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TTIP: Political and Economic Rationale and Implications — Source link

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TTIP: Political and Economic Rationale and Implications

The Transatlantic Trade and Investment Partnership will reduce tariffs and lower regulatory hurdles that currently impair trade between the EU and the US. However, TTIP has been controversial from the outset. Non-governmental organisations are concerned about lowered health and environmental standards, unions fear a further weakening of labour conditions, and economists debate whether or not there will actually be any noticeable impact on employment and GDP growth. This Forum, featuring contributions by the speakers at the 2015 Intereconomics conference, presents a balanced overview of both the prospective benefits as well as the possible drawbacks to the potentially monumental trade agreement.

Jacques Pelkmans

TTIP: Definition, Rationale and Significance

The Transatlantic Trade and Investment Partnership (TTIP) is a comprehensive bilateral trade and investment negotiation between the US and the EU with strong regulatory features. The intention is to achieve not only a comprehensive but also a "deep" agreement, with much lower costs of market access and bilateral trading than today. Technically, for such agreements to comply with the World Trade Organization (WTO), with all its disciplines and care to remain as non-discriminatory as possible, they are legally free trade agreements (FTAs), even if the elimination of tariffs between the two parties is only one of several characterising features. The emphasis in TTIP is on regulation, insofar as differences in regulation, especially with respect to the instruments and enforcement, can be more cumbersome than necessary, thereby rendering bilateral trade more costly than it needs to be. In some sectors, such unnecessary costs can be high.

In other words, the core of TTIP is about the unnecessary costs of technical barriers to trade (TBTs), sanitary and phytosanitary (SPS) barriers (in food and feed regulatory instruments), and other regulatory barriers in goods and services markets. Furthermore, the partnership aims at preventing, where possible, new unduly costly barriers from arising. TTIP is meant to become an advanced trade agreement, but most of the issues are neither new nor unique to TTIP. It is also not about the objectives ("levels") of health, safety and environmental protection. Less ambitious forms of addressing TBTs and SPS barriers are routinely undertaken in the world economy – at the WTO level under the WTO TBT and SPS Agreements, in force since 1995 – as well as bilaterally or regionally in FTAs. In such agreements and in the TBT/SPS Committees in Geneva, great care is taken not to impede upon the national right to regulate while still reducing trading costs by obeying certain good regulation principles and WTO disciplines. Careful WTO case law by the WTO Appellate Body has given much authority to such efforts. TTIP also includes issues related to intellectual property rights (IPRs), especially with regard to food products and beverages with geographical indications (GIs), and public procurement discrimination, as well as its effective openness.

It is important to stress that the emphasis on many regulatory features is nothing new and is not a special feature of TTIP. The WTO has a large number of special agreements besides the General Agreement on Tariffs and Trade (GATT) and General Agreement on Trade in Services (GATS) which, for the most part, comprise regulatory features. These include certain customs procedures (including pre-shipment inspection or customs valuation), TBTs, measures against plant and animal diseases (SPS), disciplines about local trade conditions of investment (TRIMs) and disciplines for intellectual property rights (TRIPs). The WTO, which is now 20 years old, is therefore long familiar with the combination of trade and investment, on the one hand, and regulation, on the other.

When FTAs are WTO-plus, it is mostly these regulatory features which are enhanced. TTIP falls squarely in the category of the WTO-plus types of FTAs. Is it as special or novel as some contend? Does it move into uncharted territory and hence put the regulatory achievements of the EU at risk? The short answer is no. In terms of substance and scope, TTIP is comparable to CETA, the Canada-EU Comprehensive Economic and Trade Agreement, which is not yet ratified. Some EU proposals for certain aspects of TTIP go further than have been negotiated in FTAs elsewhere. On the other hand, CETA also has novel features, and not all of these are likely to appear in TTIP. And although the EU-Korea FTA of 2011 is somewhat less ambitious, it is still an advanced FTA, not least because of its four sectoral (regulatory) annexes.[1] TTIP is supposed to lead to a "living agreement" led by a Regulatory Cooperation Body, but this is not really very different from the FTA with Korea. The latter has active working parties on the four sectoral annexes, on customs procedures and rules of origin, on trade in goods (mainly on TBTs), on government procurement, on GIs, on SPS, on sustainable development, on trade in services, on trade remedies, and one on outward processing zones on the peninsula. The substance of TTIP is therefore nothing more than a logical next step in how the EU has tried to develop its FTAs since about 2006. Also, the scope of horizontal and sectoral policy or regulatory domains in TTIP is surely rather wide, but no more so than in CETA and not radically different from the EU-Korea or EU-Singapore FTAs. Incidentally, from what we know of the Trans-Pacific Partnership (TPP) thus far, it also deals with many regulatory issues and its scope is rather broad, though presumably less deep and binding than what TTIP is aiming for.

The main difference in TTIP is the size of the two economies. The only other bilateral coming somewhat close is the ongoing negotiation between the EU and Japan. The only regional one that is larger is the TPP, which still has to be ratified (and that is not entirely sure). The EU and the US have traditionally been the leaders and protectors of multilateralism. Their leadership is not yet finished, but it has been diminished as the economic rise of the BRICS and the large membership of WTO nowadays have reduced the dominance of the two. In the near future, the Atlantic "bi-gemony" is bound to decline even further. Yet today, the importance of a common, credible and deep initiative of the two overshadows any other FTA. Economic size is therefore the only argument that renders TTIP unique.

TTIP is a potentially important regulatory trade and investment agreement, no less and no more. In order to succeed, the challenges to be met consist of regulatory leadership for a number of horizontal and sectoral chapters as well as the difficulties in overcoming systemic or traditional differences in the instruments of domestic regulation which cause stubborn and costly TBTs as well as other costly regulatory barriers. The objectives of EU and US regulation are not at issue, but more often than not, the "levels" of protection are similar, which should make it easier to address the unnecessary costs of the instruments or seek forms of "equivalence" (given similar objectives).

Understanding the scope of TTIP

It is useful to grasp the scope of the TTIP agenda. Figure 1 distinguishes three columns of TTIP negotiation

1 On the automotive, chemicals, pharma and medical devices sectors.

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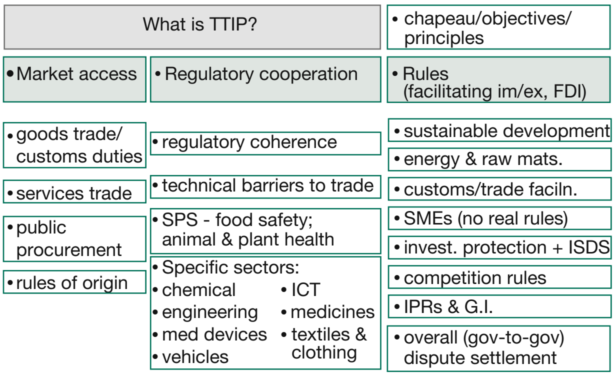
Figure 1
The structure of TTIP negotiations



Source: D. Hamilton, J. Pelkmans: Rule-makers or rule-takers? An introduction to TTIP, in: D. Hamilton, J. Pelkmans (eds.): Rule-Makers or Rule-Takers? Exploring the Transatlantic Trade and Investment Partnership, Rowman & Littlefield International, London 2015, p. 10.

issues, besides the customary "chapeau" of objectives and principles. The first column, market access, comprises the traditional tariffs and customs matters, origin rules, government procurement, and services (curiously, without sectoral services annexes, unlike e.g. CETA). The original idea of an FTA is to remove tariffs for trade between the two parties, but this is now merely a relevant but certainly not prominent element of TTIP.[2] Outside agriculture, US and EU tariffs are low (with very few peaks), and indeed many are already zero. However, even in this classical market access column, regulatory issues play a significant role (particularly in services).

The second column is entirely focused on regulatory issues – more precisely, on whether the costs of differences in regulation or its technical enforcement for bilateral trade can be substantially lowered. This is the hard core of TTIP. Based on a history of more than two decades of consultations, exchanges on regulatory regimes, mutual recognition agreements (MRAs) regarding conformity assessment results and a string of specialised bilateral successes on overcoming regulatory barriers, the motivation to increase ambitions is found in these areas. The primary focus is on TBTs and SPS questions, as well as on sectoral committees of regulators going further and attempts to address such issues horizontally in a Regulatory Cooperation Body.

The third column contains selective regulatory features as well, e.g. IPRs and GIs, investor-to-state dispute settlement (ISDS), and competition and state-owned enterprises. However, it does not entirely live up to its label "rules".[3]

What TTIP is not

So far, there has been much "campaigning" about TTIP and rather little analysis and in-depth policy debate.[4] The campaigning is the consequence of highly exaggerated and often misplaced social media accusations, gone unchecked or at first ignored by policy makers. This has become so extreme that there seems to be no connection between these campaigns and the emerging policy debate on TTIP. The two seem to move in a parallel fashion. The campaigns appear immune or uninterested in the (belated) counterarguments and the firm rejection of the "myths about TTIP".[5] An unusually large number of documents have become available on TTIP, including negotiation papers, but their download rates are low. If there is any dialogue at all, it is a dialogue of the deaf.

The practical effect is that TTIP opponents create "straw men" which caricature TTIP and which can be fought vigorously, presumably to please NGO members or impress national and EU lawmakers. The many straw men out there turn TTIP into what it is decisively not and make TTIP more intrusive than what it is or indeed could possibly be. TTIP in and of itself does not change the objectives of regulation, that is, the levels of protection against risks towards safety, health, the environment or consumer (or saver, or investor) detriment. Why do campaigners turn against TTIP with such unreasonable vigour when they could have done the same – but never did – with respect to the EU-Korea, CETA or EU-Japan negotiations, or indeed the WTO SPS and TBT agreements and the latter's 25,000 notifications of new technical regulations by WTO parties over 20 years?

These FTAs and the TBT agreement work, not only because objectives of regulatory protection are never at

2 In D. Hamilton, J. Pelkmans (eds.): Rule-Makers or Rule-Takers? Exploring the Transatlantic Trade and Investment Partnership, Rowman & Littlefield International, London 2015, we made a choice not to include a separate chapter on tariff removal, except for agro-food tariffs and tariff-rate quotes, which are dealt with analytically in T. Josling, S. Tangermann: Agriculture, food and TTIP: possibilities and pitfalls, in: D. Hamilton, J. Pelkmans, op. cit.

3 The rules referred to are multilateral or plurilateral rules, possibly to be upgraded in TTIP, that serve as an example.

4 In this limited space, there is no room to discuss the slowly emerging policy literature about TTIP. D. Hamilton, J. Pelkmans, op. cit., is the first comprehensive volume on TTIP. However, a series of solid contributions that has gone too little noticed has been solicited by the trade (INTA) and internal market (IMCO) committees of the European Parliament, and, on specialised topics, by its Legal, Industry, Environmental and Economic committees.

5 See, for example, European Commission: The top 10 myths about TTIP, Publications Office of the European Union, Luxembourg 2014.

stake, but also because national or EU regulators do not like to be governed by trade rules, and they are legally bound to give primacy to the levels of protection enacted in such agreements. Key terms such as harmonisation (very rare in practice outside the EU), mutual recognition, "equivalence" and MRAs (for conformity assessment) are all already in the TBT agreement, and they have been used for decades. There are around 140 MRAs[6] in the world (including one between the US and the EU from 1998) and some equivalence agreements (e.g. the US-EU Veterinary Agreement of 1998, which works partially,[7] and one on aircraft certification between the US and the EU from 2009). Both veterinary and aircraft safety matters are sensitive areas.

In the "Regulatory cooperation" column of Figure 1, TTIP is more of the same, but even deeper than previous agreements. This is difficult, precisely because national (or EU) regulators wish to be (and should be) in control, even when the overall framework is a trade agreement. It is puzzling to observe that all kinds of sentiments that could have played just as large a role in e.g. aircraft certification or selected food issues under equivalence are suddenly played up to enormous proportions now that TTIP is being negotiated. Most of the campaign material of the various anti-TTIP groups seems to be based on a profound lack of trust. Some NGOS fear that EU (or US) regulators cannot withstand multinational business lobbying, given their "disproportionate" influence. But why would that be true now and not in the two prior decades of EU-US regulatory cooperation? Have campaigners forgotten that the Trans-Atlantic Business Dialogue, consisting of CEOs of large EU and US companies, attempted for a decade with great efforts and creativity to reduce the costs of regulatory barriers after the Madrid US-EU summit of 1995? And that, despite this highest level of engagement by the business elites, rather little was accomplished because regulators were loath to follow? Why would a Regulatory Cooperation Body – which cannot of course make laws but can merely prepare initiatives for national legislators to adopt or reject – suddenly be more influenced by business than it has been in the past and, for that matter, more than by very noisy and assertive NGOs, labour unions and consumer groups like the European Consumer Organisation? Why would this set-up be fundamentally different from what has already been happening for years under EU-Korea? True, in the EU proposals for TTIP regulatory cooperation and TBTs, there are stronger incentives to come to joint proposals than in e.g. CETA, and there are more sectoral groups, but the practical difference to the outcome of the many working groups under EU-Korea is not a priori all that different, and if it were, it still has to be approved by the lawmakers, with consultation and impact assessment first. Moreover, as CETA has shown, such EU proposals may not be accepted so easily in North America and are likely to be watered down.

Moreover, the straw men created often narrow TTIP down to only one or two topics, with the greatest prominence given to ISDS. The scope illustrated in Figure 1 is conveniently ignored, as are the costs of rejecting TTIP on the basis of only one of its elements. But is ISDS in TTIP the problem? If one wishes to focus on ISDS, the answer is that the genuine and far more problematic issues related to ISDS are *not* in TTIP.

The huge and painful inconsistencies of some German politicians and NGOs in declaring themselves uncompromisingly against ISDS become apparent when one realises that ISDS originates from Germany, which has many BITs (bilateral investment treaties) comprising ISDS. These outdated BITs should be the first and foremost target. The CETA approach to ISDS constitutes a welcome modernisation, with no less than 11 concrete improvements,[8] even though one might reasonably take the view that this is still not enough of an improvement. However, if the CETA approach or a further improved version of ISDS were to be accomplished in TTIP and Germany were to oppose it, the odd situation would arise that the country would continue to apply its large stock of old and biased pro-investor BITs – often with developing countries – while rejecting a much better ISDS in TTIP with a developed country, with more guarantees for the "right to regulate" and safeguards against improper conduct by investors. Why do critical German MPs and others not turn against their own outdated (130+) BITs?

Rather than fight TTIP, it would be more reasonable to devise a programme for urgently addressing the 1300 BITs of EU countries, BITs which are far less "balanced" and provide scope for frivolous claims by clever investors. Furthermore, non-European countries could be urged to upgrade and balance their more than 1700 BITs, which frequently contain outdated ISDS provisions. That would do much more good, also for developing countries, than

6 For a survey of their approaches and substance, see J. Pelkmans, C. Kauffmann, A. Correia de Brito: Mutual Recognition Agreements: concepts, stocktaking and case studies, OECD, Paris, forthcoming.

7 See T. Josling, S. Tangermann, op. cit.

8 See F. Mustilli, J. Pelkmans, S. Woolcock: The Comprehensive Economic and Trade Agreement [CETA] between Canada and the EU: survey and assessment, study for the INTA committee of the European Parliament, forthcoming, for detail. For a more elaborate legal view, see also C. Tietje, F. Baetens: The Impact of Investor-State Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership, study prepared for the Dutch Ministry of Foreign Affairs, 2014.

caricaturing TTIP solely because of (a much improved) ISDS, while carelessly ignoring 20-plus other important areas in TTIP with known potential.

