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Shaping 21st century trade

TTIP, global standards and multilateralism

By Christian Odendahl and Rem Korteweg

CENTRE FOR EUROPEAN REFORM

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★ The Transatlantic Trade and Investment Partnership (TTIP) between the EU and the US, currently under negotiation, is a highly complex trade deal that promises to go well beyond the tariff-reducing regional trade agreements of the 20th century. At the centre of TTIP are non-tariff barriers to trade: regulation, standards, market access and investment protection.

★ Common regulation and standards would create a bigger and simpler market for producers and consumers, increase competition and lower costs, since producers would no longer need to go through different regulatory procedures on each side of the Atlantic. This is especially important for global value chains – production networks that stretch across many firms and countries – which dominate 21st century international trade. Trade in parts and components (intermediate goods) makes up 50 per cent of globally traded goods. The share is even higher for intermediate services, and trade within firms already accounts for half of all commerce between the EU and the US.

★ The idea of regulatory co-operation between the EU and the US is nothing new, but TTIP aims to intensify such co-operation, without compromising the rights of both regions to regulate for health, safety or environmental reasons. Contrary to a common perception, especially in Europe, the US does not generally have lower regulatory standards. The regions are natural partners with similar demands and preferences for health and safety, as well as environmental and labour standards. TTIP would set new international norms that third countries would have a strong incentive to follow.

★ TTIP also covers investment protection. Economically, such protection is probably not necessary, as both regions have sophisticated legal systems and large existing flows of investment. But worldwide, there are roughly 3,000 bilateral investment treaties in existence which contain some form of investment protection and arbitration, not always to the benefit of the signing parties. An improved investment agreement between the US and the EU, therefore, would help set a new, better worldwide benchmark.

★ TTIP will also have an impact on multilateral trade, where current negotiations are stuck in the never-ending 'Doha round'. Not all aspects of regulation and standards are suitable for full multilateralisation, as countries at different levels of development have different preferences. But in those areas in which common global rules and standards should be the goal, TTIP could provide the benchmark that other countries can adopt. It is thus important that TTIP is kept open to third countries, especially in Europe's neighbourhood. These countries should be consulted on regulatory initiatives and given market access once they adopt TTIP standards.

The Transatlantic Trade and Investment Partnership (TTIP) is the most ambitious trade deal that the EU has ever sought to negotiate with another country. It is also the most controversial. Trade deals in the past have focused on removing tariffs, which hurt some industries and their workers in Europe, but benefited other industries as well as consumers: lower tariffs meant more variety and cheaper products.

By contrast, TTIP would follow the example of the EU's single market: it focuses mostly on regulation and standards, the so-called non-tariff barriers (NTBs) to trade. Harmonising rules helps businesses, as they no longer need to deal with two sets of regulations, mostly serving the same purpose, to sell goods and services on both sides of the Atlantic. Instead, they can cut costs by applying one set of standards and regulations. But citizens and consumers may worry that democratic control over the regulation of, say, health or environmental standards is under threat.

Critics of TTIP also argue that large, regional trade deals harm third countries and threaten the multilateral trading system. Previous regional trade deals have led to more trade between the signatories, sometimes at the expense of third countries. Tariff reductions in such trade deals are discriminatory: the parties reduce tariffs among themselves, but keep them at higher levels for everyone else. The removal of NTBs, on the other hand, is not necessarily discriminatory: if a common standard is agreed, all countries fulfilling this standard could be granted access to the market concerned. If TTIP is kept open, that is, if third countries can participate once they meet its standards, they might benefit: they could find it easier to trade with the EU and the US if the pair shared common rules.

For their part, multilateral trade negotiations have stalled for years – the current 'Doha' round in the World Trade Organisation (WTO) started in 2001 and remains far from completion. Large regional deals may advance trade more effectively than multilateral deals – for example in global value chains, where different stages of the production process are spread across several countries. What matters most in these production networks are NTBs, easier trade in services, as well as the protection of intellectual property rights and investment – issues that are very hard to solve with 162 WTO members around the table. In fact, some of the areas that TTIP covers might not be ready for large multilateral trade deals with countries at different levels of development. 'Mega-regionals' such as TTIP could thus offer a blueprint for a new form of gradual multilateralism.

"Third countries could find it easier to trade with the EU and the US if the pair shared common rules."

This policy brief first outlines what makes TTIP a new type of trade deal. It discusses how EU-US regulatory co-operation could lead to global standard setting, and what TTIP could mean for world trade and investment, the future of the multilateral trading system and third countries.

The main barriers to trade

There are two main barriers to trade: tariffs and non-tariff barriers. The latter include different health, labour, environmental and sanitary regulations, administrative barriers, or rules on government procurement.

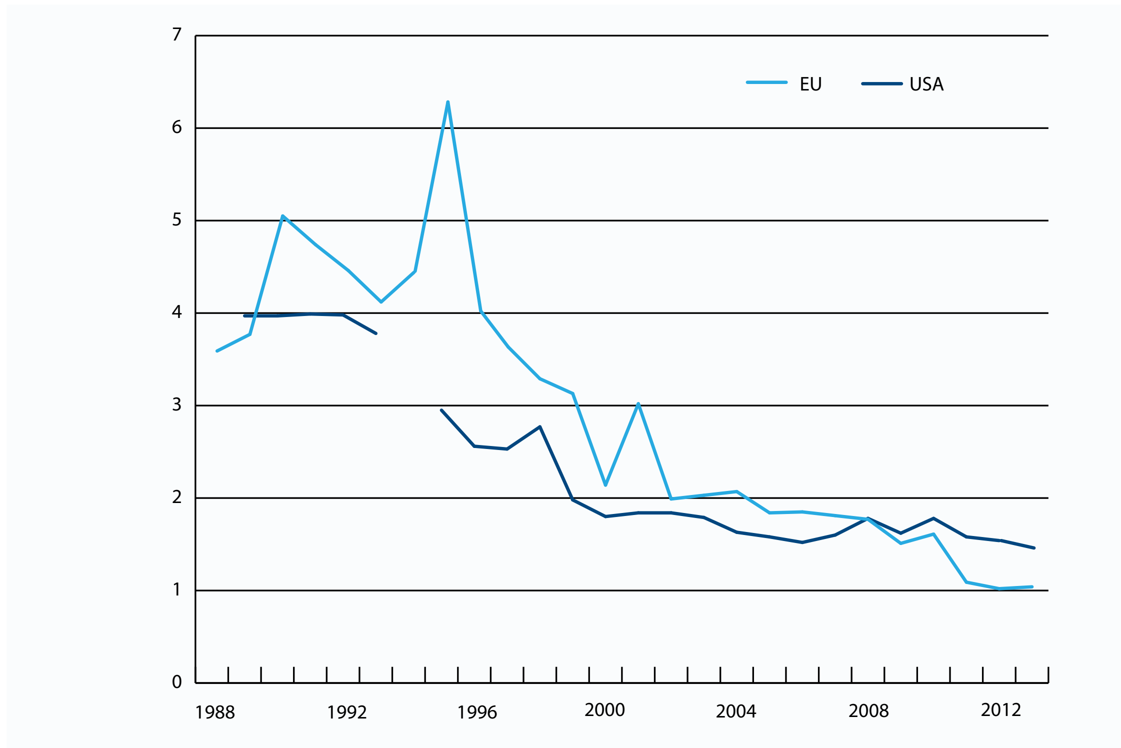
Many countries use, or have used, tariffs to protect domestic producers from foreign competition. The argument in favour of such protectionism is that industries have to be shielded from competition to allow them to get established before competing on global markets. This argument has often been abused to justify high levels of protectionism for political reasons. But the argument had, and still has, widespread appeal.

