



Contents lists available at ScienceDirect

Economic Modelling

journal homepage: www.elsevier.com/locate/econmod

Stopped TTIP? Its potential impact on the world and the role of neglected FDI

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ARTICLE INFO

JEL codes:

C68
F14
F15
F17
F21

Keywords:

Foreign direct investment
Multinationals
Trade agreements
Computable general equilibrium
CGE
Monopolistic competition

ABSTRACT

The Transatlantic Trade and Investment Partnership (TTIP) has been one of the most heavily debated issues in international economics over the last few years. We analyze its potential impact on the world, including both insiders and outsiders of the agreement, using a Computable General Equilibrium (CGE) model with Foreign Direct Investment (FDI) under imperfect competition. In our simulation, TTIP consists of reductions of tariffs, non-tariff barriers and barriers to FDI. Our results show that the FDI component, which has often been neglected in previous studies, would contribute to nearly half of the overall impact of TTIP for the US and nearly one third for the EU. Insiders would heavily benefit from TTIP, whereas, it would be slightly negative for outsiders (Middle East, Sub-Saharan Africa, Latin America, Southeast Asia and Other Advanced Countries), except for the big Asian economies (China, Japan and India), which would remain unaffected. The slightly negative effects would turn into positive with an “inclusive TTIP” (i.e., one avoiding third country discriminating rules and standards). An inclusive TTIP would benefit both insiders, who would gain more than with the standard TTIP, and outsiders, who would be better off than without the TTIP. Welfare, GDP, wages, as well as aggregate imports and exports of the world economy would clearly increase following either a modest or ambitious TTIP agreement. Our results suggest that policy makers should resume TTIP negotiations and try to strike an inclusive and ambitious deal.

1. Introduction

Among other protectionist measures, the US president Donald Trump has withdrawn the country from the Trans Pacific Partnership (TPP). The TPP looks dead, even though its former members and other countries from the Pacific want to continue with a similar deal (New York Times, 2017). However, the US president has not made any explicit declaration about the Transatlantic Trade and Investment Partnership (TTIP) as of August 2017. According to the latest news, the US administration will only negotiate bilateral instead of multilateral trade agreements. What does this mean for the TTIP? It is unclear. For some this implies the TTIP is dead (The Economist, 2017a, 2017b); for others it is still possible (Inside US Trade, 2017a; 2017b; Lester, 2017). At the moment, TTIP negotiations are on hold but future US governments may resume the negotiations.

The TTIP was the largest of what had been called the “modern trade

agreements”. The slow pace of the World Trade Organization (WTO) in attaining multiregional agreements had brought about a surge in regional and bilateral trade agreements since the beginning of the 1990s (Maggi, 2014; Baldwin, 2015). These regional negotiations had extended the scope beyond tariffs. This is understandable with the proliferation of Foreign Direct Investment (FDI) flows, trade in services, global value chains and other far-reaching elements related to trade. In fact, some scholars are suggesting that even the WTO should try to reach deeper trade agreements (Antràs and Staiger, 2012a, 2012b; Hufbauer and Cimino-Isaacs, 2015).

The potential impact of the TTIP has attracted great attention. It has raised vociferous opposition due to concerns about the secrecy of the negotiations, a possible regulatory race to the bottom or the privatization of public services, as well as about the power that it could give to multinationals.¹ On the other hand, all available economic analyses have derived a positive impact, with the only exception of Capaldo (2014), as

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¹ The Comprehensive Economic and Trade Agreement (CETA) agreement, which is the latest of the big agreements the EU has signed (in this case with Canada) is supposed to be very similar to the TTIP. The text is now publicly available and it has been released together with a Joint Interpretative Declaration (which has been agreed with the Canadian authorities) and it is a legally binding document. The Joint Interpretative Declaration stresses that the EU and Canada will “continue to have the ability to achieve the legitimate public policy objectives that their democratic institutions set, such as public health, social services, public education, environment, [etc.]” and that CETA “will also not lower our respective standards and regulations related to food safety, product safety, consumer protection, health, environment or labour protection” (Van der Loo, 2016, p. 2).

reviewed in Bekkers and Rojas-Romagosa (2016).