There is also another side to what TTIP is not. TTIP is not a "growth machine",[9] although initially some advocates, including EU Commissioner De Gucht, asserted as much, without much hard economic underpinning. It is anyway an illusion to believe that one single policy (EU trade policy), and indeed one element of EU trade policy (namely, only TTIP) can generate a lot of growth, even when the negotiations are very ambitious. Moreover, while Atlantic trade and investment runs into barriers at times and in some sectors, it should also be acknowledged that much of Atlantic economic intercourse is free and has been exploited quite well.

Pursuing TTIP will not generate a growth miracle, although it is likely to generate a modest addition to EU GDP. TTIP also has to be assessed in terms of alternatives. There is a spectrum of growth policies for the EU including the earnest further deepening of the single market; the pursuit of structural reforms in the working of markets in member states (e.g. services) and taxation; the more aggressive upskilling and applied education of low-skilled workers in countries such as Italy, Portugal and Greece, which in the longer run would add sizeable percentage points to GDP;[10] and greater budgetary expenditure by countries with current account surpluses, for example on infrastructure.

The rationale of TTIP

TTIP has six distinct, though interrelated, rationales: greater bilateral trade potential, greater bilateral investment potential, greater confidence in bilateral regulatory cooperation, global strategic and diplomatic positioning, greater competitiveness for TTIP firms in global value chains, and a "guardian" of Atlantic economic interdependence. Given space constraints, here are just a few words on each of these rationales.

Like all trade agreements, TTIP is ultimately driven by "growth and jobs". In terms of trade, the North Atlantic potential seems to be underused,[11] and more than two decades of experience on TBTs and SPS (bilaterally and in the WTO) as well as in services generated a conviction that much more bilateral trade would be possible if the unnecessary costs of regulatory differences could be addressed. The second rationale (greater investment) was far less important, at least initially. Foreign direct investment (FDI) in both the EU and the US is largely free, and the bilateral stocks of FDI are by far the biggest in the world. There is still more potential, due to a few restrictions (e.g. US in air transport and coastal shipping) and the fact that in some countries the investment climate is weak (e.g. Italy underperforms in attracting US FDI relative to many other EU countries). Nevertheless, the investment chapter in TTIP was originally regarded as secondary. These arguments have not changed, but ISDS – a term hardly known by anyone except specialised lawyers only three years ago – has been catapulted into a critical issue.

Greater regulatory cooperation offers a significant opportunity, in the light of ample experience since the 1990s.[12] This explains the considerable ambition in the second pillar of Figure 1. This process is bound to be difficult and slow, and it has to be given time for trust to be built up. One also has to invest serious resources into detailed comparative analyses on equivalence at all required levels of detail, as has been done in the automobile sector. In chemicals, dogmatism and mistrust ("the systems are too different") dominate, rather than the assumption of a similar analytical perspective with profound investments in fact-finding and verifying testing, e.g. on whether workers and citizens are similarly protected against a risky substance in the EU and US (if yes, equivalence might be granted).[13] Global positioning of the EU and US in the WTO and in world diplomacy (the fourth rationale) can also be enhanced through TTIP, as discussed by Hamilton and Blockmans.[14]

Greater competitiveness of EU and US firms in global value chains (GVCs) would almost certainly follow from a successful TTIP. Much of transatlantic trade is intra-firm trade, linked with value chains for additional components, and components trade with or between affiliates of EU and US companies in both economies. Recent progress in value-added trade statistics shows that the significance of value chains in transatlantic trade is even greater than formerly suggested. In simple words, more is made

9 See also F. Mustilli: Estimating economic gains of TTIP, in: Intereconomics, Vol. 50, No, 6, 2015, pp. 321-327.

10 See J. Varga, W. Roeger, J. in 't Veld: Growth Effects of Structural Reforms in Southern Europe: The case of Greece, Italy, Spain and Portugal, European Economy Economic Papers 511, December, 2013.

11 For example, see the trade intensities exercise in P. Egger, J. Francois, M. Manchin, D. Nelson: Non-Tariff Barriers, Integration and the Trans-Atlantic Economy, in: Economic Policy, Vol. 30, No. 83, 2015, pp. 539-584.

12 See P. Chase, J. Pelkmans: This time it's different: turbo-charging regulatory cooperation, in: D. Hamilton, J. Pelkmans, op. cit., for elaboration and the full list of regulatory cooperation initiatives since the Madrid EU-US summit.

13 See D. Elliott, J. Pelkmans: Greater TTIP ambition in chemicals: why and how, in: D. Hamilton, J. Pelkmans, op. cit., for elaboration.

14 D. Hamilton, S. Blockmans: TTIP's Broader Geostrategic Implications, in: D. Hamilton, J. Pelkmans, op. cit.

(with goods and services input) not just “in” the TTIP region but “by” TTIP producers. Especially here, the lowering of costs of unnecessarily cumbersome enforcement procedures (not less enforcement) and more equivalence agreements (where possible) form a direct contribution to the strengthening of TTIP firms in GVCs. This matters all the more now that the TPP and other mega-regionals might negatively affect such competitiveness. The sixth rationale concerns the proper management of the very deep transatlantic economic interdependence in trade, FDI, IPRs, ideas and persons. This interdependence needs a permanent “guardian”, and the parties should not continue to rely on ad hoc fire extinguishers, as has been the case so far. The interdependence is too valuable to be disrupted.

What TTIP could do better

The design of TTIP can be improved. I shall emphasise three points of improvement. First, TTIP seems to underplay services. This is hard to understand. When it comes to cross-border services and FDI in services (mode 3 of the GATS), the bilateral relationship between the US and the EU is overwhelmingly the strongest in the world. But this does not mean that there are not many problematic and costly barriers, both to cross-border services and to mode 3 in some services sectors. Financial services in TTIP are resisted by the US Treasury, courier services cannot benefit from cabotage (which here results in a major competitive disadvantage), parts of transport are taboo for foreigners (the mercantilist Jones Act in shipping and the US ban on takeovers in air transport), and professional services could benefit from a regulatory arrangement or even a mutual recognition agreement under TTIP. Services are also becoming ever more important in GVCs, and hence what matters for the US and the EU is the supply of high-quality services throughout the TTIP area.

Second, the TTIP mentality to determinedly tackle the unnecessary costs of regulatory differences has not trickled down in all areas, whether US or EU. Rather than genuinely attempting to lower regulatory costs without affecting the objectives, regulators fall back far too easily on what is easy or safe for them. This is often defended in generalities, through suggestions that the “levels” or “standards” of protection require a cautious stance, whereas TTIP is about the instruments and technical procedures. Such meekness reflects a “trenches” mentality rather than creativity and a search for fact-finding and alternatives.

Third, TTIP ought to be opened to third countries. The net balance of trade diversion and positive “spillovers” may be negative for some countries.[15] TTIP political leaders should begin with a declaration in early 2016 that TTIP, once concluded, will be open and that modalities will be offered.

15 For more on the direct and indirect spillovers of TTIP, see A. Lejour, F. Mustilli, J. Pelkmans, J. Timini: Economic Incentives for Indirect TTIP Spillovers, CEPS Special Report No. 94, October 2014.

Thea M. Lee

TTIP Must Protect Jobs, Workers and Public Services

Increased trade between the United States and the European Union has the potential to spur job creation and income growth for workers on both sides of the Atlantic – but only if our negotiators have the courage to adopt a new model that focuses on decent work, shared prosperity and equitable development.

Unfortunately, the U.S. has a long history of negotiating agreements that ignore these goals in favor of policies that benefit corporations and shareholders, while disempowering workers and communities and undermining democratic institutions. These flawed trade deals combine extraordinary protections for investors with enhanced deregulation, which has contributed to stagnant wages, precarious employment, increased inequality and a weaker relationship between citizens’ policy preferences and the policies implemented by our government.

Unions on both sides of the Atlantic want the Trans-Atlantic Trade and Investment Partnership (TTIP) to embody a new set of pro-worker objectives. In 2014, the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and the European Trade Union Confederation published a joint statement urging the TTIP negotiators to adopt an "open, democratic and participatory" process.[1] The document reflects the importance of building a strong, united coalition.

In the U.S., we have recently completed negotiations on the Trans-Pacific Partnership (TPP), a trade agreement between the U.S. and 11 other Pacific Rim countries. Over the past five years, the American labor movement has provided the Obama administration with concrete proposals to adjust U.S. trade positions so that they create decent jobs, protect the environment and ensure safe imports. Unfortunately, the administration has ignored most of our proposals, and so it appears TPP will mostly benefit the largest global corporation, while working families are left behind.

We recognize that, given the history of U.S. trade deals, even negotiating TTIP is fraught with risks to workers. However, we maintain an open mind as we continue to work with coalition partners in the U.S. and throughout Europe to shape a new trade model. Should TTIP live up to its potential, it could earn support from progressive American constituencies, including labor.

Unfortunately, the TTIP negotiations remain shrouded in secrecy. While officials are quiet about the specifics of the agreement, they admit it has little to do with tariffs and much more to do with "regulatory harmonization".[2] Under this flawed framework, policy measures that reflect societal choices about how to solve problems and balance risks, including worker and environmental protections, procurement standards, intellectual property rights, and financial regulations, risk being reduced to "trade barriers".

Meanwhile, global corporations brazenly search for ways to "overcome regulatory sovereignty".[3] One way is using closed-door trade negotiations to secure rules that would be defeated if they were open to public scrutiny or democratic accountability. Past agreements have required governments to adopt policies that ensure market access and favorable terms for foreign corporations, regardless of the needs or priorities of local communities. They have also granted investors extraordinary rights to challenge state policy choices. This leaves communities with less influence over the decisions that shape their lives and constrains governments' ability to adopt progressive policies.

Trade agreements should aim to build a prosperous, equitable society for all – including working people and the poor. Unfortunately, past deals have fallen remarkably short of that goal, and TTIP is in danger of repeating mistakes of the past. This article will focus on the potential treatment of investor-to-state dispute resolution, public services, financial services, procurement and labor protections. There are numerous other areas – including consumer protections, access to medicines and environmental regulations – that are also vulnerable under the current trade regime.

ISDS

The investor-to-state dispute settlement (ISDS) process has drawn heavy criticism, as it gives foreign investors the extraordinary ability to bring claims against governments for action that harms current or even future profits. Instead of engaging with domestic procedures, foreign investors bring these claims directly to private international tribunals. While these panels cannot directly reverse policy, they can order states to choose between reversing policy and paying monetary compensation.

ISDS is increasingly being used to target regulations designed to benefit the public. Germany is currently facing a claim brought by the Swedish company Vattenfall over the decision to switch from nuclear energy to renewables.[4] The company is demanding compensation for both current and future profits stemming from the closure of two nuclear power plants.

Considering a complex problem with wide-ranging social implications through the narrow lens of investor rights is inherently problematic. The danger is compounded by the fact that ISDS panels are structurally biased in favor of investors.[5] Arbitrators have a direct financial stake in the system. Unlike judges, arbitrators are individually selected and paid by the investor bringing the claim and the government defendant. Issuing investor-friendly legal interpretations and rulings both expands the overall caseload and increases the likelihood the arbitrator will be selected again in the future. There are no strict conflict of

1 European Trade Union Confederation and the American Federation of Labor – Congress of Industrial Organizations: TTIP Must Work for the People, or It Won't Work at All, Declaration of Joint Principles, 2014.

2 D. Mullaney: Opening Remarks, Speech at TTIP Round Seven Press Conference, 3 October 2014, available at https://ustr.gov.

3 See, e.g., S. Poe: Trade on the Forefront: U.S. Chamber President Chats with USTR, FreeEnterprise.com, 30 July 2013; and M. Stoller: NAFTA Origins: The Architects Of Free Trade Really Did Want A Corporate World Government, PopularResistance.org, 25 February 2014.

4 N. Bernasconi-Osterwalder, M. Dietrich Brauch: The State of Play in *Vattenfall v. Germany II*: Leaving the German public in the dark, International Institute for Sustainable Development, December 2014; and N. Bernasconi-Osterwalder, R.T. Hoffmann: The German Nuclear Phase-Out Put to the Test in International Investment Arbitration? Background to the new dispute *Vattenfall v. Germany II*, October 2013.

5 P. Eberhardt, C. Olivet: Profiting from injustice, Transnational Institute and Corporate Europe Observatory, November 2012.

interest rules, so many arbitrators rotate between deciding cases and representing companies bringing claims.

Democratic justice systems have corrective mechanisms. Erroneous judgments can be appealed, rogue judges can be impeached and legislatures can pass or repeal laws in response to unintended interpretations. Conversely, it is extremely difficult to appeal ISDS judgments for any reason, private arbitrators cannot be impeached and there is no legislative body with the authority to override rulings that contradict democratic decisions.

Even if the state wins, defending a case costs an average of $8 million. Given the expense and potential for biased decision-makers, governments can be pressured to change regulations or drop new proposals at the mere specter of an ISDS case. In fact, Vattenfall first threatened a lawsuit against Germany years earlier over proposed regulations on coal-fired power plants, which were subsequently modified.[6]

On 16 September 2015, the European Commission revealed a new proposal dubbed an "Investment Court System", which is intended to address many of the criticisms of ISDS.[7] Indeed, the proposal seeks to eliminate much of the pro-investor bias, limit conflicts of interest and establish an appellate mechanism. These important changes represent an improvement over the current model. Nevertheless, the new proposal retains an overly broad definition of investment, fails to impose any obligations on investors, fails to adequately protect non-discriminatory regulatory measures from challenge, and leaves unchanged the unequal justice created by an investor-only "court". The new proposal – while an improvement over previous models – does not address the fundamental concern that ISDS provides special, privileged justice for a select few.[8]

This spring, an ISDS panel split 2-1 in *Bilcon v Canada*, with the majority deciding a mining company deserved compensation for being denied a permit to expand a quarry. Two arbitrators concluded that Canadian taxpayers should pay the corporation, in part because government decision-makers put too much weight on "core community values". In dissent, the third arbitrator noted the perverse effect the decision would have on regulators' ability to respond to community opposition and promote responsible environmental stewardship. It is not clear that the new proposal would prevent a similar case from advancing or being similarly decided under TTIP.

In 2014, the French multinational Veolia challenged a package of Egyptian labor reforms that include raising the minimum wage. The U.S.-based energy company Lone Pine Resources recently launched a claim for $250 million against Canada because Quebec banned fracking, a practice that has been linked to earthquakes and contaminated drinking water.

When critics try to raise these issues with trade negotiators, they are assured that ISDS has been "fixed". But ISDS is intrinsically and fundamentally flawed. As Joseph Stiglitz recently wrote, its true goal is to restrict governments' ability to regulate corporate behavior, achieving "by stealth – through secretly negotiated trade agreements" what could not be attained "through an open political process".[9]

Critical public services

Public services, including health care, education, sanitation services, transportation, infrastructure and water management, play a critical role in alleviating poverty and ensuring equitable access. They are essential to addressing market failures and ensuring sustained economic growth, which is negatively impacted by high levels of income inequality.[10] The U.S. and the EU should be exchanging best practices and adopting policies that result in the highest possible quality services. Many European countries have particularly robust state-provided services, and there is much to be learned from comparing experiences, ideas and outcomes.

Unfortunately, if the TTIP rules reflect the language in prior agreements, public service provisions could be subjected to restrictive policies that favor deregulation and privatization. Privatization has often resulted in declining quality, deteriorating working conditions and wages for service workers, and exclusion of the poor and those too geographically isolated to make delivery profitable. The rules in current trade agreements not only promote private provision of public services, they also make it difficult and often costly for governments to reverse a decision to privatize if the results negatively impact service

6 Ibid.

7 European Commission: Commission proposes new Investment Court System for TTIP and other EU trade and investment negotiations, Press release, 16 September 2015.

