RESEARCH

Economic Watch

United States

Houston, December 19, 2013
Economic Analysis

Shushanik Papanyan
shushanik.papanyan@bbvacompass.com

EU-US: Transatlantic Trade and Investment Partnership

- **TTIP: A roadmap towards the world's largest free trade area**
- **Reduction of NTBs could result in substantial economic benefits**
- **Motor vehicles will benefit the most**

On Friday, December 20th, the U.S. and the EU will conclude the third round of negotiations on the Transatlantic Trade and Investment Partnership (TTIP). The TTIP is a bilateral free-trade agreement (FTA) that aims to eliminate trade tariffs and reduce non-tariff barriers (NTBs) such as arbitrary differences in regulations and industry standards, for goods, services and foreign direct investment (FDI). The TTIP will create the world's largest free trade area, as the U.S. and the EU account for over 40% of global trade and nearly half of the world GDP.

The negotiations that started in July 2013, cover all-encompassing areas of trade flows and hurdles existing between both regions; namely energy and raw materials, agriculture, manufacturing, services, investment, government procurement, regulatory coherence and industry regulatory approaches, sanitary and phytosanitary barriers, intellectual property rights, labor and trade issues, and small- and medium-sized enterprises.

The TTIP is another example of the U.S. ongoing strategy to capture the economic benefits from free trade. The TTIP will create substantial economic benefits for both the U.S. and EU in the long run, by increasing the total volume of bilateral trade and investment, and consequently boosting labor productivity and growth. The trade agreement is expected to have a 7% to 8.5% greater impact on U.S. exports to EU than on imports from that region. However, from a GDP growth perspective, Europe is expected to benefit more than the U.S.[1]

Table 1
U.S. Free Trade Agreements

US Free Trade Agreements (FTA)	Entered into Force
Australian FTA	January 1, 2005
Bahrain FTA	January 11, 2006
CAFTA-DR (Dominican Republic-Central America FTA)	March 1, 2006 to January 1, 2009
Chile FTA	January 1, 2004
Colombia FTA	May 15, 2012
Israel FTA	September 1, 1985
Jordan FTA	January 1, 2010
KORUS FTA	March 15, 2012
Morocco FTA	January 1, 2006
North American Free Trade Agreement (NAFTA)	January 1, 1994
Oman FTA	January 1, 2009
Panama TPA	October 21, 2011
Peru TPA	February 1, 2009
Singapore FTA	January 1, 2004
Trans-Pacific Partnership	Negotiating
Transatlantic Trade and Investment Partnership	Negotiating

Source: BBVA Research

The reduction in NTBs negotiated under TTIP will have positive direct spillover effects into other countries. The CEPR reports a 0.07% - 0.14% increase in the "rest of the world" GDP due to the spillover effect. According to the study, the largest gains are expected for ASEAN[2] countries and Eastern Europe. The TTIP-led improvements should result in simplification of the regulatory environment for third-party countries and thus serve as global standards for other trade negotiations.

Despite these benefits, institutions like the World Trade Organization (WTO) condemn the rise of regionalism and Preferential Trade Agreements and view the TTIP as a way to export the U.S. and EU regulatory standards to other trading partners. For the WTO, a better solution would be to reform the international trading system.

TTIP Effect on Productivity and Growth

Since the average tariff rate between the U.S. and EU is already quite low, major measurable gains to be made from trade liberalization between the two economies are vastly expected to arise from decline in NTBs. In fact, the trade weighted average tariff rate for industrial goods is around 2.8% for both regions with a slightly higher import tariff rate for agricultural goods at 2.6% and 3.9% in the U.S. and EU respectively.[3]

The effect on U.S. GDP of a partial trade agreement that only tackles tariff elimination on the service sector or procurement, is small at 0.01 – 0.04%. However, the implementation of a comprehensive FTA like the TTIP can add up to 0.4% to U.S. GDP, raise U.S. exports to the EU by up to 37%, and increase total U.S. exports by up to 8%. Similarly, the TTIP is expected to add up to 0.5% to the EU GDP, increase EU exports to the U.S. by up to 28% and EU total exports by up to 6%.[4]

Overall, the positive welfare gains arise from an intensified competitive environment for domestic firms, leading to a decline in the average price paid by the domestic consumer as well as an increase in labor productivity. These labor productivity gains are explained by a shift in utilization from lower productivity to higher productivity firms and by higher productivity firms producing larger volumes of output. In the case of the U.S. and the EU, bilateral negotiations that further heighten competition will mostly result in a reduction in NTBs. Thus the productivity and real wage gains are more pronounced when both tariffs and NTBs are minimized. The Ifo Institute reports that the maximum U.S. labor productivity gain expected is 1.14%. It is worth noting that the wage change for less skilled and more skilled labor is expected to be similar. At the same time, while TTIP is expected to add thousands of new jobs in the U.S., it has an overall minor effect on the unemployment rate.