To break the political gridlock on tariffs, multilateral deals offered the chance to reduce tariffs reciprocally: one country reduced its tariffs if others followed suit. This pitted exporters and importers within countries against each other. Suddenly, there was a strong constituency of exporting firms demanding domestic tariff reductions in order to gain reciprocal benefits from tariff reductions elsewhere. Such multilateral trade agreements – starting in 1947 with the General Agreement on Tariffs and Trade (GATT), and from 1995 in the newly formed WTO – reduced the tariffs applied to traded goods considerably. The European Union's common external tariff on goods averaged just 1 per cent in 2013. For the US, the corresponding figure was 1.5 per cent.[1] Some sectors, such as agriculture, footwear, textiles and vehicles, continue to face higher tariffs, however (see charts on page 3).

1: The figures represent the weighted average of external tariffs on all products. World Bank, 'World development indicators', 2015.

Chart 1: Average applied tariffs for the EU and the US

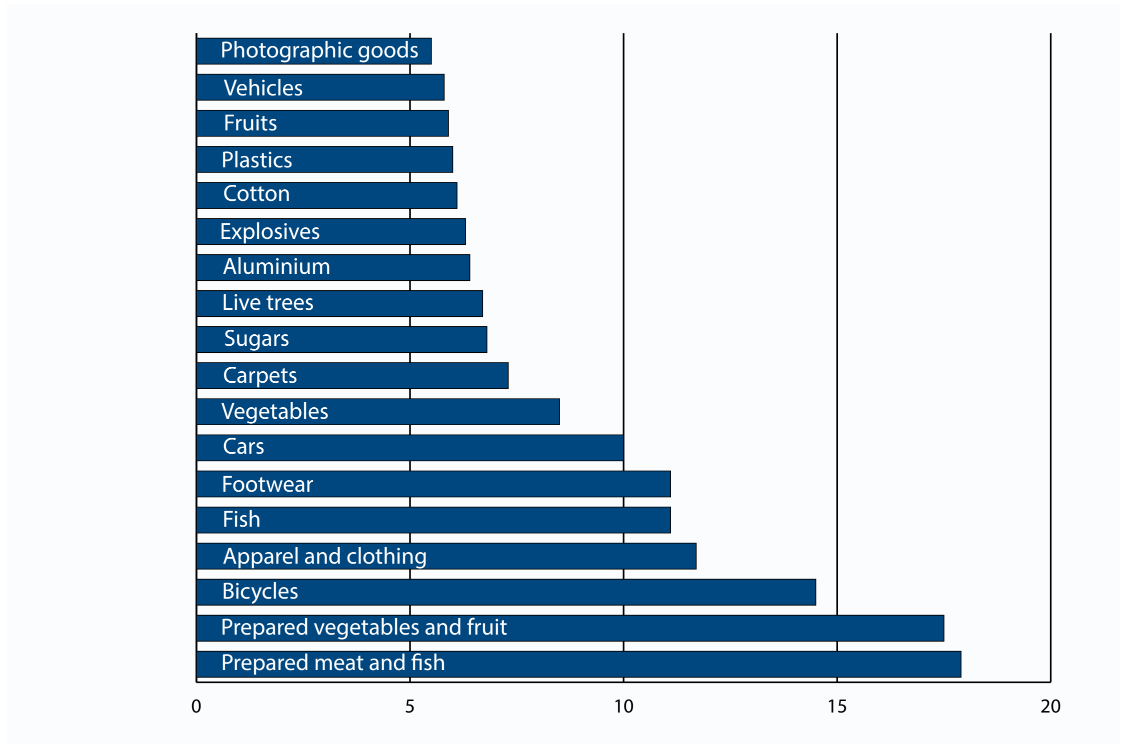
Source: WTO tariff database.



Notes: This chart indicates average tariffs applied by the EU and the US. Weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner tariff region or country. The original data contains a gap for 1995.

Chart 2: Selected average EU tariffs in per cent for high-tariff goods

Source: WTO tariff database for 2015.



Notes: The category names were simplified and some categories were left out altogether to provide an illustrative chart. All categories contain subgroups that may have a higher or lower tariff. Cars and bicycles for example have a higher tariff than the category 'vehicles and vehicle parts' because lorries and most car parts are cheaper to import.

The second obstacle to trade comprises non-tariff barriers (NTBs), where much less progress has been made. Even after tariffs have been reduced or removed, foreign firms can still struggle to gain market access. For example, goods from beyond the EU need to comply with European technical, environmental and safety standards in order to be allowed onto its markets. Trade in services is even more complex, as markets tend to be tightly regulated, for example with national qualification standards for those providing the services. They are also in part provided by public bodies or supported by government subsidies. In general, the more regulated a sector, the more NTBs play a role.

Global value chains add another layer of complexity. These days, goods are often not produced locally, but rather via networks of firms and suppliers across many states. Countries therefore no longer put together national bundles of capital, labour and technology to sell as goods to another country. Instead, they use trade itself in the process of making products.[2] The OECD estimates that parts and components (intermediate goods) account for 50 per cent of globally traded goods. The share is even higher for intermediate services (75 per cent).[3] Moreover, 50 per cent of trade between the US and the EU consists of intra-firm trade, that is, trade between affiliates of the same firm.[4] Trade between countries is thus becoming deeper, and more complex. As a result, countries aim to facilitate trade in intermediate products, components and ancillary services. They also want their firms' intellectual property rights and investment to be protected when they expand their value chains into other jurisdictions. TTIP is an attempt to tackle these issues, especially standards and regulations, as well as investment protection.