8 The AFL-CIO continues to review this recent proposal and will have more to say at a later date.

9 J.E. Stiglitz: Developing countries are right to resist restrictive trade agreements, The Guardian, 8 November 2013.

10 See, e.g., J.E. Stiglitz: The Price of Inequality, W. W. Norton & Company, New York 2012.

provision.[11] For example, we understand that education services are receiving particular attention in the TTIP negotiations.[12] Private education providers are eager for access to the European market, although their performance record in the U.S. is sometimes abysmal.[13]

TTIP should protect and promote public services, but it is not clear it will do so. Absent firm commitments to ensure protections, it presents a serious threat to effective, equitable public services. Service commitments should only be made on a "positive list" basis. Positive lists ensure that states only commit the services they truly intend to commit and leave policy space open for services yet to be invented that negotiators cannot even contemplate today. There is no evidence that pre-committing a yet-to-be-invented service to the rules of a trade agreement leads to the best possible policy outcomes.

Financial services

Unfortunately, TTIP appears poised to open financial services to the same restrictive requirements that other services are currently subjected to under trade agreements. This has troubling implications for the maintenance of balanced economic policy making that ensures sustainable, stable growth.[14] Antiquated and often unclear rules risk not only delaying needed reforms to rein in the excesses of the past decades but could actually prevent sensible measures that would ensure stability. Past trade agreements have included language that promotes long-discredited Washington-consensus era policies. Recent deals have placed limitations on the use of capital controls, which even the International Monetary Fund has concluded can be useful to alleviate market volatility.[15] Given the precarious conditions in Greece and other eurozone countries and the incomplete efforts to rein in Wall Street deregulation in the United States, it is critical that TTIP protect governments' ability to provide and sustain stable financial services.

ISDS already presents a threat to governments' ability to guard against economic crises. Argentina has the dubious distinction of being sued at least 51 times, most of these suits related to the country's financial collapse of 2001-02.[16] There are several pending claims against Greece over measures the country implemented that were required to secure an international loan package to stabilize the economy.[17] Making explicit financial services rules commitments in TTIP will heighten this danger.

Public procurement

In the past, trade agreements have limited public procurement programs, making it difficult or impossible for government contracts to state even a preference, let alone a requirement, for local companies or local employment. In addition, such commitments have never made clear that preferences can be given to businesses that adhere to enhanced human rights or environmental standards.[18] Governments should be able to tackle social problems like youth unemployment, climate change or a legacy of discrimination by attaching standards to public contracts. The growing movement to include human rights due diligence in government purchasing, which could protect labor standards throughout the supply chain, could also be undermined by restrictive trade rules.

Labor protections

Workers on both sides of the Atlantic face hardship, with high levels of unemployment and inequality, increasing precarious work, and reduced social protections. TTIP must not become a vehicle to promote failed policies centered on austerity and labor "flexibility". Already, there is a push in both the EU and the U.S. to undermine worker protections and cut back on public services and investment. The result has been a spiral of economic contraction, sparking increasingly frenzied cuts and job losses.

Worker protections are not just critical to ensuring that workers are treated with respect. Strong protections for freedom of association and collective bargaining are critical to tackling income inequality[19] and thereby ensuring sustained economic growth.[20] Unfortunately, the U.S. has ratified only two of the International Labour Organization's core labor rights, and anti-union legislation at the state and federal levels continues to violate workers' interna-

11 AFL-CIO: AFL-CIO Response to Request for Comments on the "Trans-Atlantic Trade and Investment Partnership" Federal Register (April 1, 2013) Docket Number USTR-2013-0019, 10 May 2013.

12 G. Maslen: Universities at risk under free trade agreements, University World News, No, 353, 4 February 2015.

13 For-Profit Education Scams, New York Times, 23 March 2012.

14 Warning from Civil Society: TTIP Threatens to Undermine Financial Reform, Global Policy Forum, 1 October 2014.

15 International Monetary Fund: The Liberalization and Management of Capital Flows: An Institutional View, 14 November 2012.

16 N. Buxton: Legalised Profiteering? How corporate lawyers are fuelling an investment arbitration boom, Transnational Institute and Corporate Europe Observatory, 10 November 2011.

17 P. Eberhardt, C. Olivet, op. cit.

18 Given that such requirements may be challenged as specifying the "process" under which the good or service is provided rather than the "product" to be provided, it remains unclear whether a bidder wishing not to comply with the responsible purchasing criteria could successfully challenge the criteria as an unfair barrier.

19 F. Jaumotte, C. Osorio Buitron: Inequality and Labor Market Institutions, International Monetary Fund Staff Discussion Note, July 2015.

20 See, e.g., J.E. Stiglitz: The Price … , op. cit.

tionally recognized rights. Corporations spend heavily to deter unionization and demonize unions. For example, in Chattanooga, Tennessee, corporate and political influence prevented workers at a Volkswagen plant from organizing a union. American and European labor unions need to work together to ensure that TTIP strengthens important industrial relations, for example via co-determination and works councils.

At its best, TTIP could be an opportunity to move beyond the "lowest common denominator" approach to labor rights and create truly people-centered rules. Unfortunately, labor commitments in trade agreements are too often treated as an afterthought to commercial provisions, not a central mechanism through which to achieve shared, stable growth and to reduce inequality.

The AFL-CIO will continue to work with our union counterparts and other social justice allies throughout Europe to advocate for strong labor and environmental standards and to ensure that transatlantic negotiations do not undermine shared prosperity, democratic accountability or regulatory integrity. But if TTIP does not meet that standard, we will have no choice but to oppose it.

Federica Mustilli

Estimating the Economic Gains of TTIP

The 2013 launch of the negotiations between the EU and US for a deep trade and investment partnership has stimulated a controversial debate on the economic modelling used to quantify the economic gains of TTIP.

The economic methodology and its ability to accurately estimate the economic impact of the partnership has been scrutinised not only in academic circles but also in policy circuits. Indeed, criticism of the economic methodology has even been used in advocacy by NGOs and ultimately in the streets of e.g. Brussels and Berlin, where TTIP is heavily criticised or even rejected.

Besides modelling techniques, what really matters in the assessment of the overall agreement is the extent to which trade negotiators will make progress on the regulatory cooperation chapter and the several related sectoral chapters. TTIP is not only, and indeed not even primarily, about removing tariffs: it is about reducing unnecessary differences in non-tariff (essentially "regulatory") measures so as to boost the goods and services exchange without compromising the current level of health, safety or environmental protection that each country or sub-federal government is expected to ensure to its citizens.

The potential for the economic gains of TTIP hinges mainly on two aspects: understanding the assumptions, such as with regard to non-tariff measures (NTMs)[1] and their removal or reduction, and the quantitative results that econometric techniques can provide. Unfortunately, both tasks are far from easy.

The present paper will discuss the main contributions to the literature on estimating the impact of trade and investment liberalisation between the EU and US on key economic variables in the long run.

We have selected six studies that animate the current debate on economic gains and modelling: CEPR,[2] Bertelsmann,[3] CEPII,[4] Capaldo,[5] Egger et al.[6] and Felbermayr et al.[7] Although it provides detailed estimates on the potential effects of TTIP, we do not discuss ECORYS as a

1 Non-tariff measures refer to regulatory divergences, in particular, technical barriers to trade and sanitary and phyto-sanitary measures. See K. Berden, J. Francois: Quantifiying Non-Tariff Measures for TTIP, CEPS Special Report No. 116, July 2015.

2 J. Francois, M. Manchin, H. Norberg, O. Pindyuk, P. Tomberger: Reducing Transatlantic Barriers to Trade and Investment: An Economic Assessment, CEPR, Report prepared for DG Trade, European Commission, 2013.

3 G. Felbermayr, B. Heid, S. Lehwald: Transatlantic Trade and Investment Partnership (TTIP): Who benefits from a free trade deal?, Part 1: Macroeconomic Effects, Bertelsmann Stiftung, 2013.

4 L. Fontagné, J. Goudron, S. Jean: Transatlantic trade: Whither Partnership, Which Economic Consequences?, CEPII, Policy Brief No. 1, 2013.

5 J. Capaldo: The Trans-Atlantic Trade and Investment Partnership: European Disintegration, Unemployment and Instability, Global Development and Environment Institute, Working Paper No. 14-03, Tufts University, 2014.

6 P. Egger, J. Francois, M. Manchin, D. Nelson: Non-Tariff Barriers, Integration and the Trans-Atlantic Economy, in: Economic Policy, Vol. 30, No. 83, 2015, pp. 539-584.

7 G. Felbermayr, B. Heid, M. Larch, E. Yalcin: Macroeconomic potentials of transatlantic free trade: A high resolution perspective for Europe and the world, in: Economic Policy, Vol. 30, No. 83, 2015, pp. 491-537.

separate study, as it serves as the foundation of the CEPR paper.[8]

We begin with a comparison of the modelling applied by the studies and the economic results they generate for the EU and US. We will then examine the main assumptions made by the studies and explore how they influence the results.

The econometric modelling: a comparison

Our discussion of these six studies focuses on two aspects: the econometric techniques applied to compute the economic results, and the underlying assumptions. The latter can be subdivided into two groups of assumptions: (i) those concerning the definition and quantification of NTMs, the resulting estimation of trade costs (other than tariffs), and an analysis of how *actionable* they are; and (ii) those concerning third country spillovers and the treatment of the labour market.

Basic CGE Modeling

With respect to methodology, it is commonly argued that the current state of the art in assessing the impact of liberalising trade flows is the Computable General Equilibrium (CGE) model. CGE models are quantitative tools describing the interactions among several markets and the impacts that an economic shock (such as a free trade agreement) could have on economic variables, such as GDP and trade flows, as well as the intersectoral adjustment for workers and capital. Characteristic of these models is the full flexibility of goods and input prices, assuring in the longer run that demand and supply are in equilibrium. If, in the long run, the labour supply is fixed, the model cannot estimate changes in unemployment (or the creation of new jobs) but only job reallocation adjustments (among the sectors and between high and low-skilled jobs) in the short to medium run.

The inability to model changes in unemployment, together with the difficulty of including foreign direct investments and their impact on the new equilibrium, renders the technique difficult to digest for policy makers and stakeholders. They are generally keen to find out whether the successful conclusion of TTIP could lower unemployment in EU member states without generating more than marginal job losses in any specific sectors.

This approach was pursued in the first attempt to assess TTIP, undertaken before the official launch of the negotiations. The CEPR report was commissioned to support the European Commission Impact Assessment of the TTIP proposal.[9] It is the first time that a quantitative analysis underpins the Commission's request to the European Council for a mandate to negotiate. The assignment to CEPR was expected to provide an assessment of the quantitative impact of the agreement at a moment when the actual content and the degree of ambition of TTIP was still under discussion.

The model, supported by the 2007 Global Trade Analysis Project database, estimates long-term (through 2027) increases in GDP growth of 0.48 per cent for the EU and 0.39 per cent for the US, larger trade flows (for the EU, a 28 per cent increase in bilateral exports), and job reallocation effects of the work force, resulting in upward pressure on real wages. These positive but modest results are foreseen only if the agreement were to reach a high level of ambition. What does that imply?

Due to the regulatory nature of the agreement and the low level of tariffs (with some exceptions), the report tackles the difficult task of quantifying the costs of NTMs across the Atlantic on goods and services by turning them into *ad valorem* equivalents (AVEs).

Once the AVEs are calculated, they cannot be treated as pure tariffs: most of them represent regulatory differences that cannot be entirely cancelled during trade negotiations. Some of them must remain in areas for which regulations on both sides of the Atlantic assure different but legitimate levels of citizen protection (e.g. health, safety, environment, etc.). That is why, according to the ECORYS background study, the degree of *actionability* of non-tariff barriers between the EU and US is limited, even in the most ambitious scenario, which is why the study sets it at 50 per cent. By actionability, CEPR refers to the extent (expressed in a percentage share) to which the identified costs of an NTM or regulatory divergence can potentially be reduced (through various methods), under the assumption of a TTIP agreement that will address these barriers.

These results have been debated in the CEPII study.[10] The study applies a multi-sector CGE model called MIRAGE supported by a different dataset on NTMs. The quantification of average protection in cross-border trade in services is computed through gravity estimates for nine service sectors in 65 countries instead of by running esti-

8 K.G. Berden, J. Francois, M. Thelle, P. Wymenga, S. Tamminen: Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis, ECORYS, Report prepared for DG Trade, European Commission, 2009.

9 J. Francois et al., op. cit.

10 L. Fontagné et al., op. cit.

mates from business surveys, as was done in the CEPR study. Regardless of the different ways of calculating AVEs,[11] overall results on long-term increases in GDP do not change significantly, ranging from 0.3 per cent (both for the EU and US) in the reference scenario to 0.5 per cent with the inclusion of harmonisation spillovers.[12] Bilateral EU exports would increase in the long run by 49 per cent, mainly from agro-food products.

The debate which has emerged since the publication of the CEPR report has persuaded some of its authors to upgrade the exercise. Egger et al. once again uses a multi-sectoral CGE approach, but the study calculates the AVEs as the NTM reductions induced by previous preferential trade agreements.[13] The different assumption allows the authors to judge the effect of fully liberalised trade flows without imposing a limit on actionable NTM removals. Of course, assuming a much higher level of liberalisation inevitably brings higher gains if the underlying methodology does not change. Indeed, the authors estimate a 2.27 per cent increase in EU GDP in the long run and a 0.97 per cent increase in US GDP (exclusive of spillovers). The results of the model indicate an increase of bilateral trade flows that could reach 80 per cent.

Structural general equilibrium model

A second group of studies, Bertelsmann and Felbermayr et al., applies a different approach by estimating a structured single-sector trade model that, compared to the traditional CGE approach, allows a certain flexibility in the inclusion of the labour market.[14] The model does not allow sector-specific results, nor relocation across different factors or skill groups. The reason for this approach is to conduct an exercise that precisely simulates the trade flows that can take place between the two economies by assuming a degree of liberalisation equal to previous deep agreements such as NAFTA or the European Union. In order to do so, gains are not foreseen in the long run but are estimated relative to the 2012 baseline.

In doing so, they avoid the complexities of how to calculate NTBs and treat them as pure unobserved trading costs. In Felbermayr et al., they hold that by simulating trade flows from other trade agreements in which the EU and US participate, the potential of TTIP could be either underestimated because TTIP will be more ambitious and can deliver higher welfare gains or overestimated if past regional trade agreements (RTAs) have already lowered part of the existing NTMs.

In Bertelsmann, increases in real income are country-specific and relatively large, ranging, in a deep liberalisation scenario, from 3.66 per cent for Belgium and Luxembourg to 9.70 per cent for the UK. In their mapping, Spain and northern countries (the UK, Denmark, Finland and Sweden) will gain more (six per cent to almost ten per cent) compared to the rest of the EU countries (zero to six per cent). The US seems not to gain significantly, reaching an increase in real income of only 0.8 per cent.[15] Felbermayer et al. estimates lower but still relatively high gains: an average increase for the EU of 3.9 per cent, (ranging from 2.25 per cent for Belgium to 5.56 per cent for Spain) and 4.89 per cent for the US.

