Strategic Sectors | **Economy and Territory**

The Importance of the Transatlantic Trade and Investment Partnership and Potential Drawbacks for Mediterranean Countries

Giorgia Giovannetti
University of Florence and the European University Institute, Florence

Mauro Lanati
University of Pisa

The EU and the US are the two most integrated economies in the world, due to imports and exports of goods and services, mutual investments, and their strong commercial presences in each other's economies. Hence, the Transatlantic Trade and Investment Partnership (TTIP), the agreement that the EU and the US started negotiating in February 2013, will potentially be the largest regional free-trade agreement in history (covering nearly 50% of global economic output and 25% of global trade). The aim of TTIP is (i) to eliminate or substantially decrease the (already low) tariff barriers between the EU and the US (on average, around 2% for the US and 3% for the EU); and (ii) to reduce (or prevent) non-tariff barriers through enhanced compatibility of regulations and standards and the elimination of behind-the-border non-tariff barriers (NTBs) in all categories. TTIP also aims to introduce a new generation of regulatory standards covering issues such as protection of foreign investments and intellectual property or, more ambitiously, public procurement.

The first proposals for a transatlantic free trade area date back to the 1990s. But only in February 2013, as a reaction to the stalemate of the multilateral negotiations within the WTO, and after important preliminary work throughout 2012, was the launch of TTIP announced. The first round of TTIP negotiations was in July 2013; as of April 2014, four rounds have been held, but the completion date, previously announced for the end of 2014, is still unknown. TTIP's potential in terms of mutual economic benefit represents a long-term strategy that could help the EU and the US recover from the financial crises in a situation of increasing international competition with emerging economies. It could also help them regain their leading role at the international level. Furthermore, in light of the trend towards the signing of important regional agreements, especially in Asia, TTIP can be seen as the response of Western economies to potential trade diversion effects.

Given the size of the economies involved and the ambitious nature of the agreement, the welfare gains for the US and the EU are expected to be (very) positive, although they may vary depending on the nature of the exact agreement reached. TTIP will also have important consequences for "outsiders," which may not necessarily be positive. As far as the EU and US are concerned, the welfare gains that will result from the additional trade created are likely to overcome the welfare losses due to trade diversion, although there will be substantial differences between and within EU countries and US states, depending on their specific sectoral and skill composition. Several independent studies – including those by CEPR (2013) and Felbermayr et al. (2013) – have forecast different scenarios in which deep liberalisation of trade between the two regions increases the real per capita gross domestic product of Member States while simultaneously boosting employment.

Without entering into the exact estimates, which depend too much on the hypotheses used by the different models, their structure, possible dynamics, the country's (or State's) specific production specialisation and the skill composition of the local workforce,[1]

[1] According to the estimates of Felbermayr et al. (2013), in a scenario in which non-tariff barriers are also significantly reduced, real per capita income would increase by an average of 13.4% in the US and 5% in the EU (with important differences between countries). CEPR predictions are more conservative, with an estimated gain of 0.48% for the EU and 0.39% for the US. According to Felbermayr et al. (2013), the most

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in what follows we shall highlight the impact the agreement will have on outsiders – a topic that has certainly been dealt with less in the literature so far – and, in particular, on Mediterranean countries. The economic gains of the EU and the US are in fact likely to come at a price, especially for neighbouring countries. Despite a boost for the EU and the US, which could favourably impact world GDP, countries that do not participate in TTIP, especially the US and EU's traditional trade partners, could face a decrease in real income and employment. For instance, Canada and Mexico, members of NAFTA but outsiders to TTIP, are expected to suffer a substantial decline in GDP according to all existing estimates.[2] More specifically, countries with an existing free trade agreement with the EU or US would be affected by an additional form of trade diversion, what Deardorff (2014) has called the *reversal of trade diversion*. On top of the conventional trade diversion effect, imports that were diverted from the new partner (US) under the first FTA will revert to it under the second (TTIP). This could further increase the already high inequalities currently found between developed Western and emerging economies.

Mediterranean countries are likely to be highly penalised by the signing of TTIP. The majority of these EU neighbours are fairly small countries that have signed a free trade agreement with the EU in the past.[3] The trade effects of TTIP on these countries can be briefly summarised as follows.[4]

1. Albania, Serbia, Montenegro, Bosnia & Herzegovina and Macedonia have a free trade agreement (FTA) with each other – CEFTA – and with the EU, but not with the US. They have similar characteristics: the EU is their main export destination market and import origin, while their trade with the US is insignificant (Deardorff, 2014). These countries are likely to suffer from two forms of trade diversion. First, they will suffer from a conventional trade diversion effect, as their exports to the US will now have to compete with tariff-free exports from the EU; and second, the trade that was originally diverted from the US by the first FTA agreement between the EU and CEFTA members may now revert back to the US under TTIP.

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All countries that participated in the Barcelona Process – namely Algeria, Egypt, Lebanon, Syria, Tunisia, Israel, Jordan and Morocco – have existing FTAs with the EU. Israel, Jordan and Morocco also have either an FTA or an economic integration agreement (EIA) with the US. The countries that have an FTA with only the EU have the EU as their main partner, but also trade significantly with the US; these countries are likely

optimistic scenario is expected to create more than 1.1 million new jobs in the US and lead to a significant reduction of unemployment in the EU. Additional jobs do not imply a reduction of real wages: on the contrary, real wages are likely to increase, especially in Great Britain (6.6%). CEPR estimates indicate that the benefits to the EU and the US will not be achieved at the expense of the rest of the world: the GDPs of high-income OECD economies (minus the US and EU) will gain €36 billion (or +0.19%), while low-income countries would see GDP gains of some €2.4 billion.