"Negotiating precautionary rules, as in TTIP, is very different from trading off reciprocal tariff reductions."

Not your father's trade deal

Standards and regulations are different from tariffs. While tariff reduction is about dismantling the protection afforded to domestic businesses, standards concern health, safety, labour, environmental and consumer protection, or in short, the core precautionary regulations of an economy. Negotiating precautionary rules, as in TTIP, is therefore very different from trading off reciprocal tariff reductions.

The removal of NTBs does not mean that regulations and standards are scrapped, or even lowered. Rather, it requires countries to co-operate on how to regulate. By avoiding unnecessary regulatory duplication, cross-border suppliers of components, goods and services incur fewer costs. The negotiation mandate of TTIP specifies the following aim:[5]

> "The agreement will aim at removing unnecessary obstacles to trade and investment, including existing NTBs, through effective and efficient mechanisms, by reaching an ambitious level of regulatory compatibility for goods and services, including through mutual recognition, harmonisation and through enhanced co-operation between regulators. Regulatory compatibility shall be without prejudice to the right to regulate in accordance with the level of health, safety, consumer, labour and environmental protection and cultural diversity that each side deems appropriate, or otherwise meeting legitimate regulatory objectives."

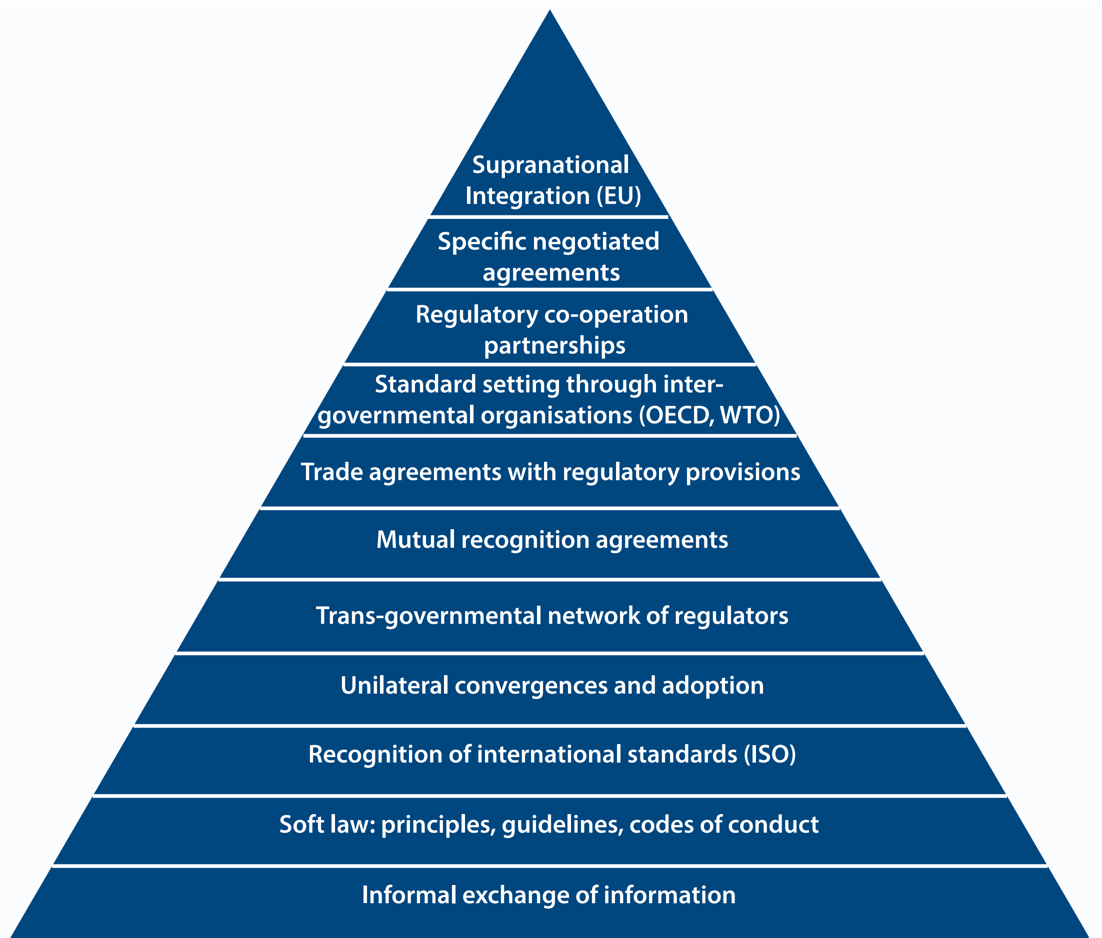
Such regulatory co-operation is nothing new in principle.[6] The OECD identifies eleven different forms of international regulatory co-operation. They range from an informal exchange between regulators; to adoption of international standards; or mutual recognition of each side's testing procedures or regulations. They extend as far as full harmonisation of regulation and standards via supranational law-making and regulation as in the EU or as in certain sectors between Australia and New Zealand (see chart 3). The degree of regulatory co-operation in TTIP would vary according to sector. While a final TTIP agreement would in all likelihood exclude the highest level of regulatory co-operation, the ambition is to reach as high as possible.

The US and Europe have a long history of co-operation on regulation. The rationale for such coordination is that it brings economic benefits, and that highly developed and culturally similar democracies have similar objectives when it comes to precautionary regulation, such as safe cars, clean water or effective medicines.

2: See Richard Baldwin, 'Multilateralising 21st century regionalism', Global forum on trade, OECD, February 2014.
3: Sébastien Miroudot, Rainer Lanz and Alexandros Ragoussis, 'Trade in intermediate goods and services', OECD Working Paper, November 2009.
4: Csilla Lakatos and Tani Fukui, 'EU-US economic linkages: The role of multinationals and intra-firm trade', EU Commission, 2013.
5: Council of the European Union, 'Directives for the negotiation on a comprehensive trade and investment agreement, called the transatlantic trade and investment partnership, between the European Union and the United States of America', June 2013.
6: The following description and examples are taken from Céline Kauffmann and Nikolai Malyshev, 'International regulatory co-operation: The menu of approaches', E15Initiative, 2015; and Peter Chase and Jacques Pelkmans, 'This time it's different: Turbo-charging regulatory co-operation', in Daniel Hamilton and Jacques Pelkmans (eds), 'Rule-Makers or Rule-Takers?', 2015.