The UN Global Policy Model

A different and isolated view is found in Capaldo, which, by applying the UN Global Policy Model (GPM), claims to estimate the impact of TTIP without estimating potential trade flows derived from the removal of tariffs and non-tariff barriers (basically the essential point of a trade agreement).[16]

The GPM reflects instead a demand-driven macroeconometric approach that, according to the author, presents the following advantages. First, the model does not evaluate how the economy reaches an equilibrium after a policy change (removing tariffs and cutting NTMs) but analyses the impacts of its subsequent effect on demand. Once demand is affected, all the other variables in the economy will be, too. Second, it describes how each region in the world will be affected at the macro-level. Finally, it is possible to estimate employment effects, as the model incorporates non-constant relations between GDP growth and unemployment growth.

The results of the model indicate a negative impact on GDP by 2025, specifically -0.5 per cent for northern economies, -0.48 per cent for France and -0.29 per cent for Germany. In this respect, Capaldo includes the phrase “European disintegration” in his title, as trade diversion effects, according to his exercise, will negatively affect

11 While NTMs in goods and agricultural products are higher than in services in the ECORYS and CEPR studies, US services look more protected than goods in the CEPII study. However, the estimations of AVEs in services provided by CEPII are much higher than the ones used in ECORYS.

12 The inclusion of regulatory spillovers can increase the overall gains, as we will explain later in the text.

13 P. Egger et al., op. cit.

14 G. Felbermayr, B. Heid, S. Lehwald, op. cit.; and G. Felbermayr, B. Heid, M. Larch, E. Yalcin, op. cit.

15 Trade diversion effects are assumed to be large, especially for a neighbouring country like Canada, which is exepcted to experience a GDP loss of nine per cent.

16 J. Capaldo, op. cit.

Table 1
Economic gains from TTIP

	CEPR (2013)	CEPII (2013)	Egger et al. (2015)		Bertelsmann (2013)	Felbermayr et al. (2015)		Capaldo (2014)
Econometric model	Multi-sector CGE model - GTAP	Multi-sector CGE model - MIRAGE	Multi-sector CGE model - GTAP		Augumented gravity model (single-sector)	Structural general equilibrium model (single-sector)		UN Global Policy Model
EU GDP (% change)	0.48	0.3	2.27*	2.97**	0.52-1.31	3.94	7.76**	North EU -0.5; France -0.48, Germany -0.29
US GDP (% change)	0.39	0.3	0.97*	1.13**	0.35-4.82	4.89	7.05**	0.36
EU real wages	0.29%-0.51%	NA	2.46% (LS); 2.25% (MS); 2.37% (HS)***		NA	NA		North EU -4848 (EUR/employee); France -5518; Germany -3402

Note: *Annual real consumption on average: nominal household income by region deflated by changes in price (national income changes); ** real incomes exclusive of spillovers; *** LS: low-skilled; MS=medium-skilled; HS=high-skilled.

Source: Author's elaboration.

current trade integration among EU member states.[17] Shrinking trade flows will bring about an increase in unemployment, resulting in around 600,000 job losses across the member states.

Although the CGE criticisms brought up in the study are understandable, the attention that the study has received is not due to the merits of the model or its simulation. Rather, the acclaim is entirely the result of a deep mistrust of studies which show positive economic impacts from TTIP. Although economists differ on TTIP's empirical economic effects, there is widespread recognition of and respect for the many difficulties of doing solid work on TTIP. However, the technical debate does not show much confidence in the Capaldo model. Indeed, a model approach to a trade agreement that excludes tariffs and NTM costs yet "imports them" from the very CGE models it sharply criticises, is hardly coherent.[18]

Economic gains and driving assumptions

Quantifications of non-tariff measures

Table 1 provides an overview of the various studies' estimates of the economic gains from TTIP. The main methodology employed to estimate these gains is the quantification of NTMs and their degree of *actionability*.[19] The exercise consists of comparing actual bilateral trade flows presumably distorted by the presence of regulatory divergence with the potential trade flows. The comparison, estimated through a set of gravity equations, delivers the AVEs.[20] The ultimate goal is to understand the extent to which the AVEs can actually be removed, thus unlocking the liberalising trade potential.[21]

In the CEPR study, the methodology applied consists of the quantity-based approach proposed by Berden [22] They apply a five-step approach based on a large sectorial survey aimed at collecting bilateral NTMs (converted into AVEs) for each pair of bilateral trade flows. The final results relied on more than five thousands responses

17 Ibid.

18 There is the more theoretical point of whether Keynesian models are suitable for these questions. A recent neo-Keynesian contribution by Ganelli and Tervala shows that unilateral trade liberalisation generates an adverse effect on terms of trade, reducing welfare. This forms an incentive to negotiate trade agreements. The authors show that a multilateral agreement generates strong positive effects. The next question is then whether bilateral (TTIP) negotiations are powerful enough to turn this into positive results. See G. Ganelli, J. Tervala: Value of WTO Trade Agreements in a New Keynesian Model, IMF Working Paper WP/15/37, 2015.

19 For a detailed and authoritative technical overview, see K. Berden, J. Francois, op. cit.

20 These are often defined as trade cost equivalents.

21 In this paper, we only discuss quantification of NTMs based on the quantity approach. The price-based approach has not been exploited to estimate trade agreements like TTIP (and is extremely demanding in terms of data). See J.M. Dean, J. Signoret, R. Feinberg, R. Ludema, M. Ferrantino: Estimating the Price Effects of Non-Tariff Barriers, The B.E. Journal of Economic Analysis & Policy, Vol. 9, No. 1, pp. 1-41.

22 K. Berden et al., op. cit.

Table 2
Main assumptions of the different studies

	CEPR (2013)	CEPII (2013)	Egger et al. (2015)	Bertelsmann (2013)	Felbermayr et al. (2015)	Capaldo (2014)
Estimates of NTMs	Bottom-up approach by Berden et al.	Kee et al. for goods; Fontagne et al. for services	AVEs based on historical depth of previous agreements	Top-down approach on the basis of existing trade flows	Top-down approach on the basis of existing trade flows	NA
Actionability	50% NTM reduction	30% and 15% NTM reduction	NTMs reduction based on deep FTAs	NA	NA	NA
Labour market	Fixed labour supply	Fixed labour supply	Fixed labour supply	Search-and-matching framework EU/US employment – up to 2.3 million new jobs	NA	Growth-employment simulation: North EU-223,000; DE-134,000; FR-130,000;
Spillover effects on third countries	Direct 20%; Indirect 10%	Harmonisation spillovers	Yes, but with non-discriminatory mutual recognition	NA	Positive effects, with reservations	NA

Source: Author's elaboration.

combined with the OECD FDI restrictiveness indicators and data from the Global Trade Analysis Project.

In the CEPII study, different approaches to quantify NTMs in goods and services have been combined.[23] The results are based again on a quantity-based approach.

The effects of trade liberalisation on trade flows can also be proxied by the observed effects of already existing trade agreements. This is why the authors of Bertelsmann apply a top-down approach, assuming that increasing trade due to TTIP will replicate the increasing trend already observed in agreements in which the two signatories are already involved (like NAFTA or the EU). While this approach represents an ingenious way of avoiding the laborious quantifications and the discussion on the degree of actionability, the simulation exercise can only replicate the average gains achieved in previous RTAs without addressing the peculiarities of TTIP and its different possible degrees of ambition.

The approach is also defended in Felbermayer et al., which stresses that RTAs are induced by the existence of unobserved trade costs due to NTMs. Assuming that RTAs have successfully lowered NTMs between the signatories, the authors use their average effects to estimate a trade costs matrix.

23 For goods, see H. Kee, A. Nicita, M. Olarreaga: Estimating Trade Restrictiveness, in: Economic Journal, Vol. 119, No. 534, pp. 172-199, 2009. For services, see L. Fontagné, A. Guillin, C. Mitaritonna: Estimations of Tariff Equivalents for the Services Sectors, CEPII Working Paper 2011-24, 2011.

The importance of evidence from existing agreements has also been recognised by Egger et al. The authors apply a two-step approach to quantify trade cost equivalents (TCEs) by first estimating levels of NTMs using historical values on the depth of existing agreements. These values can then be turned into TCEs. The approach seems similar to the top-down methodology applied by Felbermayer et al., but there is a crucial distinction that makes the former more cautious in the TCE quantifications. Indeed, while the depth of previous agreements is further analysed in Egger et al. to determine how much of it can be attributed to the consequences of TTIP for the countries directly involved, in Felbermayer et al., the average effects of previously concluded FTAs directly proxy the scope of TTIP.

The discussion on how to quantify NTMs cannot be continued with Capaldo, simply because this aspect is totally neglected. Being a study on the potential effects of TTIP on overall consumption and not on TTIP itself, the trade flows that modify demand are adopted from the CEPR study.

Labour market

Table 2 provides an overview of the main assumptions of the various studies with regard to NTMs, actionability, labour market and spillover effects. Discussions on labour market effects are more crucial for the acceptance of economic modelling than other assumptions. TTIP is generally described as a project aimed at delivering more growth. Thus, stakeholders want to have estimates of unemployment changes that CGE techniques fail to deliver. Indeed, CGE as applied by CEPR, CEPII and Egger et al. relies on markets with imperfect competition and flexible prices. This implies that wages move to ensure that the labour market is always in a long-run equilibrium in which the labour supply (which is fixed by region) is always equal to demand. Trade liberalisation scenarios do not deliver employment effects in these models. In reality, however, it is quite often the case that production increases and more labour is demanded. As a result, wages increase. This is the typical labour market effect. However, changes in real wages or intra-sectoral job reallocations can be translated into changes in employment. CEPR estimates real wage increases in the EU ranging from 0.34-0.51 per cent for unskilled labour and 0.34-0.50 per cent for skilled labour.

An interesting variation is proposed by Bertelsmann, which includes a search-and-matching framework that allows for the long-run existence of frictional unemployment. Countries with market frictions can experience increasing unemployment as the reallocation effects driven by lower prices and wages cannot immediately re-equilibrate the market. However, as Raza et al. point out, it is unclear why the model simultaneously delivers real wage increases and positive employment effects, as the latter can only be possible in the presence of a real wage decrease.[24]

Finally, the mechanism through which Capaldo comes to the conclusion that TTIP will lead to strong job losses across Europe is based solely on the demand side while ignoring the effects on supply. The model can predict trends in employment based on a relationship between employment and growth that is not constant over time. According to his estimates, the TTIP scenario will bring job losses due to GDP contraction following the reduction of net exports.

Third-country spillover effects

The regulatory cooperation process that TTIP can stimulate by removing NTMs can, due to the importance of the two economies, create spillovers in third countries, most likely in neighbours like Mexico, Canada or Turkey, but also in other countries only indirectly linked to the EU and US.[25]

24 W. Raza, J. Grumiller, L. Taylor, B. Tröster, R. von Arnim: Assess_TTIP: Assessing the Claimed Benefits of the Transatlantic Trade and Investment Partnership (TTIP), ÖFSE, Vienna 2014.

25 For details on TTIP spillovers, see A. Lejour, F. Mustilli, J. Pelkmans, J. Timini: Economic Incentives for Indirect TTIP Spillovers, CEPS Special Report No. 94, October 2014.

CEPR postulates spillover effects to third countries that can, in turn, improve the total estimated gains from TTIP. Direct spillover effects are an automatic result, without requiring any further action on the part of third countries, if TTIP regulatory convergence falls under most favoured nation treatment. This should enlarge third countries' trade possibilities. While spillover effects are foreseen to be positive for mature or emerging economies in the orbits of the US and EU, there is increasing concern that setting up a regional regulatory framework involving, for instance, common standards or harmonisation processes may increase the intra-regional exchange of goods and services while de facto excluding developing economies that are not able to comply with the agreed upon levels.[26] In the CEPR study, the conjectured spillovers are 20 per cent of the direct gains, but there is no explanation for such a figure. Indirect spillovers are also a possibility if third countries adopt the (TTIP) regulatory standards or procedures agreed to by the EU and US. Such "policy-induced spillovers" would occur if the agreed upon harmonisation or mutual recognition in TTIP were also to be adopted by third countries. CEPR postulates indirect spillovers to be half of the scale of the direct spillovers, i.e. ten per cent of the original decrease in NTM costs.

The positive effects of spillovers are also emphasised by Egger et al. They argue that the mutual recognition of standards or successful regulatory cooperation would lead them to revise their estimated per cent change of real income to 1.13 per cent for the US and 2.97 per cent for the EU. Again, while the benefits are driven by easier access to bigger markets for third countries, the order of magnitude is very difficult to foresee. CEPII also includes estimates with a spillover effect due to full harmonisation.

Felbermayer et al. use the same parameters introduced by the previous studies and agree that regulatory spillovers can have a positive impact on the overall welfare effect generated by TTIP for third countries. For example, once they are active, spillovers of ten per cent bring the unweighted average from 0.9 per cent to 2.9 per cent. However, the authors do not see a solid theoretical foundation to quantify them; moreover, they support the view that, given the size of the TTIP signatories, a larger share of trade will take place between them, likely resulting in trade diversion effects for third countries (especially the ones that are unable to meet the higher global standards, assuming TTIP establishes new ones).

26 A. Mattoo: An EU-US trade deal: Good or bad for the rest of the world?, voxeu.org, 10 October 2013.

Through a simple exercise, Lejour et al. explore the incentives for third countries to join potential standards set by TTIP. Among them, they noticed that mutual trade-in-value-added relations in goods can provide information with which to identify countries that can be involved.[27]

Conclusions

Several studies have attempted to estimate the potential economic gains of TTIP. In this paper, we have surveyed the main results of and assumptions behind the most frequently discussed and debated contributions. We can conclude that CGE models, despite their limitations, represent the state of the art in assessing the partnership. Other supply-driven models, however, deliver results that are in the same order of magnitude, leading us to conclude that the economic gains will likely be positive but not big.

The assumptions used by a study, especially those concerning the inclusion of non-tariff measures, can influence the final economic gains probably to a greater degree than the econometric strategy adopted. Given the nature of the agreement, more research is also needed to better understand its short-term effects on the labour market and how to deal with the regulatory spillovers that can potentially lead to trade diversion effects in third countries.

27 A. Lejour, op. cit.

Lucian Cernat, Ana Norman-López and Alessandra Tucci*

How Important Will the Transatlantic Trade and Investment Partnership Be for EU Small and Medium-sized Enterprises?

The increasing availability of firm-level data has enabled the rapid growth of academic literature analysing trade at the firm level and led to a deeper understanding of national export performance. One of the conclusions of this literature is that international trade is a world of a "happy few" exporters. Based on a subset of EU member state firm-level data, Mayer and Ottaviano found that a handful of firms account for a disproportionate share of aggregate exports.[1]

In absolute terms, however, the "happy few" EU exporters are quite numerous. Cernat, Norman-López and Duch T-Figueras used the Eurostat Trade by Enterprise Characteristics (TEC) database and found that the number of EU exporting firms is quite significant: there are over 750,000 European companies exporting outside the European Union.[2] This makes a fairly large "economic constituency" that stands to benefit from existing and future EU trade policy initiatives. Moreover, the Eurostat figures also indicated that the large majority of EU exporting enterprises are small and medium-sized enterprises (SMEs), i.e. firms with fewer than 250 employees and less than €50 million turnover, which generate a non-negligible share of EU exports. In 2011, over 600,000 (81 per cent of the total) EU enterprises exporting outside the EU were SMEs, with export sales over 500 billion euros (more than a third of EU total exports).

The TEC enterprise size distribution can also be used to calculate a rough estimate of the total number of jobs that are supported by SMEs exporting outside the EU. If the lowest employment value in each band is considered, it is possible to conclude that at least 6 million jobs in Europe are found in these SMEs.[3] In fact, this is a conservative estimate, as the estimation only considered the lower employment size band defined in the EU recommendation 2003/361[4] and Eurostat TEC data, since the distribution of EU SMEs within each of the size bands is not available.

