TTIP: SMALL GAINS, HIGH RISKS ?

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AGENDA

1. Multilateral Deadlock
2. Underutilized Trade Potentials
3. TTIP: Substantial Possible Gains
4. Trade Diversion and Losers
5. From TTIP to the WTO 2.0
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SINCE 1995: VERY LITTLE PROGRESS ON WTO LEVEL

Freedom to trade internationally, WTO average, Index 0-10.

Source: Heritage Foundation.
SINCE 1995: VERY LITTLE PROGRESS ON WTO LEVEL

Freedom to trade internationally, WTO average, Index 0-10.

Source: Heritage Foundation.
HETEROGENEITY AMONGST WTO MEMBERS

Freedom to trade internationally, WTO average, Index 0-10.

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EU-US TRADE: STILL SOME UNTAPPED POTENTIAL?

*Shares in World GDP, current USD, 2012*

<table>
<thead>
<tr>
<th></th>
<th>Hyp. Benchmark</th>
<th>Obs. EU-US trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU GDP</td>
<td>23.0%</td>
<td></td>
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<tr>
<td>US GDP</td>
<td>22.4%</td>
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Source: World Bank, ifo calculations.
EU-US TRADE: STILL SOME UNTAPPED POTENTIAL?

Shares in World GDP, current USD, 2012

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<tr>
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<td>22,4%</td>
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</tr>
<tr>
<td>EU Exports to US:</td>
<td>550 USD bn.</td>
<td></td>
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<tr>
<td>US Exports to EU:</td>
<td>455 USD bn.</td>
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<tr>
<td>World GDP:</td>
<td>71,697 USD bn.</td>
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</tbody>
</table>

EU-US TRADE: STILL SOME UNTAPPED POTENTIAL?

Shares in World GDP, current USD, 2012

- EU GDP: 23.0%
- US GDP: 22.4%
- Obs. EU-US trade: 1.4%
- Hyp. Benchmark: 10%

Assumptions:
- No trade costs
- Identical preferences
- National product differentiation

EU-US TRADE: STILL SOME UNTAPPED POTENTIAL?

*Shares in World GDP, current USD, 2012*

- **EU GDP**: 23.0%
- **US GDP**: 22.4%
- **Obs. EU-US trade**: 1.4%
- **Hyp. Benchmark**:
  - Missing trade puzzle
  - Trade costs
  - ∆: 8.9%

BREAK DOWN OF TRADE COSTS WITHIN OECD

Ad valorem tax equivalents

Transportation: 21%
Currency: 14%
Policy barriers: 8%
Language: 7%
Information: 6%
Security: 3%
Total: 74%

Tariffs: 2.5%
NTMs: 5.5%

Source: Anderson and van Wincoop (JEL, 2004), p. 693; US trade with industrialized countries.
### HAVE TRADE AGREEMENT REDUCED TRADE COSTS?

**Causal average effects, changes in ad valorem trade costs (%pts)**

<table>
<thead>
<tr>
<th></th>
<th>Trade elasticity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>7</td>
</tr>
<tr>
<td>Baier &amp; Bergstrand (JIE, 2007)</td>
<td>-25</td>
</tr>
<tr>
<td>Baier &amp; Bergstrand (JIE, 2009)</td>
<td>-43</td>
</tr>
<tr>
<td>Baier &amp; Bergstrand (JIE, 2009)</td>
<td>-29</td>
</tr>
<tr>
<td>Egger et al. (AEJ, 2011)</td>
<td>-50</td>
</tr>
<tr>
<td>Magee (BEP, 2003)</td>
<td>-108</td>
</tr>
</tbody>
</table>

**Note:** All estimates from published papers, significant at the 1% level; comprehensive recent samples (year 2000-2005; >100 countries; all notified RTAs); all estimates from published refereed articles.
HOW HAVE TRADE AGREEMENTS ACHIEVED THIS?

... through formal policy changes and changed incentives

- Transportation: total: -19%pts*
- Currency: 14%
- Policy barriers: 8%
- Language: 7%
- Information: 6%
- Security: 3%

Private and public investment
Tariffs and NTMs

EVALUATING AN AGREEMENT THAT DOES NOT YET EXIST

Ex post performance of standard CGE models disappointing: „models drastically underestimated the impact of NAFTA on North American trade“ (Kehoe, 2005)

- Right trade model?
- How define an appropriate scenario ex ante?
  - „Guess“ likely/realistic scenario?
  - Use measured effects of past agreements.

Assumption: TTIP lowers trade costs by as much as existing agreements have
ADVANTAGES OF THE ifo APPROACH

1. **Top-down strategy** on trade costs
   - No need to estimate non-tariff measures (NTMs)
   - Comprehensive measure

2. **Data-defined scenario** for TTIP
   - Capturing „actual“ direct and indirect effects
   - Political feasibility

3. **Easily applicable on very large country samples**
   - 173 countries, i.e., 29,756 country pairs
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LONG-RUN EFFECTS ON REAL PER CAPITA INCOME, EU 28

Base year 2012, equivalent variation, %

EU: + 3.9%:
EUR 1.005 p.a./cap.