Chart 3: Hierarchy of regulatory co-operation

Source: Authors' chart, adapted from OECD, 'International regulatory co-operation: Addressing global challenges', 2013; and Céline Kauffmann and Nikolai Malyshev, 'International regulatory co-operation: The menu of approaches', E15Initiative, 2015.



An early example is the 1998 agreement on mutual recognition between the EU and the US. It was not a far-reaching agreement, however. In it, both sides allowed merely a designated body from each party to certify that products in specific sectors met the regulatory requirements of the other party. It did not involve regulatory changes, but focused only on making it cheaper for firms to comply with regulations in the other jurisdiction. The agreement worked best in less regulated sectors (where it was also less necessary), but was less effective in more highly regulated sectors. In the latter, deeper co-operation is necessary to ensure that regulators trust each other.

An example of such a deep form of mutual recognition is the 2009 US-EU Bilateral Aviation Safety Agreement. In it, the US and EU aviation safety regulators agreed to accept each other's seal of approval for, say, Boeing and Airbus planes. The agreement predates TTIP, and is remarkable given that the subsidies paid to both companies were the reason for fierce trade disputes between the US and the EU over the years. But because Europe and the US have very strong preferences for safe aircraft, it is not surprising that both sides found that the other does a good enough job in ensuring that planes are safe. The aviation industry therefore has, in regulatory terms, its very own 'TTIP' already.

Does Europe have higher standards?

A common misconception regarding regulatory convergence is that the other side has lower standards, and therefore 'convergence' would lead to deregulation or lower standards at home. The United States is generally more litigious than most European member-states, and the US legal system leads to higher damage compensation. As a result, critics in Europe conclude that the US under-emphasises precautionary regulation.

But such general statements are seldom borne out by the evidence.

The most comprehensive study of average levels of precautionary regulation finds that transatlantic differences are small, and cut both ways (see table below).[7] European standards are lower, for example, when it comes to the approval of medical devices such as breast implants

7: James Hammitt, Jonathan Wiener, Brendon Swedlow, Denise Kall, & Zheng Zhou, 'Precautionary regulation in Europe and the United States: A quantitative comparison', Risk Analysis, 2005.

or pacemakers.[8] Not even in agriculture, which is among TTIP's most controversial issues in Europe, are European standards higher across the board than US ones. While Europe is more cautious when it comes to hormone use in beef production, and genetically modified organisms (GMOs), the US has been more cautious with regard to mad cow disease (BSE) and its possible transmission between humans via blood donations.[9] The prevention of the spread of foodborne illnesses – one key aim of food regulation – also tends to work better in the US than in the EU, although the empirical comparison is difficult.[10] The recent Volkswagen car emissions scandal also suggests that Europe has a problem with enforcing standards.

Table 1: Differences in precaution between the US and Europe

Source: James Hammitt, Jonathan Wiener, Brendon Swedlow, Denise Kall, & Zheng Zhou, 'Precautionary regulation in Europe and the United States: A quantitative comparison', Risk Analysis, 2005.

	Score
Greater US precaution	
Alcohol, tobacco and drugs	-0.56**
Pollution	-0.17
Accident risks	-0.17
Recreation and sports	-0.13*
Medication and medical treatment	-0.01
Equal precaution	
Other	0.00
Consumer products	0.00
Greater European precaution	
Energy production	0.01
Food and agriculture	0.03
Human disease and health	0.05
Occupational risks	0.09
Crime and violence	0.11
Transport	0.15
Toxic substances	0.15
Weather, wildlife and natural disasters	0.25
War, security and terrorism	0.41
Climate change and biodiversity	0.52

*Notes: The score shows the difference in regulatory precaution between the US and Europe, with a positive figure indicating more precaution in Europe. The scores can range from -1 to 1. Only the differences in alcohol, tobacco and drugs regulation are significantly different (denoted with ** for the 5 per cent significance level), and recreation is somewhat significant (denoted with * for the 10 per cent level) across the Atlantic, all others are small and overall insignificant.*

However, unlike tariffs, which are relatively straightforward to reduce, regulatory co-operation is a complex and continuous process (see chart 4). TTIP is therefore planned as a 'living agreement' that will tackle both current and future regulation and standards. But the EU and the US have set a challenging timetable for completing TTIP – US lead negotiator Michael Froman famously aimed to "get it done on one tank of gas", suggesting it would be finalised within Barack Obama's final term in office. The rationale is clear: maintain political momentum in favour of TTIP. But a quick deal on TTIP would be far less effective than a properly negotiated one.

One option that could save time and still yield a meaningful deal is that the parties agree on a framework for discussions on regulatory compatibility – and perhaps suggest broad contours for convergence in specific sectors – instead of specifying elements of regulatory convergence per se. This would also

8: In 2010, the EU had to take certain breast implants off the market, after it was found that industrial grade silicon had been used in them. See US Food and Drug Administration (FDA), 'Unsafe and ineffective devices approved in the EU that were not approved in the US', May 2012; Jana Diels and Christian Thorun, 'Risks and opportunities for consumer welfare arising from the Transatlantic Trade and Investment Partnership', Friedrich Ebert Stiftung, February 2015; BEUC, 'TTIP & health', June 2015.