In this paper, we offer new estimations of the potential effects that would be missed if the TTIP is not signed. We derive them for insiders and outsiders of the agreement, as well as for the world. An important policy implication from our analysis is that an “inclusive” TTIP (i.e., one avoiding third country discriminating rules and standards) would be much more beneficial than a standard TTIP. Both the US and the EU would gain more with an inclusive TTIP than with a standard one. In addition, some outsiders could be slightly damaged by a standard TTIP. However, all outsiders would be better off with an inclusive deal than without the TTIP. As a consequence, the world economy would gain more with an inclusive TTIP. Interestingly, because our model includes multinationals in services, we derive considerably larger positive impacts of TTIP than those from previous influential studies (e.g., Francois et al., 2013; Fontagne et al., 2013).

We obtain these results using a Computable General Equilibrium (CGE) model of the world economy with 10 regions (US-EU28-other advanced economies-China-India-Japan-South East Asia-Latin America-Middle East-SubSaharan Africa) and 21 sectors. This methodology has become the most commonly used by economic institutions to quantify the impact of trade agreements (e.g., Francois et al., 2013; Fontagne et al., 2013; Egger et al., 2015; Petri and Plummer, 2016). A general equilibrium perspective seems mandatory for this type of analysis. Trade agreements are expected to have an impact in all sectors of the economy because the reductions in tariffs and the different types of Non-Tariff Barriers (NTBs) they entail cover all sectors. In addition, it is necessary to take into account the economic interrelationships (i.e., backward and forward linkages) across sectors, as CGE models do. Furthermore, the policy makers are interested in both the macro and sectoral outcomes of the agreement. This contrasts with the more parsimonious approach of other methodologies, which yield estimations confined to one or two variables, such as GDP or welfare (e.g., Felbermayr et al., 2013, 2015; Alvarez et al., 2016). What is more, the detailed sectoral analysis provided by a CGE model is lacking in other more stylized general equilibrium analyses considering the interplay between FDI and trade (such as, Arkolakis et al., 2015; Burstein and Monge-Naranjo, 2009; McGrattan and Prescott, 2009; Ramondo, 2014; Ramondo and Rodríguez-Clare, 2013).

We use an innovative CGE model that introduces multinationals and FDI operating in imperfectly competitive sectors via Mode 3 (i.e., through foreign affiliates sales) within a multiregional framework. Our model follows the literature of “FDI in services” (reviewed in Tarr, 2012) in which the combination of the characteristics we have just mentioned had still not been achieved. This is of relevance for the analysis of modern agreements and even more in the case of the TTIP, since the EU and the US are both home and host of the vast majority of FDI flows and stocks in the world. According to UNCTAD (2017), the TTIP partners account for 53.5% and 61.2% of the world inward and outward FDI stocks in 2015, respectively. These shares are larger than their weight in world trade. The US and the EU explain 45.7% and 46.3% of world exports and imports of goods and services in 2016, respectively.² These figures justify our special focus on FDI in this paper. In addition, 57% of the sales of foreign affiliates are in services sectors both in the EU and the US in 2014, according to Eurostat (2017) and OECD (2017).³

² These shares in world trade include intra-EU trade and would, of course, be smaller without it. Note that TTIP weight in the world economy surpasses that of TPP. TPP accounts for 36.3% and 38.8% of the world inward and outward FDI stock. In addition, the EU and US account for 21.3% and 24.4% of the world GDP measured in current prices in 2016, while the weight of TPP is 37.8%. UK's weight in world GDP, FDI inward stock, FDI outward stock, world exports and world imports is 3.4%, 5.8%, 6.1%, 3.6% and 3.9%, respectively. All these figures are from UNCTAD (2016). Needless to say, TPP weight without the US experiences a huge contraction and changes completely the prospects of the agreement (e.g., Hiro and Itakura, 2017; Ortiz-Valverde and Latorre, 2017).