Large?
Total gains from trade for Germany ~52.9%
for 2011*

Change in per capita welfare (%)

Source: updated ifo calculations; *Costinot & Rodriguez-Clare (2014), Handbook of Int’l Econ.
EU28: WHAT SHAPES THE WELFARE EFFECTS?

Source: updated ifo calculations.
POTENTIAL CHANGE IN REAL PER CAPITA INCOME
Long-run effects, %, base year 2012

Source: updated ifo calculations.
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TTIP: TRADE CREATION AND TRADE DIVERSION

Ceteris paribus results from introduction of TTIP, base year 2012

Trade Creation
• Trade up in all 56 EU-US links (e.g., USA-GER: +98%)

Trade Diversion
• Trade down between EU/US and third countries (e.g., GER-BRA: -8%; USA-CHN: -33%)
• Trade up between many third countries (e.g., CAN-CHN: +46%)

Preference Erosion
• Trade down in EU (e.g., FRA-GER: -24%)
• Trade down within existing EU/US bilaterals (e.g., USA-MEX: -16%)

Source: ifo calculations.
POTENTIAL CHANGE IN REAL PER CAPITA INCOME
Long-run effects, %, base year 2012

Change in per capita welfare (%)
- n.a.
-3.1 -- -1.5
-1.5 -- -0.1
-0.1 -- 0.1
0.1 -- 1.5
1.5 -- 3.6
3.6 -- 5.6

Source: updated ifo calculations.
NEGATIVE THIRD COUNTRY EFFECTS?

Theory and evidence

• Preferential tariff liberalization discriminates (Viner, 1950)
• Lower trade costs: discriminatory, but welfare gains more likely

• Regulatory cooperation
  – „Spillovers“ conceivable
  – Everything depends on rules of origin (RoO) ...

➢ WTR 2012: evidence points towards discrimination

But large PTAs affect trade policy incentives of countries...

• Multilateral reform (Bali 2013!)
• Further creation, deepening and consolidation of PTAs
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EU AND US TRADE AGREEMENTS IN THE FUTURE: OVERLAP

Source: WTO and USTR, current negotiations as announced at WTO.
FROM TTIP TO WTO 2.0?

The logic for consolidating our deep mega regionals

• Attenuate negative effects of trade diversion and minimize complexity (e.g., RoO)
• Ensure mutual compatibility of agreements
  ➢ Free trade, plurilateral governance amongst OECD countries
  ➢ Other major plurilaterals with wider coverage: e.g., TiSA

A world trade order of different „speeds“?

• An ambitious, open core
• Openness of TTIP is decisive: „make trade, not war“
THANKS FOR YOUR ATTENTION
Since 1995 we have the WTO...

- But, in the meantime, world trade has changed
  - Growing role of global production chains
  - Trade in increasingly complex products
  - New distribution channels
  - ...

- The need for improved global governance
  - Services, mobility of people
  - Standards & norms
  - Intellectual property rights
  - Defend freedom of the new global common: internet
  - ...

» Is the WTO – as we know it – able to deliver on this?
HETEROGENEITY AMONGST WTO MEMBERS

Share of fully democratic GATT/WTO members

Source: Polity IV project (polity IV index +8 to +10), ifo Berechnungen.
REFERENCES


EU-US TRADE POTENTIAL AND THE REALITY

Shares in World GDP, 2009

- EU GDP: 28.0%
- US GDP: 24.6%
- EU-US trade: 1.3%

In VA terms (2009):
- EU Exports to US: 422
- US Exports to EU: 327
- World GDP: 58,704

TRADE COSTS IN EU-US TRADE

... *ad valorem tax equivalents*, %

74% for US trade with OECD countries, Anderson & van Wincoop (2004, *JEL*)

VA-trade, 2009

Source: ifo calculations.
HOW MUCH DO TRADE AGREEMENTS LOWER TRADE COSTS? ECONOMETRIC EVIDENCE

Average trade cost savings from existing trade agreements

Point estimates
- 0.68 (B&B, 2007)
- 1.15 (ifo, 2011)
- 1.52 (C&S, 2010)

CHANGES IN REAL PER CAPITA INCOME

Long-run effects, equivalent variation, %

Source: updated ifo calculations.
EU28: WHAT SHAPES THE WELFARE EFFECTS?

Source: updated ifo calculations.
T-TIP: BIG EFFECTS. WHY?