[2] According to Felbermayr et al. (2013), their GDPs would decline 9.5% and 7.2%, respectively, in the deep liberalisation scenario (0.7% and 1.1% in the tariff scenario). CEPR predictions are again more conservative: the study predicts a collective gain for the rest of the world in the region of €99 billion, €36 billion of which is expected to be for OECD countries.

[3] The member countries of CEFTA (Central Europe FTA) and the Barcelona Process (North Africa and the Middle East) have existing free trade agreements with the EU; the only exceptions are Moldova, Kosovo and Libya.

[4] Deardorff (2014), on which our analysis partially builds, does not include Libya. We have considered it, given its geographical proximity and its importance as a trade partner for some EU countries.

to be penalised by a substantial trade diversion effect. Egypt is an interesting example: Felbermayr et al. (2013) predict that Egypt will lose 2.8% in real income per capita in a broad free trade agreement scenario. Countries that have free trade agreements with both the EU and the US (i.e., Israel, Jordan and Morocco) will be the ones to lose the most. To the extent that their significant exports to both of these partners were diverted from direct EU-US trade, this advantage will vanish under TTIP. Furthermore, Mediterranean countries may also face a decrease in foreign direct investment, since investors from Asia and sovereign wealth funds may increase their FDI in the EU (and the US) as a means of avoiding tariffs and NTBs. Turkey is a special case among the EU's Mediterranean neighbours. In 2012, more than 40% of its foreign trade was with the EU and the US; two thirds of Turkish capital was invested in either the EU or the US, and it has a customs union (CU) with the EU, negotiated with the expectation that it would be a transitional arrangement while Turkey moved towards full EU membership and that it could help Turkey to strengthen its economy in the meantime. A closer transatlantic trade and investment partnership could affect Turkey more adversely than other countries. Turkey's CU with the EU implies that it will share the EU's external tariffs, which will presumably include its zero tariffs on imports from the US under TTIP; however, because it is not formally part of the EU, Turkey will not benefit from reduced US tariffs on its exports. In other words, US products would enter the Turkish market freely without duties, while Turkey would continue to face duties and other limitations in the US market. Turkey's current trade deficit with the US (totalling around $8.5 billion in 2012; see Kirisci, 2013) would probably increase. Moreover, further trade diversion would also likely occur, as South Korean (thanks to the South Korea-US Free Trade Agreement, or KORUS FTA) and TransPacific Partnership (TPP) countries' goods are likely to enter the US market preferentially[5] (see Deardorff, 2014). This peculiar situation is likely to make Turkey worse off after TTIP. According to Felbermayr et al. (2013), Turkey will lose 2.8% in real income per capita. On the other hand, the possible inclusion of Turkey in TTIP could increase GDP up to 4.6% and would also favour the EU and the US in terms of higher GDP growth rates.

2. Libya, Moldova and Kosovo are the only Mediterranean countries that have not yet concluded a free trade agreement with the EU.[6] Moldova's largest trade partner is the EU, but it also has significant trade with Eastern European countries and Russia. The EU is also Libya's main trading partner (in 2008, 49.7% of the country's imports and 78% of its exports were from/to the EU). As complete outsiders to TTIP whose main trading partner is the EU, these countries are likely to suffer trade diversion.

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Summing up, TTIP concerns not only trade and investments between the US and the EU but also behind-the-border protectionism (e.g., regulations, rules of origin, procurement, investment protection, etc.) and outsiders. While different models give a range of estimates (for both insiders and outsiders), the interesting thing to point out is the transmission mechanisms and resulting changes in the composition of output and employment. The main mechanisms at work are both standard, such as the understanding that a larger market will bring higher competition, and non-standard. For instance, to the extent that trade is intra-industry, there is a dynamic effect from an increase in labour productivity. Likewise, the attraction of new investment flows, including from countries outside the

[5] The top exports from Turkey to the US (vehicles, machinery, iron and steel products, and cement) overlap to a large extent with exports from the EU, South Korea and some Asian-Pacific countries. This is likely to amplify the adverse impact.
[6] Deardorff (2014) does not include Kosovo in the analysis because of a lack of data.

agreement aiming to bypass tariffs and regulations, could have a positive impact (on both insiders and outsiders), especially in the long run. Furthermore, the likely increase in EU and US exports could lead to an increase in outsourcing (offshoring), especially of the low-value-added parts of global value chains, enabling foreign firms, including in the Mediterranean, to increase their role as suppliers. TTIP is therefore an important component of the broader globalisation process; however, when gauging its overall impact, it is important to account for the heterogeneity of its various specific impacts and for the fact that it will take time to know how the partnership will affect the dynamic relationships between countries, given the different possible geopolitical and economic scenarios and the changes that will effectively take place in terms of both tariffs and non-tariff barriers. For instance, regulatory convergence could result in important welfare gains at the worldwide level. As for the Mediterranean countries, they are likely to lose if TTIP is implemented, unless they can successfully integrate their firms into global value chains and the TTIP negotiations manage to take into account the impact of digitalisation and servicification.

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