³ Both countries coincide in the 57% figure, by chance. Further, 51.8% of the sales of US multinationals abroad are also in services. By contrast, for EU multinationals the figure is much smaller. Only 25.2% of their sales abroad are in services (Eurostat, 2017; OECD, 2017).

In this paper multinationals are modelled in services sectors because in most cases the provision of services requires the presence of the seller. It is harder to export or import services than goods. As a consequence, sales through foreign affiliates constitute a more important form of serving foreign markets in services than in goods. In addition, there are no estimations of barriers faced by foreign multinationals operating in manufactures of host countries. Thus we cannot endogenously model manufacturing multinationals responding to reduction in barriers to FDI as we do with services multinationals. Therefore, we model two types of firms operating within the majority of services sectors, namely, domestic firms versus foreign multinationals (while it is much smaller in services, we also have the foreign firms exporting to the market). In addition to barriers to trade, foreign multinationals face other extra barriers which are not applicable to domestic firms. Because GATS (General Agreement on Trade in Services⁴) remains an incomplete project within the WTO framework, barriers in services are considerable and tend to be larger than in goods. They are, however, very heterogeneous across countries and for FDI larger in the US than in the EU. TTIP would explicitly lower restrictions applicable only to the operations of foreign multinationals and this is explicitly modelled in this paper.⁵

To the best of our knowledge, previous studies on the TTIP have not analyzed the effects of FDI and the reduction of FDI barriers. Our results confirm that this is an important omission. We obtain that the reduction of FDI barriers has a very sizeable effect for the TTIP partners. In the US, this FDI component would contribute to nearly half of the overall positive impact of TTIP, while in the EU it would explain nearly one third. Interestingly, the impact of FDI would not be harmful for outsiders. Some relevant policy recommendations emerge from this. Because cross border services transactions do not involve tangible products, customs and port clearance procedures are generally less relevant for them. Instead, a successful regulatory approach to services is related to issues of market structure and domestic regulation (e.g., Latorre et al., 2017). As we have mentioned before, these issues are to a great extent still underdeveloped in GATS and involve only a small group of countries in the TISA negotiations.

The rest of the paper is organized as follows. The next section introduces the content of the TTIP providing detailed data on the costs related to trade and investment between the US and EU. Section 3 describes the model. Section 4 explains the data used and the simulations. We analyze the import and export structure of all the regions and of the world economy. Section 5 presents the sectoral and macroeconomic results. Section 6 summarizes the main conclusions. A final appendix offers some tables with sectors and regions definitions, as well as more detailed results together with the sensitive analysis. In addition, there is an online appendix with the algebraic description of the model.

2. The Transatlantic Trade and Investment Partnership (TTIP)

In 2013 the US and Europe formally have begun the negotiations of this ambitious agreement. Politicians have declared that their main purpose is to create jobs at both sides of the Atlantic. The TTIP is based on three major pillars: 1) Increasing *market access* for products and services by eliminating tariffs, reducing Non-Tariff Barriers (NTBs) and opening up government procurement practices, particularly, in some US States; 2) Streamlining *regulatory standards* in a process that somehow could be (in part) similar to the “mutual recognition of standards” that took place in the process of European integration; 3) Establishing a *set of rules* on elements relevant to

⁴ Trade in all services other than governmental services is regulated by GATS in the WTO and inspired by the approach of trade in goods, which is ruled by GATT (General Agreement on Tariffs and Trade). However, commitments in the GATS tend to reflect national policy objectives and are less binding than in the GATT.

⁵ Barriers to entry of foreign multinationals include among others: complicated, discriminatory and costly procedures to obtain licenses to start and operate a business; Measures that require a specific type of establishment (greenfield, joint venture, acquisitions ... etc.) or certain percentages of equity participation; Onerous fees; Domestic residents/citizens requirements on percentages of the board of directors, ...etc.

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