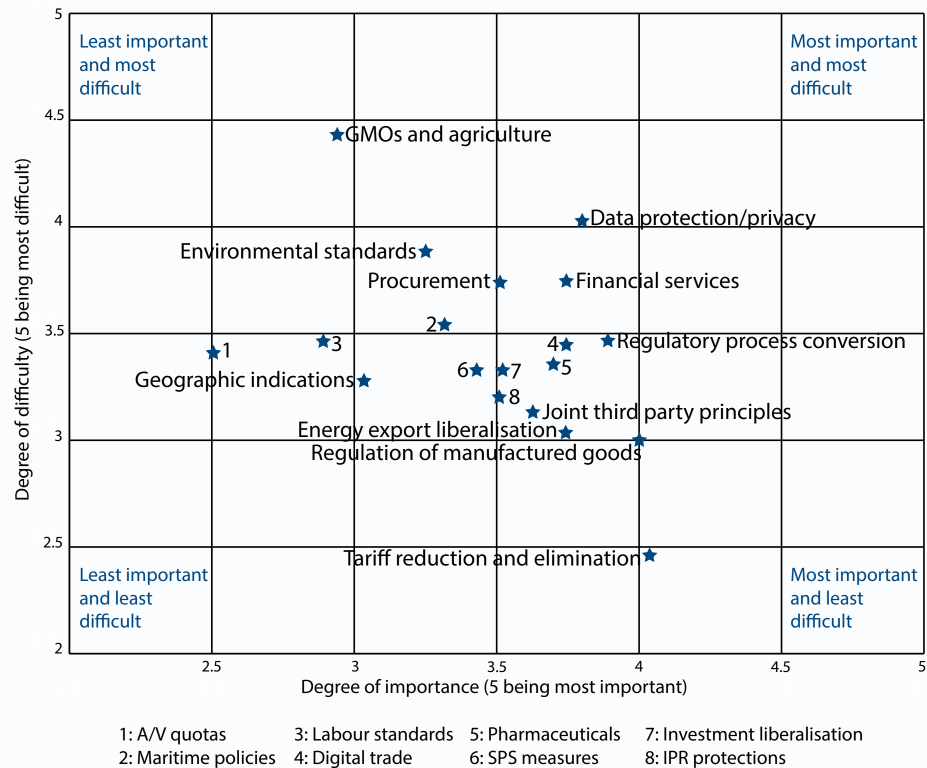
9: Jonathan Wiener and Michael Rogers, 'Comparing precaution in the United States and Europe', Journal of Risk Research, 2002.

10: Jennifer McEntire, 'Foodborne Illness: How do the US and EU Compare?', The Acheson Group, March 2014.

underline the 'living' dimension of TTIP; namely, the characteristics of regulatory co-operation would emerge over time as transatlantic regulators build confidence and mutual understanding. By contrast, in the area of tariff-reductions – the more traditional dimension of TTIP – an accord should deliver concrete results.

Chart 4: What stakeholders perceive as important and difficult in TTIP

Source: Replicated from Joshua Stanton, Kara Sutton and Garrett Workman, 'The Transatlantic Trade and Investment Partnership: On track but off message?', 2014.



Notes: The authors surveyed more than 300 respondents from business, academia, government, legislatures and the media for their assessment on which policy areas would be the most important and most difficult to achieve convergence on.

Investment as part of 21st century trade

TTIP also includes investment, which is a core element of trade in modern global value chains. Investment across borders can be risky, as firms investing in other countries face different regulatory regimes and legal systems, and risk discrimination or outright expropriation of their assets. As a result, many countries have agreed to sign bilateral investment treaties (BITs) to attract investors. Such BITs often include provisions for an investor state dispute settlement (ISDS) mechanism; that is, a procedure through which foreign investors can challenge government policies that they see as discriminatory. Roughly 3000 BITs contain some form of ISDS, and the EU and its member-states are a party to around 1400 of them.[11]

Whether BITs with ISDS increase foreign investment, and whether they are necessary between two regions with sophisticated legal systems that already have large investment flows between them – like the EU and the US – is the subject of debate. Existing empirical studies paint a mixed picture of the effectiveness of ISDS.[12] Some studies find that BITs (with and without ISDS) do increase foreign direct investment (FDI), particularly in countries that have weak legal institutions. Other studies fail to identify any positive effect – or find that BITs with ISDS do not provide more incentives to invest than those without. Brazil, for example, had until recently not signed any BITs but still attracted large amounts of foreign investment. Surveys have also found that

11: See Marta Latek, 'Investor-state dispute settlement (ISDS) – State of play and prospects for reform', European Parliamentary Research Service, January 2014; and David Gaukrodger and Kathryn Gordon, 'Investor-state dispute settlement – A scoping paper for the investment policy community', OECD Working Papers, 2012.

12: See for example Axel Berger, Matthias Busse, Peter Nunnenkamp and Martin Roy, 'More stringent BITs, less ambiguous effects on FDI? Not a bit!', WTO Staff Working Paper, May 2010; Peter Egger and Valeria Merlo, 'The impact of bilateral investment treaties on FDI dynamics', The World Economy, October 2007; Matthias Busse, Jens Königer and Peter Nunnenkamp, 'FDI promotion through bilateral investment treaties: more than a bit?', Review of World Economics, April 2010; and the survey in UNCTAD, 'The role of international investment agreements in attracting foreign direct investment to developing countries', 2009.

investors rarely consider BITs when making investment decisions.[13] In an agreement between states with sophisticated legal systems, such as the EU and the US, the inclusion of ISDS is unlikely to increase investment flows and hence create economic benefits (although some European companies feel that ISDS is necessary to remove concerns about state-level judiciaries in the US).

The costs and benefits of including ISDS in TTIP are therefore subject to considerable debate. The average ISDS case costs around $4 million per party, according to the OECD.[14] High costs are a major reason why countries often choose to agree to a settlement rather than see the case through to the end. A further risk of ISDS concerns the freedom to regulate and set policies. For example, an EU government might refrain from implementing its preferred policy on, say, the renationalisation of outsourced public services, if the decision might be challenged under ISDS.

However, past ISDS procedures are not necessarily a good guide for a new transatlantic investment arbitration system. Earlier ISDS agreements have been criticised for being untransparent and giving businesses an advantage. Some European countries, particularly in Central and Eastern Europe, would welcome a new transatlantic ISDS: they have existing arbitration agreements with the US – and have been the target of three quarters of all ISDS cases against EU member-states – but hope for a better deal in TTIP.[15] The Commission has now proposed a permanent investment tribunal with independent, permanent judges, an appeals procedure, and stricter limits on the issues in which ISDS applies.[16] A reformed and streamlined ISDS could lower legal risks to governments. Such a new generation ISDS could then set a new standard for ISDS in investment treaties around the world.

Shaping global standards

The EU and the US are the two largest economies in the world. TTIP would therefore have consequences beyond their jurisdictions. For example, one implication of global value chains is that less developed countries can join in the worldwide trade of complex goods they would not be able to produce on their own. But this makes them adopt, often unilaterally, the standards and regulations set by the countries dominating the value chains. And even countries that are able to produce complex goods on their own will have to abide by the (usually tougher) regulations and standards set by their largest consumer markets – an effect called the 'California effect' in the context of the US, or the 'Brussels effect' more recently on a global level.[17] As a result, production hubs and large consumer markets like the EU and the US have considerable leverage in determining global regulations and standards.