1. Comprehensive trade cost measures
2. Ambitious „catch-all“ scenario to gauge potentials
3. Lower trade costs save ressources: higher welfare gains than from tariff reform
4. EU and USA are top export destinations for most countries
5. No multilateral spillovers from bilateral cooperation
6. Trade diversion due to EU customs union or NAFTA partly undone
7. Trade creation and trade diversion are linked, so are gains and losses (→ redistribution effects)
## DIFFERENCES BETWEEN ifo AND CEPR STUDIES

<table>
<thead>
<tr>
<th></th>
<th>ifo</th>
<th>CEPR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Focus</strong></td>
<td>Potentials</td>
<td>„Realistic“ effects</td>
</tr>
<tr>
<td><strong>Aggregation</strong></td>
<td>130 countries, macro view</td>
<td>10 regions, 40 sectors</td>
</tr>
<tr>
<td><strong>Market Structure</strong></td>
<td>Monopolistic competition</td>
<td>Perfect competition</td>
</tr>
<tr>
<td><strong>Reallocation</strong></td>
<td>Intra-sectoral</td>
<td>Inter-sectoral</td>
</tr>
<tr>
<td><strong>Trade costs</strong></td>
<td>Comprehensive definition</td>
<td>Politics, transportation</td>
</tr>
<tr>
<td><strong>Scenario</strong></td>
<td>Trade cost reduction as in existing agreements</td>
<td>Zero tariffs, some lowering of certain NTBs</td>
</tr>
<tr>
<td><strong>NTBs</strong></td>
<td>Trade costs, bilateral</td>
<td>Trade costs, rents, multilateral spill-overs</td>
</tr>
</tbody>
</table>
## METHODS: EU COMMISSION VS ifo

<table>
<thead>
<tr>
<th>Approach</th>
<th>EU Commission</th>
<th>ifo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Calibration</td>
<td>• CGE Model</td>
<td>• New Quantitative Trade Theory</td>
</tr>
<tr>
<td>Aggregation</td>
<td>• Expenditure shares</td>
<td>• Broad trade costs</td>
</tr>
<tr>
<td>NTBs</td>
<td>• Bottom-up</td>
<td>• 173 countries</td>
</tr>
<tr>
<td>TTIP Scenario</td>
<td>• No tariffs</td>
<td>• Top-down, trade costs</td>
</tr>
<tr>
<td></td>
<td>• ad hoc reduction of identified NTMs</td>
<td>• No tariffs</td>
</tr>
<tr>
<td></td>
<td>• Spill-over effects for third countries</td>
<td>• Trade costs (policy-induced, others) fall as in existing agreements</td>
</tr>
</tbody>
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## TTIP: EU COMMISSION vs. IFO – LONG RUN EFFECTS

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<th>ifo</th>
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<tbody>
<tr>
<td></td>
<td>(GDP in 2012 prices, 2027 baseline)</td>
<td>(real per capita income, 2012 baseline)</td>
</tr>
<tr>
<td>Germany</td>
<td></td>
<td>+3.48%</td>
</tr>
<tr>
<td>EU</td>
<td>+0.48%</td>
<td>+3.94%</td>
</tr>
<tr>
<td>USA</td>
<td>+0.39%</td>
<td>+4.89%</td>
</tr>
<tr>
<td>China</td>
<td>+0.03%</td>
<td>-0.50%</td>
</tr>
<tr>
<td>ASEAN</td>
<td>+0.89%</td>
<td>-0.07%</td>
</tr>
<tr>
<td>World</td>
<td>+0.14%</td>
<td>1.58%</td>
</tr>
</tbody>
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**Source:** ifo.
HÄUFIGE MISSVERSTÄNDNISSE

• Der EU-US Handel ist heute schon barrierefrei. **FALSCH. Die Handelspotential ist nur zu 8-10% ausgelastet.**

• Geringer gegenwärtiger Handel der USA mit EU macht hohe Wohlfahrtsgewinne der USA „unmöglich“. **FALSCH. In allen bekannten Modellen korreliert das Handelsvolumen im Ausgangsgleichgewicht negativ mit der Höhe der möglichen Handelsgewinne.**

• Die Höhe der vom ifo berechneten Effekte ist unglaubwürdig. **FALSCH. Die moderne Literatur beziffert den Wohlfahrtsgewinn durch Handel mit 30-50% für Deutschland (Costinot & Rodriguez-Clare, 2004).**

• Die ausgewiesenen bilateralen Handelseffekte sind nicht konsistent mit den Wohlfahrtseffekten. **FALSCH. Was für die Wohlfahrt zählt ist nicht der Wert des Handels (Menge x Preis), sondern allein Menge und Qualität.**
AIM 1: FREE TRADE IN THE OECD (TTIP + TPP + BILATERALS)
AIM 2: OPEN CLUB AND „WTO 2.0“

Source: WTO and USTR, current negotiations.
PTAs OF EU AND US IN 1990

Source: WTO and USTR.
PTAs OF EU AND US IN 1990

Source: WTO and USTR.