* The authors are part of the Chief Economist and Trade Analysis unit in DG TRADE, European Commission. The views expressed herein are those of the authors and do not necessarily reflect the views of the European Commission.

1 T. Mayer, G. Ottaviano: The Happy Few: The internationalisation of European firms. New facts based on firm-level evidence, Bruegel Blueprint Series, Vol. 3, 2007.

2 L. Cernat, A. Norman-López, A. Duch T-Figueras: SMEs are more important than you think! Challenges and Opportunities for EU Exporting SMEs, Chief Economist Note Issue No. 3/2014, DG Trade, European Commission, 2014.

3 Ibid.

4 Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, C(2003) 1422, 2003/361/EC.

Table 1
EU goods exports to the US, SMEs vs. all enterprises, 2012

	SMEs exporting to the US		SMEs exporting to the US as a proportion of all enterprises exporting to the US	
Member state	Number of exporting enterprises (thousands)	Export value (€ billion)	Number of exporting enterprises (%)	Export value (%)
Italy	30.0	11.2	96	44
United Kingdom	26.8	11.7	93	27
Germany	20.7	12.4	77	15
France	19.3	8.3	92	32
Spain	15.5	3.0	93	35
Netherlands	6.1	9.4	94	59
Sweden	5.9	1.8	93	21
Poland	3.6	0.6	81	25
Belgium	3.2	4.5	69	23
Denmark	2.8	1.2	85	22
Austria	2.6	2.1	86	33
Finland	2.3	0.7	88	20
Portugal	2.2	0.5	90	29
Czech Republic	1.9	0.4	63	14
Ireland	1.8	7.3	90	44
Hungary	1.1	0.3	80	17
Greece	0.9	0.2	59	22
Bulgaria	0.7	0.1	87	40
Romania	0.6	0.2	61	24
Slovakia	0.4	0.1	75	9
Lithuania	0.3	0.1	86	22
Latvia	0.3	0.1	88	58
Estonia	0.2	0.4	86	65
Malta	0.1	0.0	86	13
Cyprus	0.1	0.0	79	28
Total EU	150	77	88	28

Source: European Commission: Small and Medium Sized Enterprises and the Transatlantic Trade and Investment Partnership, DG Trade, European Commission, 2015.

The conclusion that SMEs are not a negligible player in EU export performance is clear. More detailed firm-level trade information becomes key to identifying EU trade policy priorities, in line with complex and fast-changing economic realities. In the words of Mayer and Ottaviano: "This simple truth makes it clear that understanding the firm-level facts is essential to good policy making in Europe."[5]

5 T. Mayer, G. Ottaviano, op. cit, p. i.

The same powerful policy message holds for EU transatlantic trade. As further elaborated below, EU SMEs account for a very large share of both exporting and importing firms in Europe. But the fact that EU SMEs are well represented in transatlantic trade does not necessarily mean that they do not face problems. A recent survey of EU exporting SMEs done for a European Commission report on the benefits of TTIP for SMEs identified a wide range of potential trade barriers, with many of the barriers affecting firms of all sizes.[6]

Beyond aggregated Eurostat TEC figures, a wealth of detailed firm-level trade statistics allows a more detailed investigation on the participation of EU SMEs on transatlantic trade. In this paper, we use individual seaborne shipment transactions from the EU to the US to further assess the distribution of SMEs in the EU and the benefits that trade facilitation between the EU and the US might bring to EU SMEs located in tens of thousands of cities and villages, in all EU member states. The paper also highlights the importance of SMEs in service trade outside of the EU and provides a summary of the barriers facing SMEs exporting to the US.

SMEs make up a significant proportion of EU goods exports to the US

Goods

As already documented in the case of total EU trade worldwide, SMEs are important players in EU-US trade. On the basis of the Trade by Enterprise Characteristics (TEC) database, Table 1 presents the number and the shares of EU SMEs exporting to the US. Relative to the total number of exporters to the US, SMEs represent 88 per cent of the total number of EU exporting companies and 28 per cent of the total value of EU exports to the US. This means 150,000 SME exporters are selling €77 billion of goods to the US. SMEs therefore are responsible for a sizeable contribution of EU exports to the US.

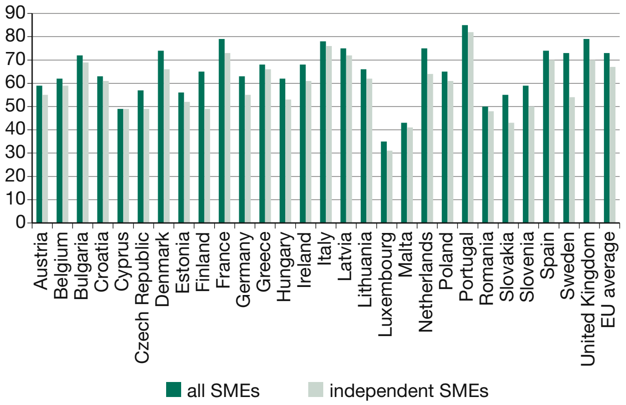
The importance of SMEs in the export of goods to the US varies across member states. Italy has the largest number of exporting SMEs and is among the top three SME exporters to the US in value terms (€11.2 billion). Germany is ranked only third in terms of the number of exporting SMEs, but it is ranked first in terms of export value to the US. Other member states have a much higher degree of

6 European Commission: European Commission: Small and Medium Sized Enterprises and the Transatlantic Trade and Investment Partnership, DG Trade, European Commission, 2015. This report was prepared by A. Norman-López, E. O'Malley, N. Sousa and A. Tucci.

Figure 1

Share of SMEs exporting to the US to total number of enterprises exporting to the US

in %



Note: Data covers the period from 1 December 2012 to 31 October 2013. In addition to the independent SMEs, "all SMEs" includes SMEs controlled by other firms as long as the total employment and sales of the group do not exceed the European Union thresholds for identifying SMEs (250 employees and €50 million turnover).

Sources: DG Trade and Dun & Bradstreet databases.

Table 2

Geographical distribution of ownership of EU SMEs exporting to the US that are affiliates of larger foreign companies

Country	Countries' share of parent companies (%)
EU	47.0
USA	31.8
Japan	8.8
Switzerland	6.9
Canada	1.1
India	1.0
Norway	0.7
Singapore	0.5
Korea	0.4
Australia	0.3
Other non-EU countries	1.5

Note: Data covers the period from 1 December 2012 to 31 October 2013.

Sources: DG Trade and Dun & Bradstreet databases.

SME participation than the EU average. For instance, 65 per cent of Estonian exports to the US are by SMEs.

A further investigation on the relevance of SMEs comes from detailed firm-level data.[7] This data allows us, inter alia, to see the ultimate owner of exporting firms. For SMEs, this permits us to identify whether these firms are independent or part of a bigger national or international group. There are reasons to think that the independent SMEs would behave differently in terms of exports than SMEs that belong to larger firms. As can be seen from Figure 1, most SMEs in all EU member states are independent (i.e. not owned by another firm, even if this is itself an SME). Overall, 92 per cent of all EU exporting SMEs are independent or together with their parent companies still qualify as SMEs, and eight per cent of SMEs belong to a large group (based on the total employment and turnover of the group).

Of those "SMEs part of a larger group" firms, about 40 per cent are owned by domestic companies. The remaining 60 per cent are owned by foreign companies. Table 2 shows the geographical distribution of the ownership of these SMEs that are foreign affiliates of bigger groups. Almost 50 per cent of these are affiliates of other EU countries' companies, and more than 30 per cent are affiliates of US companies. The other two non-TTIP countries with significant exporting SME ownership shares in the EU are Japan (8.8 per cent) and Switzerland (6.9 per cent).

Figure 2 shows the geographical distribution of EU firms of different sizes (independently owned small and medium-sized firms, large firms, and SMEs belonging to a global group) exporting to the US. From this spatial plot, it is possible to note a wider regional distribution of small and medium-sized firms exporting to the US compared to that of big exporters and SMEs belonging to a global group. Overall, most of the exporting firms are centrally located in the EU (Italy, Germany and the UK), as also highlighted in Table 1. When it comes to SME exporters that belong to a bigger group, their geographical distribution seems to mimic the distribution of larger firms.

Services

SMEs are also relevant in trade in services, as highlighted in a pilot survey carried out in six EU member states – Austria, the Czech Republic, Denmark, Estonia, Luxembourg and Poland. While the limited dataset should not be generalised, it highlights a larger variability in the importance of SMEs

7 Dun & Bradstreet carried out a project for DG TRADE matching US import transaction records from the publicly available "Manifest Data" to the publicly available balance sheets of EU exporters. This exercise covers the period 1 December 2012 to 31 October 2013, and it includes all the seaborne shipments from the EU to the US. More than a million transactions were matched to indicators from the balance sheet of EU exporting firms. The database therefore includes both the information on the transactions from the US custom forms as well as information on EU exporters such as location, employment, turnover and ownership structure.

Figure 2
Geographical distribution of EU exporters to the US

Note: Data covers the period from 1 December 2012 to 31 October 2013.

Sources: DG Trade and Dun & Bradstreet databases; plot from ggmap, see D. Kahle, H. Wickham: ggmap: Spatial Visualization with ggplot2, in: The R Journal, Vol. 5, No. 1, 2013, pp. 144-161.

in service exports than in the goods sector across member states, both in numbers and trade values (see Table 3).

As in the case of trade in goods, Estonia stands out as heavily dependent on the performance of SME services exporters, whereas in Denmark services exports tend to be dominated by large firms. The results for Denmark, at least for the values, are mainly due to one or several large firms in the transportation and storage sector exporting services outside of the EU, and this sector is very important for the

Table 3

Share of SMEs to total services exporting enterprises, 2011

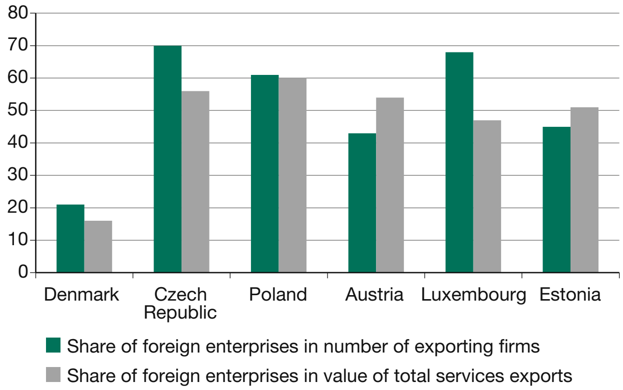
Country	Number of exporting SMEs (%)	Value of exporting SMEs (%)
Denmark	32	26
Czech Republic	40	36
Poland	51	35
Austria	51	48
Luxembourg	74	66
Estonia	82	92

Source: Eurostat, Services_trade_by_enterprise_characteristics – STEC.

Figure 3

Share of foreign-owned exporting service enterprises, 2011

in %



Source: Eurostat, Services_trade_by_enterprise_characteristics – STEC.

country. The same sector, transportation and storage, is also important for Estonia, where it represents the majority of service exports, although most of the value of exports in Estonia is derived from small and medium-sized enterprises.

Despite the fact that the share of SME services exporters in the total number of EU exporting firms is lower in most countries in Table 3 than in the goods area, the share of services SMEs in the total value of EU services exports tends to be somewhat higher than the corresponding indicator for trade in goods. This suggests that SME services exporters are "fewer, but happier" than goods-exporting SMEs.

In addition, Figure 3 presents the share of firms that are controlled by a domestic firm by number and by value of their exports outside the EU. This figure aggregates EU exporting firms of all sizes. Again, a large level of variability can be observed with respect to the domestic ownership of exporting firms outside of the EU among the six EU member states, with Denmark having the highest domestic ownership of EU exporting firms (around 80 per cent in terms of both number and value).

These first SME services export statistics, while limited to a small number of EU member states, have great potential for further policy insights. An EU-wide dataset providing service statistics by trade enterprise characteristics for all EU member states along the lines of the EU TEC database would provide a more thorough understanding of the heterogeneity facing service firms in the EU and thus better inform EU policy making in this important area.

For instance, the role of SME services exporters could be worth exploring, both in terms of more quantitative analysis and specific policy options. Several papers have concluded that the General Agreement on Trade in Services (GATS) rules offer additional avenues to consider SME-specific issues in trade agreements, given the possibility of trade disciplines by supplier characteristics (e.g. SMEs vs. large enterprises).[8] An emerging academic literature also compares the various GATS and free trade agreement (FTA) commitments for trade in services specific to SMEs.[9] Such policy analyses will ideally go hand in hand with more data becoming available in this area.

The non-tariff measures affecting EU SMEs exporting to the US

In the 2015 report "Small and Medium Sized Enterprises and the Transatlantic Trade and Investment Partnership", the European Commission presents the results of an online survey of 869 EU firms with quantitative and qualitative replies on the non-tariff barriers faced by EU firms in both goods and services.[10] On average, 30 per cent of the issues raised were linked to regulatory compliance and 27 per cent of the non-exporters that participated in the survey claimed that this was the main reason for not exporting.

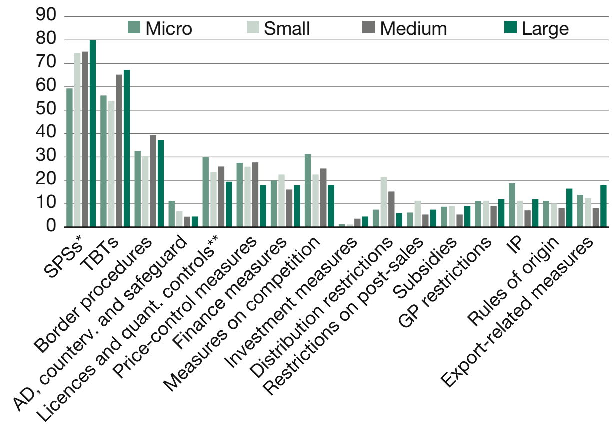
On the basis of the replies to the survey, it has been concluded that non-tariff measures (NTMs) in goods act as

8 R. Adlung, M. Soprana: SMEs in Services Trade – A GATS Perspective, WTO Staff Working Papers, ERSD 2012-09, 2012, pp. 1-30; and R. Adlung, S. Miroudot: Poison in the Wine? Tracing GATS-Minus Commitments in Regional Trade Agreements, WTO Staff Working Papers, ERSD 2012-04, 2012, pp. 1-25.

9 D. Persin: Market Access for Small versus Large Service Enterprises: The Preferential and Multilateral Trade Liberalization Tracks Compared, in: Journal of World Trade, Vol. 45, No. 4, 2011, pp. 785-819.

10 For a description of the survey and of the sample, see European Commission: Small and Medium Sized Enterprises and the Transatlantic Trade and Investment Partnership, DG Trade, European Commission, 2015.

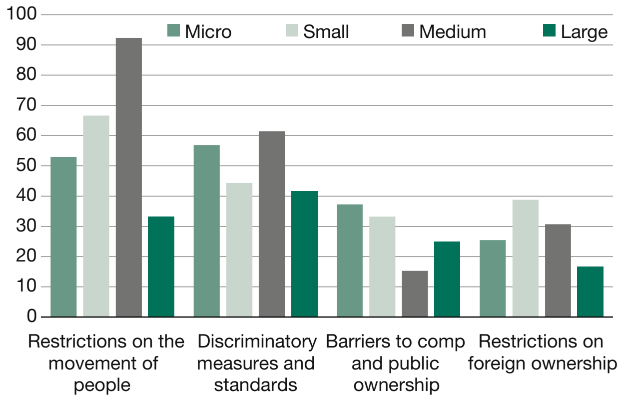
Figure 4
Reported trade barriers, goods
by firm size, in %



Notes: * Only for exporters of food, drink, animal feed and products that come into contact with food (e.g. packaging, cooking utensils). ** Including quotas.