Coercion is not required to spread standards and regulations. Market forces do the work. When it is too costly to abide by two sets of rules and regulations – one domestic and one for the largest consumer market or the main hubs of production chains – export firms may simply adopt the (usually higher) export standard. These export firms will then put pressure on their domestic regulators to implement the same rules at home, in an attempt to level the domestic playing field. Countries that dominate production networks and have big consumer markets possess the economic clout to induce other countries to follow them. That leverage increases further if they set standards together. The result will not be a race to the bottom. For many countries, this will mean beefing up their regulatory policies.

"Coercion is not required to spread standards and regulations. Market forces do the work."

Such a leadership role for TTIP also stretches to investment treaties and ISDS. As argued above, ISDS is not needed to increase investment flows between the US and the EU. But a reformed ISDS in TTIP has the potential to harmonise European and US-style investment treaty frameworks, and set the global benchmark on investment arbitration standards. It would make it more difficult for any country to negotiate a future investment agreement with laxer ISDS standards. Existing BITs are of varying quality, and additional ones are being signed. In fact, Brazil, the country that refused to sign BITs in the past, has recently started to negotiate BITs – not to attract investment, but as an exporter of capital. China wants to sign BITs, too, in order to provide security for Chinese firms investing abroad, including BITs with the US or the EU – regardless of whether TTIP contains ISDS or not. The TTIP ISDS precedent would help smaller and poorer countries in their investment treaty negotiations with large economies, like China, to ensure that BITs protect not only investors

13: One indirect effect is via political risk guarantee agencies, public or private, which do consider BITs to some extent, albeit not very strongly. See Lauge N. Skovgaard Poulsen, 'The importance of BITs for foreign direct investment and political risk insurance: Revisiting the evidence', Yearbook on International Investment Law and Policy, 2010.
14: OECD, 'Investor-State Dispute Settlement – Public Consultation: 16 May - 9 July 2012', 2012.
15: Friends of the Earth, 'The hidden cost of EU trade deals', December 2014.
16: European Commission, 'Why the new EU proposal for an Investment Court System in TTIP is beneficial to both states and investors', November 2015.
17: See for example Anu Bradford, 'The Brussels effect', Northwestern University Law Review, 2012.

but also a country's right to regulate and set policies. The Commission's recent proposal for an investment tribunal could thus be the start of an international investment protection framework. In short, a reformed ISDS mechanism in TTIP is not about the EU or the US, but about changing international investment law.[18]

TTIP and third countries

The effects of TTIP on third countries will be different from those of 20th century regional trade deals. There are two possible effects of traditional tariff-reducing regional agreements like NAFTA.[19] First, regional tariff reductions could lead to increased trade among signatory states – as would be expected since that is the goal of negotiating such deals in the first place. Second, regional agreements could divert trade away from those excluded from such trade agreements and towards those inside. Recent empirical studies have found that this second effect is small, if present at all. In some cases regional trade agreements can create more trade with those excluded from such agreements, when countries that form these regional trade agreements lower tariffs to outsiders as well, as has often happened in the past.[20]

In line with these recent estimates, TTIP could have a positive effect on third countries as well. First, transatlantic tariffs are already low. As a result, third countries would not be disadvantaged if the EU and the US removed these low tariffs: EU and US companies trading across the Atlantic would not gain major advantages over third country producers. In addition, both the EU and the US have or are negotiating free trade agreements with others (see map on page 10). There are some sectors where US or EU tariffs are still substantial, such as clothing or agriculture. However, a large share of production in these sectors is already in non-TTIP countries, meaning that tariff reductions within TTIP do not affect these countries.[21]

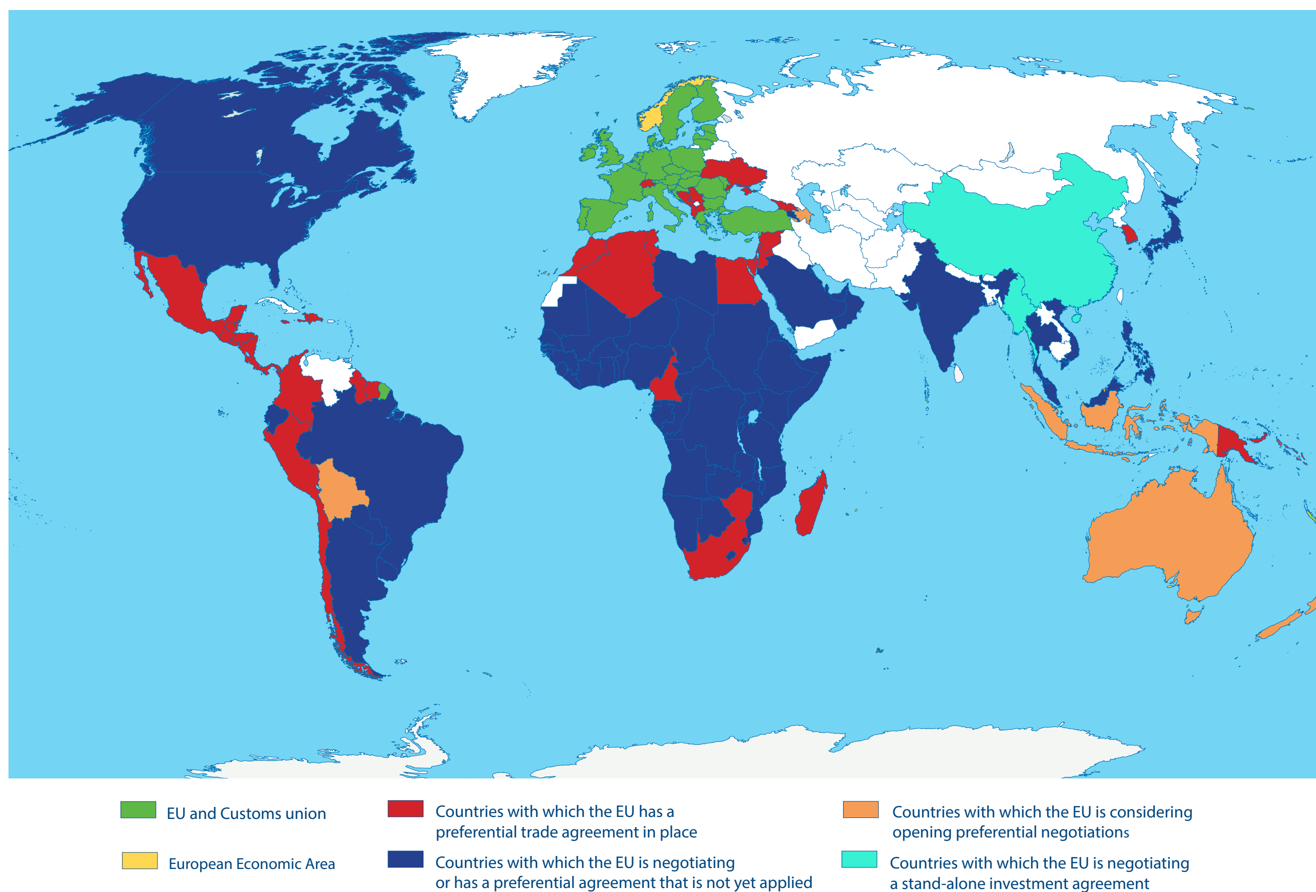
The second reason for a potentially positive effect on third countries is that it is much harder to determine the origin of a service than of a good. Even if the EU and the US attempted to discriminate against services provided by non-TTIP countries, this would be difficult to enforce. For example, a non-TTIP firm such as a bank in Japan could set up a subsidiary on TTIP territory and trade within TTIP from there – including services that originated in Japan.[22]

