but TTIP might make it more difficult for Côte d'Ivoire to enhance its market share in high-value added cocoa products, because high MFN tariffs apply to this on both sides of the Atlantic. However, studies find that, given the specific structure of Côte d'Ivoire's exports, the country will only experience low losses in real income.
- In **Indonesia**, less than one quarter of all exports go to the EU or the U.S. – mainly agricultural and forestry products (rubber, palm oil, coconut) and textile products. Indonesia would hardly be affected by TTIP at all. The volume of trade with TTIP partners is too low, and TTIP countries are not competitive enough when it comes to Indonesian export goods. Indonesia might benefit from lower prices for imported capital goods from TTIP countries if their production becomes cheaper as a result of regulatory convergence between the EU and the U.S.
- **Kenya's** exports account for about 28 per cent of its GDP. Tourism makes up almost half of this. This sector is likely to benefit from TTIP because higher incomes in the EU and the U.S. will translate into greater demand for long-distance travel. Flowers and vegetables account for one third of all exports of goods; textiles account for another tenth. Trade diversion may be expected in these sectors, but not for tea or coffee, important export commodities. Simulation studies for Kenya typically show small positive effects, but taking account of the specific trade structure makes a crucial difference in this regard.
- **Morocco** is closely integrated into European automotive companies' value chains. The country should benefit from TTIP, especially if the agreement reduces trade costs for Moroccan exporters (as a result of regulatory convergence). Positive effects are also to be expected in the service industry, while the textile sector might experience losses. On balance, most studies expect positive welfare effects for Morocco. If regulatory convergence within TTIP turns out to have discriminatory effects, Morocco might be pushed out of global value chains, which may result in welfare losses in the long term.
- Almost 80 per cent of **Mexico's** exports go to the United States. As a result of increased competition with European producers, Mexican companies might lose market share. However, Mexico's close integration into North American value

chains, especially in the automotive and electric industries, affords some protection against such losses. Whether Mexico will be able to benefit from TTIP depends crucially on the emergence of spillover effects. They can reduce Mexican exporters' costs of trade with the EU and the U.S., which is particularly significant in view of the major role of the U.S. for Mexican exports.

- One third of **South Africa**'s exports go to the EU or the U.S. More than half of these exports are mineral resources, which are not expected to be affected by any trade diversion effects. In the automotive sector, South Africa is well integrated into transatlantic value chain networks, which reduces the risk of trade diversion and enhances the country's chances of benefiting from regulatory cooperation between the EU and the U.S. However, there is a risk that South Africa will be pushed even further into low-value added extractive industries.
- **Turkey** has a customs union with the EU, meaning that it applies EU external tariffs. However, Turkey has not been taking part in the TTIP negotiations. So it will not automatically benefit from reciprocal tariff reductions between the EU and the United States. In other words, TTIP would open Turkey's market for U.S. products but Turkish exporters would not benefit from similar privileges in the U.S. market. However, Turkey is well integrated into European value chains, so that exports of semi-finished products to Europe will grow. In this way, the export of Turkish value-added products to the U.S. might grow indirectly. The country will also benefit from lower import costs, which may result in welfare gains even without any spillover effects.

6. Recommendations

1. In order to make sure that TTIP will really be able to contribute to an equitable and sustainable world trading system, the following principles should be incorporated in the agreement:
 - (i) avoid complex rules of origin to the greatest extent possible; instead, establish the principle of free movement wherever possible;
 - (ii) expand the mutual recognition of transatlantic standards to third countries to the greatest extent possible;
 - (iii) grant developing countries the right to access to information about the work of bodies that set future standards;

- (iv) avoid the diversion of protectionist tendencies to TTIP outsiders and make sure that there will be no combined effects from the coordination of such measures;
 - (v) develop a credible vision for the future participation of third countries and developing countries.
2. The following accompanying measures should be pursued outside the TTIP agreement:
- (i) multilateral reduction of MFN tariffs and other trade barriers for particularly significant export goods (such as textiles, shoes, cotton, and tobacco);
 - (ii) political support for developing countries as they form their own regional free trade agreements; provision of technical assistance based on EU and German expertise;
 - (iii) expansion and deepening of existing trade agreements between the EU and various developing countries in terms of regulatory aspects;
 - (iv) support for unilateral and multilateral initiatives to foster developing countries' inclusion in global value chains through suitable development instruments;
 - (v) efforts to strengthen the WTO's role of a "coach" so that it can enhance its advisory support to developing countries on how to counter discriminatory policies.