Source: European Commission: Small and Medium Sized Enterprises and the Transatlantic Trade and Investment Partnership, DG Trade, European Commission, 2015.

Figure 5
Reported trade barriers, services
by firm size, in %



Source: European Commission: Small and Medium Sized Enterprises and the Transatlantic Trade and Investment Partnership, DG Trade, European Commission, 2015.

an impediment to trade for firms of all sizes (even more evidence than we already had), as shown in Figure 4.

There are, however, some services trade restrictions, like the restrictions on the movement of people (see Figure 5), that seem to affect SME exports of services to the US more than the exports of larger firms.

The report also confirms the general understanding that barriers are likely to be more of a deterrent for the exports of SMEs than for those of large firms, as these smaller firms perceive them as more costly relative to their sales, as shown by the replies to the online survey reported in Table 4.

In addition, SMEs actively responded to a variety of cross-cutting issues. These responses were linked to crossing the border (inspections, delays, and administrative burden, including compliance with rules of origin), rules affecting competition in the US market and financing of transactions (including insurance), intellectual property (geographical indication and differences in patent systems), and public procurement.

Finally, one question aimed to understand which US regulator affected EU firms the most (Table 5). The surprisingly high share of "I do not know" responses shows that the access to information on applied regulations is an issue

Table 4
Disproportionate costs of NTMs to SMEs

	Micro		Small		Medium		Large		Total
(a) 0%-5%	11	31%	23	53%	32	48%	23	53%	89
(b) 5%-20%	11	31%	9	21%	25	37%	17	40%	62
(c) More than 20%	7	19%	4	9%	2	3%	2	5%	15
NA	7	19%	7	16%	8	12%	1	2%	23
Total	36		43		67		43		189

Note: Replies to: "Compared to your actual sales in the US in 2013 (or in the last year you have exported to the US), the cost of the rules and regulations identified above represent".

Source: European Commission: Small and Medium Sized Enterprises and the Transatlantic Trade and Investment Partnership, DG Trade, European Commission, 2015.

Table 5
Who applies the NTMs?, survey responses
in %

	The US federal government	The US states	It is a private standard	Do not know
Goods	43.6	16.5	6.3	33.8
Services	34.8	15.5	3.8	45.8

Source: European Commission: Small and Medium Sized Enterprises and the Transatlantic Trade and Investment Partnership, DG Trade, European Commission, 2015.

for all firms exporting to the US. Firms do not know who is imposing the regulation (even if they know that it exists), and therefore they could not trace it.

Conclusions

The analytical and policy discussions surrounding the TTIP negotiations have shown that EU exporting SMEs will be one of the main beneficiaries of the negotiated outcome, given their dominance in the total number of existing exporters and their non-negligible share in total transatlantic trade.

The broader debate about the role of EU SMEs for EU export competitiveness has also demonstrated that there is great value in further deepening our understanding of the factors shaping SME export performance. Firm-level theoretical and empirical analyses have demonstrated that export performance is critically determined by firm characteristics such as the ability to innovate, productivity levels, firm size and corporate governance. However, few, if any, trade policy analyses have been conducted at the firm level. Based on this, it is essential to take advantage of the available firm-level trade data in the public domain in order to guide trade policy.[11]

The role of global value chains (GVCs) and in particular the ability of SMEs to leverage their GVC participation to become successful exporters is also important. One empirical study, based on a sample of Italian exporting firms, found a positive correlation between the participation of SMEs in global value chains and the propensity to become an exporter.[12] This evidence proves the need to better comprehend the difference in performance between SMEs, best practices across member states and the need to detect which trade barriers have the largest effects on SME export performance.

Therefore, the various EU trade policy initiatives, although not specifically aimed at SMEs, offer good exporting opportunities for all EU exporters. Certain trade barriers may be SME-specific. In-depth analyses of how these barriers could be avoided would be useful. Given the large number of EU exporting SMEs and their important share in EU exports, it is important to identify and tackle the most detrimental SME-specific trade impediments (e.g. transparency, trade facilitation, NTMs) in future EU trade policy initiatives.

In sum, SMEs are more important for EU trade performance than one might think, and they have benefited from previous FTAs. With renewed attention and a more comprehensive database, policy makers can ensure that future FTAs are also beneficial to EU SMEs.

11 L. Cernat: Towards Trade Policy Analysis 2.0: From National Comparative Advantage to Firm-Level Trade Data, ADBI Working Paper Series, No. 516/2015, Asian Development Bank Institute, 2015.

12 G. Giovannetti, E. Marvasi, M. Sanfilippo: Supply Chains and the Internationalization of SMEs: Evidence from Italy, Robert Schuman Centre for Advanced Studies Research Paper, No. RSCAS 2014/62, 2014.

Monique Goyens and Léa Auffret*

TTIP: What Is in It for Consumers?

The Transatlantic Trade and Investment Partnership (TTIP) has become a household name across Europe. In this short paper, we outline why consumers across the EU, as well as consumer advocates at the national level and in Brussels, deservedly pay close attention to what is under negotiation between the EU and the US.

We first take up the transparency issue in TTIP. Next, we focus on the importance of the regulatory framework in delivering the expected benefits of the agreement. We also look at the missed opportunities in the version of TTIP that is currently on the table. Finally, we tackle the most controversial TTIP topic of all: the investor-to-state dispute settlement mechanism (ISDS), including our reaction to the recent EU proposal for an Investment Court System (ICS).

So much at stake, yet insufficient public debate

It is often said in official circles that TTIP is the most transparent trade negotiation in history. Although this may technically be accurate, it is not necessarily an achievement, given that negotiations were launched from a point of near total secrecy.

* Johannes Kleis, Head of Communication at the European Consumer Organisation (BEUC) and alternate member of the TTIP Advisory Group, also contributed to this article.

Let us be clear: the efforts made by the European Commission to publish its proposals and approaches are welcome and laudable, and any endeavour to question the Commission's legitimate attempt to ensure a transparent process should be countered.

Unfortunately, however, the Commission has now attained its maximum potential as far as transparency is concerned, as the US steadfastly refuses to share both its own proposals and the consolidated versions. Not only is this concealment conceptually unacceptable, but it also carries the risk of potentially unintended consequences, as the public has to date only been informed about the initial position of the European Commission. Once texts are consolidated, the public is kept in the dark about further developments or fundamental changes. This gives free rein for sharp U-turns to be made between proposals that the public has seen and commented on and the more advanced versions of the texts.

This imbalanced release of information is feeding public suspicion and will certainly not help to promote the trust that is greatly lacking in the negotiations. The situation is even more critical now that the Trans-Pacific Partnership text has been released, as it diverges significantly from the public reassurances given by negotiators. It is important to remember that there can be no accountability without direct access to the text itself, and that declarations by negotiators cannot be guaranteed as accurate in terms of actual content and outcomes of the deal.

Trade can be good for consumers, but it all depends on the overall regulatory framework

The European Consumer Organisation (BEUC) is in favour of free trade: it delivers more vibrant markets, increases consumer choice by offering a wider variety of products and places competitive pressure on retail prices. In the past, many free trade agreements have benefitted consumers by facilitating market access and reducing or eliminating tariffs.

In the context of the TTIP negotiations, the question at stake is whether the agreement will deliver similar benefits without jeopardising key consumer protection standards. To begin with, tariffs between the US and the EU are already low, and market access is generally good. The anticipated growth in transatlantic trade will thus depend on the reduction of costs for business linked to regulatory differences between the two negotiating partners. From the consumer perspective, it is crucial to know how far – and under what conditions – regulations should be aligned for the sake of trade. Concurrently, it is essential to define the "red lines" in order to fully preserve the regulatory sovereignty of each partner. In the case of regulatory differences, it is imperative that public interest policies can be rolled out.

This double approach needs careful balancing. Over the last few years, a heated debate has broken out around the different risk assessment and management approaches in the EU – which favours the precautionary principle – and the US, which uses a cost-benefit approach. US voices have repeatedly questioned the EU's precautionary principle, which involves a more cautious marketing process for products and services in the case of scientific uncertainty.

We feel that the debate over the precautionary principle versus the science-based approach is not the most relevant one from the consumer perspective. We will not repeat the arguments in favour of the strong application of the precautionary principle here, or the fact that it is a science-based principle. Instead, we want to stress that underlying this debate is another even more paradoxical issue: although open markets like those in the US and the EU are based on free consumer choice, there is a push to "force" products on the market simply because science considers them safe.

However, even though science allows something, it does not mean that consumers want it. Consumer preferences should thus be a guiding principle in policy making. At the very least, consumers must be provided with the tools to make free choices. In today's market, even labelling requirements are considered to be regulatory barriers in the case of GMOs or cosmetics, for example. A consumer-friendly TTIP must therefore strive for a regulatory framework that has robust guarantees for accurate, fair, exhaustive and truthful information for consumers.

The missed opportunities of TTIP for consumers

Trade agreements can deliver benefits for consumers if they are well designed. TTIP is being presented as an ambitious 21st century agreement that will facilitate transatlantic trade and increase bilateral flows of goods, services and investments. Therefore, it is necessary to walk the full journey of transatlantic trade. Indeed, all of the eventualities of an agreement need to be anticipated and assessed en route if benefits for consumers are to become a reality. Enhanced trade flows are likely to go hand-in-hand with an upsurge in consumer complaints. This dynamic has not yet been tackled by EU or US negotiators. They need to clarify the long-term vision behind TTIP and develop a pragmatic picture of how EU-US trade flows will look in the coming decades. This ranges from what will be offered on the market to how post-sale disputes will be handled.

Let us take the example of services in the context of TTIP. Despite repeated reassurances by TTIP negotiators about the primacy of consumer protection, US service providers will not necessarily have to comply with EU consumer law. This is not just a question of place of residence, but it also depends upon several factors such as the law applicable to consumer contracts and whether non-EU providers target EU consumers.[1] Moreover, even in the case that EU law would apply in such situations, it would be more complicated for consumers to seek redress in a dispute with a US provider (for example, choice of forum clauses might localise the dispute to US courts or even to arbitrators from the home country of the service provider). In addition, redress is unlikely when a consumer needs to be compensated by a service provider without assets in the EU. There is thus no guaranteed access to dispute resolution mechanisms for transatlantic cross-border services. From a consumer perspective, this undermines the overall logic of delivering benefits for consumers through TTIP.

Another potential missed opportunity in TTIP is the enhancement of consumer protection in sectors such as health, toy safety and food safety. Negotiators are currently discussing how to improve cooperation between regulators on both sides in order to facilitate trade and avoid unnecessary barriers beyond the border. There exist ongoing, potentially positive initiatives, notably the joint efforts around fighting against antimicrobial resistance and facilitating access to medicine and medical treatments for patients. These initiatives should be pursued on a larger scale in order to upgrade the level of protection for consumers on both sides of the Atlantic.

To give an example, European consumers could benefit from the improvement of toy safety standards as inspired by the US system. The US mandates third party certification for imported toys in order to verify their compliance with US standards. Such a requirement does not exist in the EU; toys here must simply comply with the EU Toy Safety Directive.[2] Overall, the US third party certification requirement has contributed to a decrease in the number of recalls. So far, the parties do not appear to be pursuing improved cooperation on toy safety in the context of TTIP. We regret that this kind of positive opportunity is being neglected, as it could bring direct benefits to EU consumers.

Furthermore, the argument that TTIP will provide enhanced quality and choice and that consumers will automatically benefit from reduced prices for goods and services is not empirically accurate. TTIP fails to provide a framework for strong competitive pressure. Lower prices and wider choices for consumers require an impetus to improve the quality of goods and services. In the absence of competitive pressure, these anticipated results of TTIP will not materialise. This is an issue that market authorities should take seriously.

The greatest concern: regulatory cooperation

In the history of trade agreement negotiations, there has never before been such a push for cooperation on regulatory matters. This fundamentally changes the nature of the agreement: the focus is not so much on how to facilitate trade in the current regulatory environment, but rather on how to adapt the current regulatory framework in order to facilitate trade.

What is at stake goes far beyond just a minor rephrasing of goals. The new focus substantially alters the sovereignty of countries and their regulatory components to adopt rules that they consider to be good for their constituencies.

In fact, this is also what has happened throughout the course of EU integration. However, the fundamental difference between TTIP and the EU's single market policy lies in the fact that the conditions for the latter were not agreed behind closed doors and were subject to a full democratic debate. The regulatory cooperation provisions in TTIP, however, remain partially secret, as the public is aware only of the EU's approach to the negotiations.

The fundamental flaw in the TTIP debate is the confusion that has been established and is being maintained between the issue of cooperation between *regulators* – which is to be welcomed, albeit not necessarily in the context of a trade deal – and the more formal cooperation on *regulations* – which should be rejected.[3]

1 The "Shopping online" section of the official website of the European Union states: "Your consumer rights under EU rules normally also apply to purchases from non-EU online traders targeting consumers in the EU. However, please be aware that you may have more difficulties in claiming your rights against traders based outside the EU." See europa.eu. BEUC believes that consumer disputes could increase in the future due to further facilitation of trade, and intends to focus on the issue of consumer protection outside of the EU in cases related to TTIP, as well as to the Trade in Services Agreement.

2 Directive 2009/48/EC of the European Parliament and of the Council of 18 June 2009 on the safety of toys, Official Journal of the European Union, L 170, 30 June 2009, pp. 1-37.

3 See BEUC position paper on regulatory cooperation in TTIP, BEUC: Optimising regulatory coherence in TTIP: need to focus on regulators, not regulations, 2015.

Cooperation between regulators implies the exchange of information, scientific data and best practices. This type of cooperation can prevent redundancies and, in principle, should be welcomed as long as it is considered as a tool within the general toolbox available to the regulators and is not binding. As this kind of cooperation already exists at different levels between EU and US regulators, one is forced to wonder why TTIP is needed.

But let us assume that cooperation can be given a helpful boost by TTIP and that consumers can also benefit by, for example, reduced exposure to safety risks, more fluid management of scientific data, lower costs for companies thanks to the elimination of redundancies, and therefore, indirectly, potential price reductions.

Regardless of these possible plus points, it must above all be recognised that cooperation on regulations within TTIP would grant US authorities and their lobbies preferential treatment in the early stages of the regulatory decision-making process. While the current provisions, as proposed by the EU, do not provide the formal right to veto a domestic regulation, they do offer manifold opportunities to delay the regulatory process and to exert pressure on regulators. This could in turn lead to watered down ambitions for provisions in the pipeline, certainly when combined with the threat to sue on the basis of investment protection provisions.

There is no reason to provide external stakeholders with earlier access and greater powers than those held by domestic legislators. The ramifications of this "regulatory chill" effect are not just a myth.[4] In recent years, we have witnessed several foot-dragging displays by the Commission, for example with endocrine disrupters. There have also been cases in which existing regulations have been diluted as a consequence of pressure exerted by trade partners, be they from Canada or the US. This was, for example, the situation with the regulation on the use of lactic acid or hot water treatment in the decontamination of meat.[5] In the past, the EU had only authorised the use of cold water to decontaminate meat carcasses, as its farm-to-fork approach guarantees meat safety all along the food chain.[6] The authorisation for other decontamination treatments in recent years was a turning point that can be directly linked to the trade negotiations with the US and Canada.