Table 2
TTIP Estimated Effect on Real Wage and Unemployment

	U.S.		EU	
Percentage Change	Tariffs	Tariffs and NTB	Tariffs	Tariffs and NTB
Real Wage	0.17%	2.15%	0.13%	1.67%
Unemployment Rate	0.00%	-0.05%	0.00%	-0.05%

Source: Ifo Institute and BBVA Research

TTIP Industry Effects

The U.S. manufacturing sector that will benefit the most from the TTIP is motor vehicles, which currently faces an 8% EU tariff (trade weighted) as well as high NTBs, followed by metals and metal production, and chemicals. The service sector beneficiaries list is led by finance, insurance, and business services, all of which face high NTBs. The affiliates of U.S. firms operating in Europe also face FDI-related NTBs, where the average value reported by firms for the FDI NTB index is close to 29. Reducing those NTBs can further increase jobs and income gains for both economies.

Table 3

Perceived NTB Index in U.S. and EU

Perceived NTB Index by Business (0-100)
U.S. Exports to the EU, Top 10

Services Sector	NTB Index	Goods Sector	NTB Index
Insurance	39.3	Aerospace and Space Industry	55.1
Construction	37.3	Chemicals	53.2
Recreational Services	35.4	Cosmetics	52.2
Communication	27.0	Biotechnology	50.2
Transport	26.3	Textiles, Clothing and Footwear	48.9
Financial Services	21.3	Wood and Paper, Paper Products	47.1
Other Business Services	20.0	Pharmaceuticals	44.7
ICT	19.3	Machinery	36.5
Travel	17.8	Food and Beverages	33.6
		Communication Equipment	32.3

Perceived NTB Index by Business (0-100)
EU Exports to the U.S., Top 10

Services Sector	NTB Index	Goods Sector	NTB Index
Construction	45.0	Aerospace and Space Industry	56.0
Communication	44.6	Machinery	50.9
Other Business Services	42.2	Medical, Measuring and Testing Appliances	49.3
Transport	39.9	Cosmetics	48.3
Recreational Services	35.8	Biotechnology	46.1
Travel	35.6	Chemicals	45.8
Financial Services	29.7	Food and Beverages	45.5
Insurance	29.5	Communication Equipment	37.9
ICT	20.0	Textiles, Clothing and Footwear	35.6
		Iron, Steel and Metal Products	35.5

Source: Ecorys and BBVA Research

Furthermore, the largest gains from the TTIP would be realized if, in addition to the elimination of existing tariffs, the agreement would achieve reduction of the NTBs, with the highest expected cut in the NTBs at 50%. It is assumed that the full impact of trade agreement will be realized within 10 years. Indeed, it is expected that as much as 80% of the TTIP economic benefits would come from reducing bureaucracy and regulation related costs, alongside trade liberalization in services and government tenders. Firms view NTBs as a market entry fixed cost. While larger size firms would benefit most from the tariff elimination agreement, the reduction of NTBs would also benefit medium and small- size firms. It is equally important to note that the TTIP would be expected to weaken the competitiveness of non-exporting less efficient small firms.

The top 4 states that are expected to gain from the jobs created by TTIP are California, Texas, New York, and Florida. South Carolina is expected to benefit the most from export growth. Texas gains will mainly arise from the increase in export volume in chemicals, motor vehicles, electrical machinery, and other manufacturing sectors. Overall, a fully implemented TTIP is expected to result in as much as 24% increase of Texas exports to EU. The highest job growth in Texas due to the TTIP is expected to be in business services.[5] In 2012, the Texas export share to EU member states was only 0.02% of its Gross State Product (GSP). Therefore, the largest annual impact expected from a successful implementation of the TTIP is around 0.01% increase in GSP.[6]

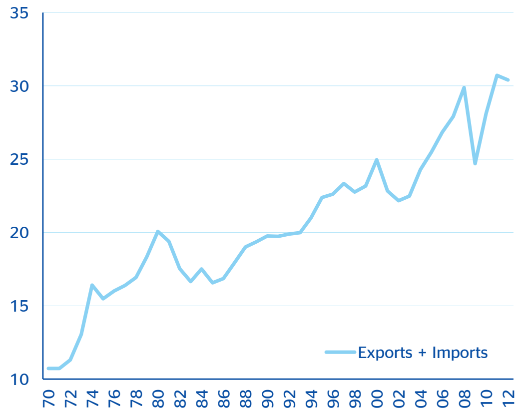
Table 4

U.S. 2012 Trade with EU, Top 5 Industries

Exports	Share of Total Products	Imports	Share of Total Products
Machinery and transport equipment	38%	Machinery and transport equipment	41.4%
Chemicals and related prod	21.3%	Chemicals and related prod	22.8%
Miscellaneous manufactured articles	12.4%	Miscellaneous manufactured articles	11.5%
Mineral fuels, lubricants and related materials	9.6%	Manufactured goods classified chiefly by material	10%
Manufactured goods classified chiefly by material	6.4%	Mineral fuels, lubricants and related materials	6.7%