Third, when NTBs are reduced, in the form of agreed standards and regulations, third countries are not necessarily discriminated against. In principle, any country fulfilling the agreed standards could be granted access to TTIP markets. In this case, third countries would not have to tailor their production to different sets of standards and regulations but only to one, reducing the costs of trading with TTIP countries. The economic gains for third countries and the TTIP zone are potentially large. A recent study found that a discriminatory TTIP would hurt EFTA[23] and TPP[24] countries, as well as Turkey. If, however, 20 per cent of the reductions in trade costs that US and EU firms enjoy from removing NTBs in TTIP also accrued to firms in third countries, the effect would be positive for all – and would further increase the positive effect of TTIP for the EU and US economies.[25]

For EFTA and Turkey in particular, given their close export and regulatory ties to the EU, there would be a strong incentive to align fully with TTIP regulation and standards, to ensure full market access. The same is true for Canada and Mexico.[26] If the goal of TTIP is to set international trade rules and standards (and it should be), common approaches to regulation and standards need to be extendable to third countries. The current plan is to conclude TTIP bilaterally, after which interested third parties may be invited to join. The precise form this would take is subject to discussion, with formalised accession to TTIP one option, as well as with bridge agreements between TTIP and existing trade deals such as NAFTA and EFTA.[27] But it is also important to include third countries in the process of regulatory co-operation. For existing regulations, access to TTIP would often be a take-it-or-leave-it proposition. But for new regulation and co-operation, NAFTA and EFTA countries, as well as Turkey, should be consulted.

18: For a full treatment of this argument, see Freya Baetens, 'Transatlantic investment treaty protection – A response to Poulsen, Bonnitcha & Yackee', in 'Rule-Makers or Rule-Takers?', 2015.
19: NAFTA is the North American Free Trade Agreement between the US, Canada and Mexico.
20: See Rohini Acharya, Jo-Ann Crawford, Maryla Maliszewska, and Christelle Renard, 'Landscape', and Richard Baldwin and Caroline Freund, 'Preferential trade agreements and multilateral liberalization', in 'Preferential trade agreement policies for development: A handbook', The World Bank, 2011.
21: There are some sectors where trade diversion could be substantial, for example in motor vehicles. See Joseph Francois, Bernard Hoekman and Doug Nelson, 'TTIP, regulatory diversion and third countries', in 'Catalyst? TTIP's impact on the rest', Centre for Economic Policy Research, 2015. Developing countries with access to the EU on preferential tariffs might also be negatively affected.
22: This argument is explained in more detail in Richard Baldwin, 'Multilateralising 21st century regionalism', Global forum on trade, OECD, February 2014.
23: The European Free Trade Association consists of Norway, Switzerland, Iceland and Lichtenstein.
24: The Trans-Pacific Partnership is a trade agreement between the US and eleven Pacific countries, including the two NAFTA countries Canada and Mexico, as well as Japan, Australia, New Zealand, Chile, Malaysia, Singapore and Vietnam, Peru and Brunei.
25: The 20 per cent is a modelling assumption. Peter Egger, Joseph Francois, Miriam Manchin and Doug Nelson, 'Non-tariff barriers, integration, and the Trans-Atlantic economy', Economic Policy, 2015.
26: Arjan Lejour, Federica Mustilli, Jacques Pelkmans and Jacopo Timini, 'Economic incentives for indirect TTIP spillovers', CEPS, October 2014.
27: For a discussion, see Sinan Ülgen, 'Locked in or left out? Transatlantic trade beyond Brussels and Washington', Carnegie Europe, June 2014.

Chart 5: Map of EU free trade agenda



Source: European Commission.

Can TTIP reinvigorate multilateral trade?

Just as TTIP is a different form of trade agreement from the 20th century agreements that focused on tariff reduction, so trade multilateralism will be different in the 21st century. In fact, services trade, investment protection, regulatory co-operation and NTBs pose a new challenge to multilateralism more broadly: should they be tackled at the multilateral level at all?

Health, labour and safety regulations depend on income levels, cultural preferences and political priorities, so different countries will want to have different standards. Regulating services markets might also be best left to national governments unless there is a strong sense of mutual trust between regulators across countries, and an equivalence of objectives. Therefore, the world trade system faces a trade-off between the benefits of agreeing rules with 162 members of the WTO, and the difficulty – politically or technically – of reaching agreement (see chart 6).