Incidentally, it must be noted that while the Commission is fully committed to its own Better Regulation Agenda with a heavy focus on public consultations and impact assessments, the provisions it proposes on regulatory cooperation in TTIP have not undergone any public scrutiny or impact assessment. This is worrying, as the proposed regulatory cooperation framework in TTIP will certainly lead to an increase in administrative burdens at all levels of policy making. Indeed, the EU's current proposal for a three-layer regulatory cooperation system would imply frequent meetings and information exchange at the political, technical and administrative levels.

The false promises of the ICS

It has become impossible to approach the TTIP debate without mentioning the now infamous ISDS. Investment provisions in TTIP might appear to be a distant concern for consumers. However, the issue at stake with ISDS is that it goes far beyond a mere technical apparatus in that it changes the way in which investment protection can influence domestic regulations and therefore consumer protection measures. We will not discuss here the flaws we have identified in the ISDS,[7] but will rather focus on the recent Commission proposal to establish an ICS.

This proposal is a positive initiative, in the sense that it proves that a public debate on TTIP can result in constructive changes in trade and investment policy. With this proposal, the Commission recognises the risks of ISDS and shows its willingness to address the concerns of citizens and decision makers regarding the right to regulate, transparency, and conflicts of interest on the part of the arbitrators.[8] Nevertheless, the proposal fails to address the fundamental flaws of ISDS for several key reasons.[9]

Firstly, the right to regulate is not protected. Although the ICS proposal does include a specific article on the right to regulate, it does not entirely prevent investor claims from setting a regulatory chill effect into motion.[10] Under the new proposal, foreign investors still have the opportunity to sue governments for compensation. This could happen, for example, if a government tries to adopt an ambi-

4 A. Alemanno: The Regulatory Cooperation Chapter of the Transatlantic Trade and Investment Partnership: Institutional Structures and Democratic Consequences, in: Journal of International Economic Law, Vol. 18, No. 3, 2015, pp. 625-640.

5 Letter of Canadian Agriculture Minister Gerry Ritz to EU SANCO Commissioner Tonio Borg, 23 March 2014, Ref. Ares(2014)897635.

6 Good hygiene practices and safety management systems have to be in place all along the food production chain so that the food sold to end consumers is ultimately safe.

7 See BEUC: TTIP – Investment protection and ISDS, BEUC response to the European Commission's Public Consultation, 2014.

8 BEUC: BEUC's key concerns about the Investment Court System proposal, 2015.

9 M. Goyens: From ISDS to ICS: Still a long way to go, The consumer view on TTIP, BEUC, 22 October 2015.

10 See also G. Van Harten: Preliminary criticisms of the new EC proposals on ISDS and TTIP, Osgoode Hall Law School, 9 November 2015.

tious consumer protection law. While the regulation would be upheld as intended, the investor would have the right to demand compensation, and this could deter governments from introducing new protections (thus resulting in regulatory chill). It is essential that TTIP legally enshrines the right to regulate by explicitly mentioning that claims against measures designed to meet public policy objectives are not admissible.

Secondly, conflicts of interest are not an issue of the past. The ICS proposal includes provisions on ethics and a code of conduct for judges and members of the court system yet fails to guarantee real independence. In particular, it allows judges to continue to work as corporate lawyers. To ensure that judges are truly independent, and to prevent conflicts of interest from arising, the Commission should further reinforce the code of conduct and the ethics provisions in its proposal. It is, for example, not acceptable for a judge to be linked directly or indirectly to one of the parties before or after a dispute. A judge must furthermore refrain from acting as a counsel, expert or witness in another dispute, as the EU proposes, and additionally should be barred from taking on the position of a corporate lawyer or arbitrator in another dispute.

Thirdly, the costs and administrative impacts of establishing an ICS have not been evaluated. It is alarming that in this "era of better regulation" the Commission is proposing a brand new bilateral court system. Although the ICS would likely become multilateral in the future, no proper impact assessment has ever been carried out. We therefore urge the Commission to evaluate the financial and administrative implications of its proposal.

Finally, and most importantly, there is still no evidence proving the need for a parallel judicial system between the two most developed legal systems in the world. Existing levels of protection in the EU and the US are surely enough to guarantee legal security for investors.[11] Therefore, the proposal does not respond to the needs of consumers or citizens regarding investment protection in TTIP.

TTIP cannot exist without trust and concrete benefits for all

TTIP negotiations have been underway for more than two years, and talks will continue in the coming years. In the end, the outcome of all these years of preparation, negotiations and legal scrubbing will not only be the conclusion of the deal, but its ratification and implementation. For TTIP to enter into force, the consent of the European Parliament and the EU Council is compulsory, and certainly the approval of national parliaments is required. Negotiators are well aware that this final green light will be directly influenced by public opinion.

Important lessons can be learned from the demise of the Anti-Counterfeiting Agreement – for example, that negotiators must keep decision makers and public interest organisations fully involved and informed.[12] Most importantly, they need to demonstrate to EU citizens that TTIP has concrete benefits for them and that it will not lower their levels of protection. Vague verbal reassurances are not enough: trust will only come from transparency, effective legal safeguards in negotiating texts and improved communication.

11 This is also the conclusion reached by the Legal Affairs Committee of the European Parliament, which is responsible for the interpretation of EU and international law. See European Parliament: Opinion of the Committee on Legal Affairs for the Committee on International Trade on recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP), 2014/2228(INI), 4 May 2015.

12 The Anti-Counterfeiting Agreement, rejected after its conclusion by the European Parliament in 2012.

Galina Kolev, Jürgen Matthes

TTIP: Effects on the Automotive Industry

The Transatlantic Trade and Investment Partnership (TTIP) is expected to remove a wide range of tariff and non-tariff trade barriers for the EU and US automotive industry. The potential benefits of trade liberalisation in the field of motor vehicles are greater than in nearly any other industry sector. Although average tariff rates are already relatively low, the expected cost reduction due to tariff elimination ranges in the billions of euros. This will also promote transatlantic trade, raise competition, increase the incentives for innovations and reduce consumer prices. Furthermore, although substantially different from each other, safety regulations often deliver similar outcomes in the EU and US, as measured e.g. by the fatality rate in road traffic.[1] Therefore, mutual recognition of many vehicle safety standards is possible. This will create opportunities to facilitate transatlantic trade in motor vehicles, parts and accessories that go far beyond tariff elimination.

Still, although the outcome of safety regulations is comparable in terms of fatality rates, this does not automatically mean that every safety regulation should be mutually recognised. Some differences in product regulations are the result of different historical developments of two independent regulatory bodies. Others, however, reflect differences in consumer preferences or geographical peculiarities. Furthermore, it is only possible to sustain the high level of consumer protection if trade liberalisation and, in particular, the elimination of non-tariff barriers (NTBs) via mutual recognition of safety standards are based on evidence that the outcome of the particular regulations is sufficiently similar.

The purpose of this paper is to contribute to the discussion about the challenges regarding trade liberalisation in the field of motor vehicles.[2] It offers an overview of some differences and similarities of the regulations regarding passenger safety and environmental standards. We find that trade liberalisation is possible based on sound evidence that technical standards and product regulations lead to the same level of safety for cars driven on both EU and US roads.

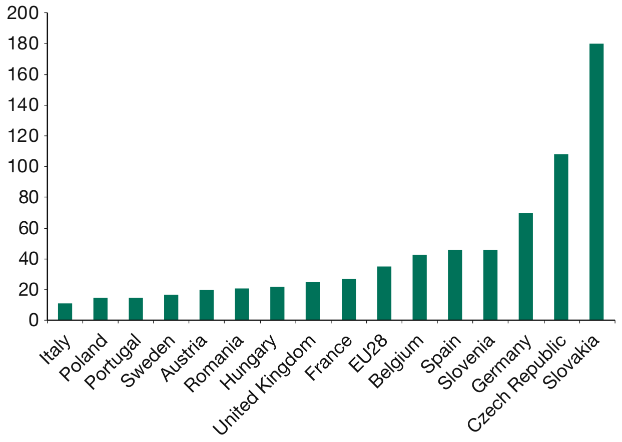
The European automotive industry

The EU automotive industry is the second largest manufacturer of motor vehicles worldwide (after China) and generates directly and indirectly millions of jobs throughout the EU. Almost 23 per cent of the 90.6 million motor vehicles produced globally in 2014 were manufactured in the EU member states.[3] The largest share in the EU can be ascribed to the German automotive industry, which produced a total of 6 million motor vehicles in 2014. Nevertheless, the automotive industry is of strategic importance in other EU member states as well, especially in countries in Central and Eastern Europe. In Slovakia,

Figure 1

Motor vehicle production per 1000 inhabitants, 2013

Number of vehicles



Source: ACEA – European Automobile Manufacturers Association: The Automobile Industry Pocket Guide 2014-2015, 2014.

for instance, per capita motor vehicle production is more than twice as high as in Germany (see Figure 1). In the Czech Republic, Slovenia, Spain and Belgium, per capita motor vehicle production also lies above the EU average.

The European automotive industry is characterised by a high degree of export orientation, and the US represents by far the largest market for EU automotive exports (followed by China and Russia). Furthermore, the EU runs a huge trade surplus in the transatlantic trade of passenger cars (as well as with motor vehicles and parts as a whole). This indicates that European automotive manufacturers should be especially interested in removing tariffs and NTBs between the EU and the USA. Indeed, both the EU and US auto industries call for a comprehensive trade agreement in the field of motor vehicles.[4]

European car manufacturers often pursue a two-pillar strategy. On international markets, they offer both exported products from Europe and products from local production abroad. Data provided by the German Association of the Automotive Industry (VDA) show that the share of automotive sales in the US market has recently shifted towards local production abroad. Exports from German automotive manufacturers increased by 20 per cent between 2004 and 2014, whereas local production in the US increased by about 230 per cent in the same period of time. Among the main reasons to relocate produc-

1 C. Freund, S. Oliver: Gains from Harmonizing US and EU Auto Regulations under the Transatlantic Trade and Investment Partnership, Peterson Institute for International Economics Policy Brief No. PB15-10, June 2015.

2 For earlier versions of the paper see G. Kolev, J. Matthes: TTIP: Motor Vehicles, Study for the IMCO Committee, 2015; and G. Kolev: TTIP: Challenges and Opportunities for the European Automotive Industry, IW Policy Paper No. 26, 2015.

3 ACEA: TTIP Regulatory Aspects. Automobile industry perspective, Presentation prepared for the joint JURI/INTA hearing on 27 January, 2015.

4 EU and US auto industry call for a comprehensive agreement under TTIP, Press release, European Automobile Manufacturers Association, 11 March 2014.

tion near the US market are trade barriers, which impede transatlantic trade due to tariff payments and/or regulatory differences. Average tariff rates are relatively low for the automotive industry. However, due to the large trade volume, annual tariff payments for transatlantic automotive trade lie in the billions of euros. NTBs are even more important as a cost-pushing factor. Producers have to cope with different technical standards and product regulations for their export products. General Motors claims that the costs for adjusting its EU-based Opel Adam to US automotive standards lie in the tens of millions of euros.[5]

Table 1
Tariff rates for automotive industry products

	Tariff rate, %	
	EU	US
Passenger cars	10	2.5
Light trucks/pick-ups	10	25
Commercial vehicles	22	25
Buses	16	2
Parts	2-5	0-2.5

Source: German Association of the Automotive Industry (VDA).

Opportunities and challenges of TTIP for the automotive industry

The negotiations on TTIP are unique in the history of international trade policy. Two global players who share common values have been negotiating a comprehensive trade agreement, the result of which will have the potential to set international product standards and thus to initiate multilateral harmonisation of technical regulations. In the automotive industry, the objective of the TTIP negotiators is to achieve a high degree of trade liberalisation while defending the right to regulate and the precautionary principle in the EU.

In May 2014, the EU Commission presented its initial position and recognised the potential for efficiency gains and cost savings that can be achieved by addressing the regulatory divergence between US and EU regulations of motor vehicles. The aim of the EU is to achieve more compatibility between motor vehicles regulations without lowering standards on either side. The industrial associations representing the interests of EU and US automotive producers also articulated their call for far-reaching harmonisation of technical standards and regulations on both sides of the Atlantic.

Reducing tariffs and NTBs is of particular interest to both EU and US companies. An overwhelming share of transatlantic trade takes place within large companies such as General Motors or Ford. Using US Census data for the trade flows in the automotive industry, Felbermayr et al. show that 38.8 per cent of German exports to the US, and 80.1 per cent of German imports from the US, take place at an intra-firm level.[6] Therefore, producers from the automotive industry at many different stages of the value chain will benefit from reducing trade barriers. Automotive suppliers also welcome the initiative to liberalise transatlantic trade. Representatives of the European Association of Automotive Suppliers stressed the positive effects to be expected from TTIP during the stakeholder event of the eighth round of TTIP negotiations, expressing their support for TTIP to be finalised before the end of 2016.

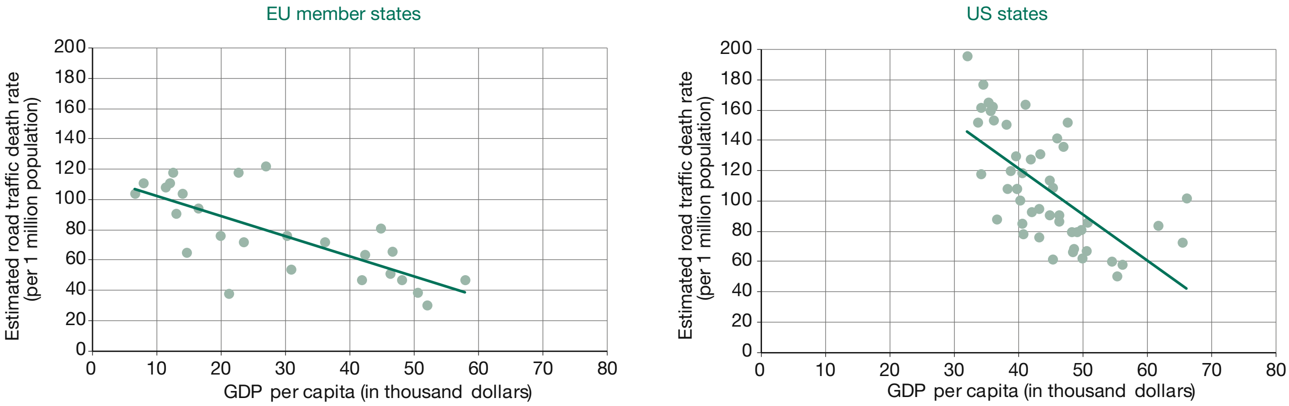
The first step to be taken to liberalise trade is *the elimination of tariff barriers* to transatlantic trade. Average tariff rates for transport equipment are already relatively low, amounting to 3.1 per cent in the US and 4.1 per cent in the EU. However, due to the large trade volume, tariff payments still represent a substantial cost factor. According to estimations by the VDA, the additional costs to members of the association due to tariff payments amount to about €1 billion.[7] Furthermore, tariff rates differ widely depending on the particular product group (Table 1). Tariff rates on imports to the US range from 0-2.5 per cent for parts to 25 per cent for light trucks and commercial vehicles. For the most important product group, passenger cars, which account for almost 80 per cent of EU automotive exports to the US, the tariff rates are 2.5 per cent on US imports and 10 per cent on EU imports.