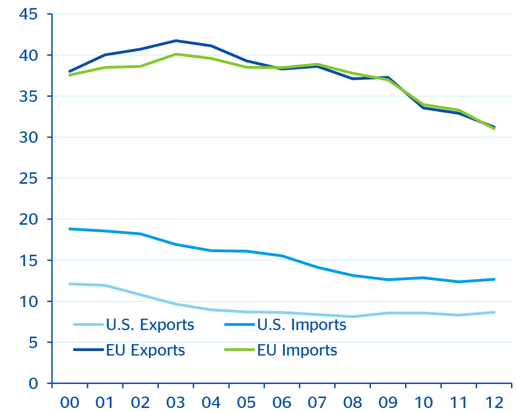
Source: European Commission and BBVA Research

Chart 1
U.S. Trade as Share of GDP (%)



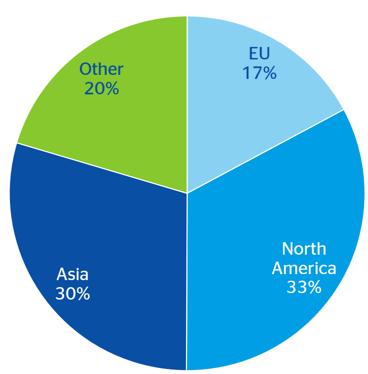
Source: BEA & BBVA Research

Chart 2
Share of World Trade (%)



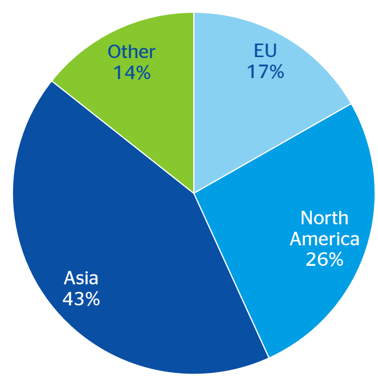
Source: IMF & BBVA Research

Chart 3
U.S. 2012 Exports by Region (%)



Source: BEA & BBVA Research

Chart 4
U.S. 2012 Imports by Region (%)



Source: BEA & BBVA Research

Bottom Line

While negotiations on the TTIP are welcomed, a better strategy would be a global trade agreement superior to regional FTAs. However, in the absence of progress at the global level, the TTIP could turn into a benchmark for international trade with widespread repercussions. For the U.S. and the EU, although the benefits from the TTIP will materialize over a long period of time, the reduction of NTBs could result in substantial gains for both regions and many other countries around the globe.

References

The Atlantic Council of the United States, the Bertelsmann Foundation, and the British Embassy in Washington (September 2013), "TTIP and the Fifty States: Jobs and Growth from Coast to Coast." Rapporteurs: Tyson Barker, Anne Collett, Garrett Workman

Centre for Economic Policy Research (March 2013), "Reducing Transatlantic Barriers to Trade and Investment: An Economic Assessment." Project leader: Joseph Francois

Ecorys (2009), "Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis." Report prepared by K. Berden, J.F. Francois, S. Tamminen, M. Thelle, and P. Wymenga

Ifo Institute, International Trade Department (January 2013),"Dimensions and Effects of a Transatlantic Free Trade Agreement Between the EU and US." Executive Summary: Gabriel Felbermayr, Mario Larch, Lisandra Flach, Erdal Yalcin, and Sebastian Benz

The Perryman Group (February 2013), "The Potential Economic Benefits for Texas of a Free Trade Agreement between the United States and the European Union."

---

[1] CERP (2013). Under the best case scenarios, the CEPR studies assumes 100% elimination of tariffs and 25%-50% reduction of NTBs with 10 years of timeline to implement these changes, thus the outcomes are reported for the 2027 benchmark year.
2 Association of Southeast Asian Nations (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam)
[3] Ifo Institute (2013).
[4] CERP (2013).
[5] The Atlantic Council of the United States, the Bertelsmann Foundation, and the British Embassy in Washington (2013)
[6] The Perryman Group (2013). Under the best case scenario the study assumes 100% elimination of tariffs and 50% reduction in NTBs.