Eliminating tariffs on transatlantic trade bears a substantial opportunity for cost reduction and welfare increase. Furthermore, tariff-free trade will raise competition in both the US and the EU market. It will increase the incentives for innovation and lead to lower consumer prices and greater product variety. A further opportunity for the EU arises from the divergence of tariff rates, in particular for passenger cars. From a mercantilist point of view, the EU should use the current high EU import tariff rates for passenger cars as a bargaining chip to motivate the US negotiators to agree on the elimination of non-tariff barriers.

Indeed, the potential scope for trade liberalisation that can be achieved with TTIP goes far beyond tariff elimi-

5 M. Efler: Adam würde TTIP mögen, in: Focus, 8 December 2014.
6 G. Felbermayr, M. Larch, L. Flach, E. Yalcin, S. Benz: Dimensionen und Auswirkungen eines Freihandelsabkommens zwischen der EU und den US, ifo report prepared for the German Federal Ministry for Economic Affairs and Energy, 2013.
7 Verband der Automobilindustrie: VDA Position on TTIP, June 2015.

Figure 2
Road traffic death rate and GDP per capita, 2010



EU member states — Note: Data excludes Luxembourg, which is a significant outlier.

Sources: IMF; World Health Organization Global Health Observatory Data Repository; Cologne Institute for Economic Research.

US states — Note: Data excludes Wyoming and the District of Columbia, which are significant outliers.

Sources: World Health Organization Global Health Observatory Data Repository; US National Highway and Traffic Safety Administration, FARS database; US Census Bureau; Cologne Institute for Economic Research.

nation. NTBs in particular should be addressed during the negotiations, since they represent a very substantial impediment to transatlantic trade. NTBs are mostly the result of the evolution of two independent regulatory regimes for automotive industry products. The NTBs are therefore largely due to technical barriers to trade, i.e. technical standards and regulations as well as testing procedures and conformity assessments. EU automotive companies have to substantially adjust their products in order to meet US technical standards – and vice versa. The products also need to be tested in accordance with US testing procedures to assure their conformity with US regulations and standards. A study by Ecorys estimates the additional costs arising from NTBs to be as high as a tariff equivalent to approximately 26 per cent (25.5 per cent in the EU and 26.8 per cent in the US).[8] The study claims that the elimination of actionable NTBs could reduce these to 14-15 per cent. The reason for this dramatic reduction is that there are many differences regarding the detailed regulation of technical standards for car components; however, the outcome of these regulations, in terms of passenger and environmental safety, is relatively similar. For instance, the data on the death ratio in road traffic show that there are considerable differences within the EU and the US but that the overall numbers for the EU and the US are comparable (see Figure 2). Both in the EU and in the US, the death ratio differs widely among countries and states respectively, and it exhibits its high correlation with GDP per capita. Within the EU, death ratios are the highest in the Central and Eastern European member states, where per capita income is the lowest (see Figure 2). Of course, the death ratio depends on many factors beyond GDP per capita, but higher GDP per capita generally also implies better infrastructure, a better overall state of the motor vehicles in use, etc. – factors that have a direct impact on the death ratio.

Although overall passenger safety is comparable for cars produced in the US and the EU, this does not mean that technical standards and regulations should be fully harmonised on both sides of the Atlantic. Many differences in product standards (not only in the automotive industry) result from a divergence in the preferences of US and EU consumers. If these different preferences are disregarded, trade liberalisation will only be pursued at the cost of lower utility for the consumers. Furthermore, some differences in the technical norms for car components are the result of the overall road conditions in a particular region, including infrastructure or speed limits. Disregarding these differences would mean lowering the level of safety in one party or unnecessarily overregulating in the other. Therefore, this part of the agreement is particularly challenging. TTIP should break new ground in regulatory cooperation, but eliminating NTBs and regulatory cooperation as a whole must not compromise the level of existing passenger and environmental safety, the EU's precautionary principle, or democratic legitimacy. This can only be achieved based on sound evidence that technical standards and product regulations lead to the same safety level for cars driven on both EU and US roads.

8 K.G. Berden, J. Francois, M. Thelle, P. Wymenga, S. Tamminen: Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis, ECORYS Nederland BV, Report prepared for the European Commission, 2009.

Regulations and technical standards relevant for regulatory cooperation between the US and the EU can be classified into two groups: environmental standards, which include emission reference values and fuel economy standards, and safety standards. In the following, a brief overview of the major challenges and opportunities concerning the elimination of NTBs will be given.

Safety regulations and technical standards

In the EU, motor vehicles safety is attested via government approval. Before a motor vehicle enters the market, production samples of the new model must be approved by national governmental authorities. The approval system in the EU is mandatory and applies to a vehicle as a whole. After receiving a formal approval for the new model, car manufacturers issue a certificate of conformity for each vehicle produced from this model and place the vehicle for sale throughout the EU. European regulation of motor vehicles also includes technical standards from the United Nations Economic Commission for Europe (UNECE), with optional implementation by member states.

In the US, safety standards are issued by the National Highway Traffic Safety Administration (NHTSA). However, NHTSA neither approves the compliance of motor vehicles and components with the released standards nor collects information about the compliance from a particular manufacturer. Contrary to the EU, manufacturers should "certify to the distributor or dealer at delivery that the vehicle or equipment complies with applicable motor vehicle safety standards".[9]

The technical standards prescribed by the NHTSA and the EU regulations for motor vehicles differ substantially in many ways and lead to high additional costs for exporters. For example, the differences in regulations for turning signals go far beyond their colour.[10] A great opportunity of TTIP is to show the extent to which different technical standards lead to different outcomes in terms of passenger safety. However, this is also a big challenge, since identifying regulations and standards which lead to similar passenger safety outcomes is very cumbersome due to the high number and complexity of regulations. Furthermore, even after identifying the areas in which different technical standards lead to similar levels of passenger safety, i.e. the potential areas where trade liberalisation can be achieved, a solution on how to deal with the different approval systems has to be found. One possible approach is to apply US technical standards but the EU compulsory government approval system for motor vehicles imported to the EU from the US. Conversely, motor vehicles imported to the US from the EU would have to be certified by their manufacturers as meeting EU standards. This approach could lead to cost reductions for exporters and still assure that the precautionary principle is maintained in the EU.

9 P.L. 89-563, 49 U.S.C. §30115.

10 European Commission: Second Test Case on Recognition of Equivalence in Relation of US and EU Lighting and Vision Standards, 30 January 2015.

Table 2

EU emission standards for passenger cars

	CO_2	HC	HC+NOx	NOx	PM	PN
			g/km			No/km
EU diesel	0.50	–	0.17	0.08	0.005[a]	$6.0x10^{11}$
EU gasoline	1.0	0.10[b]	–	0.06	0.005[a,c]	$6.0x10^{11}$[c,d]

Notes: [a] 0.0045 g/km using the PMP measurement procedure. [b] And NMHC = 0.068 g/km. [c] Applicable only to vehicles using DI engines. [d] 6.0x1012 l/km within first three years from Euro 6 effective dates.

Source: DieselNet.com.

Environmental and fuel economy regulations

Car emissions regulations were harmonised in the EU in 1987 under the Single European Act; however, member states are still allowed to issue measures more stringent than the common EU standards. Current emission standards, known as "Euro 6" standards, set emission limits for compression ignition (diesel) and positive ignition (gasoline, ethanol, etc.) vehicles.[11] Emissions are tested over the New European Driving Cycle (NEDC) chassis dynamometer procedure. The attestation of conformity with the EU emission targets is mandatory but required only when the vehicle is produced and not afterwards.

For diesel vehicles, CO_2 standards are more stringent, but higher NOx emissions are allowed. Table 2 offers an overview of the reference values of EU emission standards for passenger cars. The EU does not set explicit fuel economy standards. Fuel economy is indirectly regulated by the CO_2 emission standards. In 2009 these standards were reduced to 130 g/km, to be reached in 2015, and the long-term target was set to 95 g/km for 2020. The emissions are measured using the NEDC test cycle, and the limits are set in accordance with the mass of the vehicle using a fleet-average limit value curve.

In the US, emission standards are based on the Clean Air Act (CAA) and are issued by the Environmental Protec-

11 See Emission Standards section of DieselNet.com.

Table 3
US emission standards for passenger cars classified as bin 160

	NMOG+NOx	PM	CO	HCHO
mg/mi	160	3	4200	4
g/km	0.1	0.002	2.6	0.002

Source: DieselNet.com.

tion Agency (EPA). Emission standards are set irrespectively of the fuel the engine uses. In addition to the federal standards, California has its own emission regulations, which have traditionally been more stringent.[12] The CAA allows other states to choose between federal or Californian emissions requirements. Current EPA emission standards, known as Tier 3, regulate CO_2, NOx, PM and HC emissions (see Table 3).[13] Contrary to passenger safety standards, compliance with US emission standards cannot be attested by self-certification.

Manufacturers must certify vehicles to one of seven available certification bins.[14] The fleet-average emission standards are expressed using the sum of NMOG+NOx emissions. The bins are named using their corresponding NMOG-NOx limits in mg/mi. Certification follows the Federal Test Procedure FTP-75, and NMOG+NOx limits must be additionally met over the Highway Fuel Economy Test (HFET) cycle. The fleet-average NMOG+NOx values will be phased in starting in 2017 and must reach 30 mg/mi (0.02 g/km) in 2025. Tier 3 standards apply over a useful life of 15 years or 150,000 miles (whichever occurs first).[15]

In addition to safety standards, the NHTSA also issues fuel economy standards through its Corporate Average Fuel Economy programme in order to reduce energy consumption.

The comparison of EU and US environmental regulation systems shows significant differences regarding reference values, test cycles, fuel efficiency regulations and further details. In terms of stringency, the comparison of emission standards is challenging, since they differ in structure, form and testing methods. Still, there is an opportunity for common ground in environmental regulation, because the approval systems are more similar than they are for safety norms, as the US does not rely on self-certification. Furthermore, the overall objective of environmental regulation is the same. The large differences in the approach and details of environmental regulations raise the question of whether regulatory cooperation in this field is possible at the moment. Future target emission values do tend to converge, though, and thus future cooperation seems to be possible.

It is currently difficult to make a clear judgement about how the TTIP negotiations will be affected by irritations about Volkswagen's defeat device to cap NOx emissions of certain diesel engines in test scenarios. One likely implication certainly applies to the prospects for the envisaged regulatory cooperation. For this process to work efficiently, sufficient trust among negotiators and regulators is essential and could be endangered to a certain extent in the short term. As an additional implication, TTIP sceptics in Europe who maintain that US environmental standards are generally lower than in the EU certainly have to reconsider their criticism. In fact, this issue provides a strong argument to introduce common testing scenarios, like the Worldwide harmonized Light vehicles Test Procedure (WLTP) developed at UNECE. Overall, EU and US negotiators should be able to cope with the challenges of the Volkswagen issue if they manage to maintain a constructive and outcome-oriented approach.

Potential approaches to the reduction of NTBs and regulatory cooperation

The European Commission and the TTIP negotiators have recognised the high potential for efficiency gains and cost savings that could be achieved by addressing regulatory divergences in US and EU regulation of motor vehicles. In February 2015, the Commission published its draft textual proposal for the chapter on regulatory cooperation in TTIP. Regarding cooperation on motor vehicles, the EU aims at achieving more compatibility between motor vehicle regulations without lowering standards on either side.[16]

Regarding the elimination of non-tariff barriers, there are three possible approaches that should be considered.[17] These approaches can be applied simultaneously and are therefore complementary to each other.

12 B. Canis, R.K. Lattanzio: U.S. and EU Motor Vehicle Standards: Issues for Transatlantic Trade Negotiations, Congressional Research Service Report, 2014.
13 See Emission Standards section of DieselNet.com.
14 Ibid.
15 Ibid.
16 The Commission presented the initial EU position on motor vehicles in May 2014; see European Commission: EU position on motor vehicles, 14 May 2014. For the draft proposal for a TTIP chapter on regulatory cooperation, see European Commission: TTIP and Regulation: An Overview, 10 February 2015.
17 G. Kolev, J. Matthes, op. cit.

First, *convergence* of regulatory approaches can contribute to trade liberalisation via the harmonisation of existing product standards and technical regulations. The best way to achieve convergence is to rely on international standards and to offer the opportunity for a multilateral liberalisation of trade. There is hope that enhanced EU-US cooperation in the framework of the UNECE 1998 Agreement will lead to the further development of common global technical regulations in the near future.

Harmonisation of existing regulations and standards is, however, a very challenging process, since the EU and the US have highly developed regulatory systems that have evolved over decades. Regulatory and standard-setting bodies will not easily embark on a complete overhaul of their systems. A more promising approach, therefore, is the *development of common international standards* for new products or regulations. In the field of new technologies such as hydrogen and electric vehicles, cooperation between the EU and the US is already happening. TTIP should support this cooperation and strengthen the role of the EU and the US as the global setters of product standards for the automotive industry.

A third fairly promising approach to achieve regulatory cooperation is the mutual *recognition* of technical regulations and standards. However, this should only be the case for regulations that lead to a similar outcome in terms of passenger safety or environmental protection. It is a highly complex task to identify the areas where mutual recognition is possible. A reliable methodological approach has to be developed. It could enable regulators to assess the extent to which the outcome of the regulations is equivalent.

The Alliance of Automotive Manufacturers ordered a report focusing on possibilities to determine the equivalence of regulatory outcomes. This report has been conducted in a joint project by the University of Michigan Transportation Research Institute and the Vehicle and Traffic Safety Centre at the Chalmers University of Technology in Sweden.[18] The results suggest that vehicles produced in accordance with EU standards offer reduced risk of serious injury in frontal/side crashes, while motor vehicles meeting US standards provide lower risk of injury in rollovers.

The representatives of the automotive industry call for a performance and cluster-based approach for the different aspects of vehicle safety instead of a line-by-line comparison of the multitude of individual regulations and standards. For instance, regulations and standards regarding vision (e.g. front lights, windscreen, etc.) should be assessed together in terms of their combined effects on the level of safety.

Conclusion

This paper shows that trade liberalisation in the field of motor vehicles is possible, and that the first and most straightforward step to be taken is the elimination of tariffs. Although relatively low on average, tariff payments are a considerable cost factor due to the large trade volume. However, TTIP bears the potential to break new ground in trade liberalisation and should go far beyond the achievements of other trade agreements. The US and the EU should use TTIP to support the process of developing international standards in the field of motor vehicles and to confirm their role as global standard setters.

The expected gains from TTIP for the automotive industry depend crucially on the scope of trade liberalisation that can be achieved. Francois et al. estimate that EU exports to the US would increase by 13.7 per cent after ten years if 98 per cent of tariff rates were eliminated and NTBs were not addressed at all.[19] However, in this scenario, US exports to the EU would rise by 109.5 per cent, and the overall effect on EU automotive output would be negative. This negative effect stems from the asymmetry of current tariff rates. If, on the contrary, non-tariff barriers were also addressed, TTIP could lead to an increase of EU output in the automotive industry of about 1.5 per cent after ten years. These estimations should be taken with caution, since they rely on a wide range of assumptions. Still, they show that the overall effect of TTIP would be positive and large if the scope for trade liberalisation goes far beyond tariff elimination.

The elimination of non-tariff barriers remains a challenging endeavour, however, and should be based on sound evidence on the equivalence of outcomes produced by the regulations on both sides of the Atlantic. Priority should be given to retaining high levels of passenger safety and environmental standards, the EU's precautionary principle, and democratic legitimacy.

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19 J. Francois, M. Manchin, H. Norberg, O. Pindyuk, P. Tomberger: Reducing Transatlantic Barriers to Trade and Investment. An Economic Assessment, Report for the European Commission, 2013.