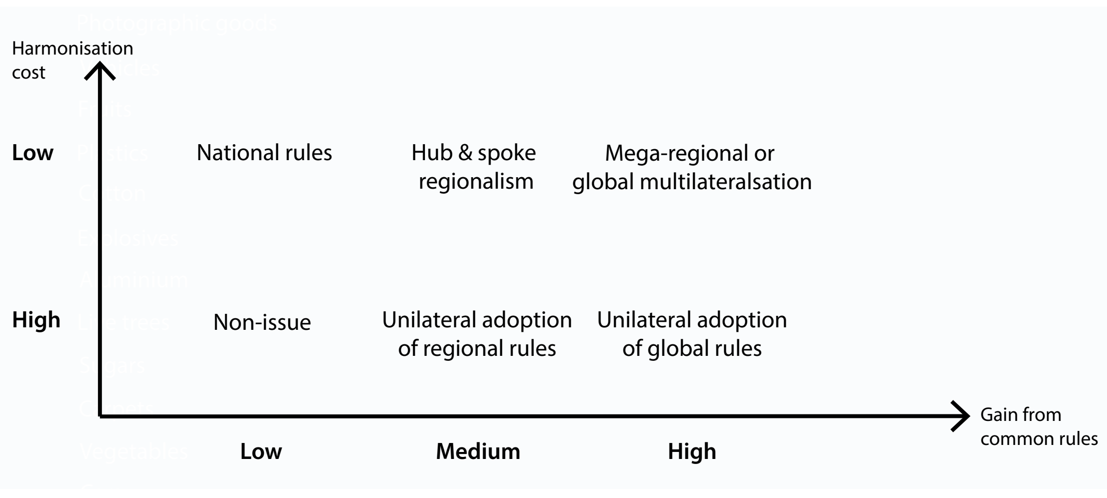
When the gains from global rules are low, there is no issue: rules should be a national responsibility. When the gains are medium, countries should adopt the rules of their regional hegemonic economic 'hub' unilaterally, as for example neighbours of the EU do; or the regional hub needs to offer something in return to induce harmonisation – which benefits both sides. For example, the customs union between Turkey and the EU includes annexes on EU regulations that Turkey must adopt. In return, Turkey gets access to the European market.

"An open TTIP that explicitly welcomes third countries is a means of solidifying the role of the West in shaping the world economy."

The most interesting case is when the gains from establishing global rules are high, that is, when there is the potential for true multilateralism. With low costs of such harmonisation, global rules should be drawn up that are then unilaterally adopted. The power plug would have been a good opportunity – unfortunately missed – but there are more current examples where it has worked, with the USB plug a fitting example. The work of the International Organisation for Standardisation (ISO) offers other examples for such global co-ordination.

Chart 6: Where and how to multilateralise rules?

Source: Richard Baldwin, 'Multilateralising 21st century regionalism', Global forum on trade, OECD, February 2014.



The final case is in the top right corner, when the costs of agreeing common rules are high, for example the political costs of agreeing common safety standards. In this case, there is potential for true multilateral, negotiated action. Multilateral negotiations in the WTO, however, are stuck on much simpler issues by comparison. Agreeing on global rules may simply go beyond what can reasonably be settled at a truly multilateral level at this juncture, given that countries at lower stages of development may have different preferences for rules and standards. Mega-regional deals such as TTIP can therefore be the intermediate step.

How can mega-regional deals be multilateralised? The key is again global value chains. As Richard Baldwin from the Graduate Institute in Geneva puts it, the old trade deal was "I'll keep my market open if you keep yours open", whereas the new trade deal with value chains in mind is "I'll offshore my factories and technologies if you assure my tangible and intangible assets are protected".[28] Those countries that want to, and are able to join such value chains should take part in a broader effort to establish common rules, including for regulation and standards, investment protection, access to services markets and intellectual property.

An ambitious TTIP agreement between the US and the EU can lay the groundwork for this: if two of the three largest economic hubs, Europe and the US – the third being China – reach an agreement, the incentives for other countries to join such a new multilateral order, in parallel to the old WTO, would be very strong. It would provide an opportunity to encourage countries to observe property rights, be transparent and predictable in their setting of regulations, and to implement and enforce standards in a fair and transparent manner. But TTIP will only drive such a new multilateral order if it is explicitly open to third countries along the above lines.

A change to TTIP's narrative

Policy-makers have in the past asked for the public's trust when it came to trade, and tended to downplay the potential consequences of freer trade for income inequality – which economists have always acknowledged, though rarely in public. Two recent studies found that between 1999 and 2011, the US economy lost 2.4 million jobs because of Chinese import competition, and that those American workers who changed occupation because of increased trade suffered a loss of about 15 per cent in real wages.[29] As a result, the public has lost trust in official trade policy.

TTIP would not have similar distributional consequences for workers in the EU and the US – job switching as a result of TTIP, for example, is expected to be low.[30] But some countries in the EU will benefit more than others.[31] The effects on small and medium-sized enterprises (SMEs) in Europe are uncertain: SMEs will benefit from easier access to another large market, but a larger market usually favours larger firms, or encourages mergers.[32] It is positive for the economy, and the consumer, to have larger, more efficient firms able to exploit economies of scale and reduce prices. But some European SMEs might lose out from TTIP. In order to regain the public's trust, policy-makers need to communicate realistic expectations about the benefits of TTIP.

28: Richard Baldwin, 'WTO 2.0: Global governance of supply chain trade', CEPS, December 2012.
29: Daron Acemoglu, David Autor, David Dorn, Gordon H. Hanson, Brendan Price, 'Import competition and the great U.S. employment sag of the 2000s', NBER Working Paper, 2014; and Avraham Ebenstein, Ann Harrison, Margaret McMillan, and Shannon Phillips, 'Estimating the impact of trade and offshoring on American workers using the current population surveys', NBER Working Paper, 2015.
30: Joseph Francois, Miriam Manchin, Hanna Norberg, Olga Pindyuk and Patrick Tomberger, 'Reducing transatlantic barriers to trade and investment – An economic assessment', CEPR report, March 2013.
31: World Trade Institute, 'TTIP and the EU Member States', January 2016.
32: Richard Baldwin, 'Economics', in 'Preferential trade agreement policies for development: A handbook', The World Bank, 2011.

Second, the EU and its member-states need to change their expectations about the nature of TTIP – which thankfully the Commission has started to do, but member-states still have not: away from a rushed trade deal that is negotiated with limited democratic scrutiny, towards a process of long-term transatlantic co-operation to achieve better standards and better regulation for Europe, its neighbours and the multilateral trade system. Expectations regarding the timing of such a deal need to be realistic, too. TTIP is a comprehensive deal on complex issues and negotiating it will inevitably take time. The political context on both sides of the Atlantic has created time constraints, particularly to negotiate all the details surrounding regulatory co-operation. So the EU should opt for a tiered agreement: TTIP establishes the framework for regulatory co-operation, and only then do transatlantic regulators start to identify areas of regulatory compatibility.

This new approach to TTIP should also make clearer that it will have an impact beyond the Atlantic region. Europe should underline that the US and the EU are natural partners on trade policy, and that they have the highest global standards on issues such as the environment, labour standards, and transparent and accountable regulation. An open TTIP that explicitly welcomes third countries is a means to solidify the role of the West in shaping the world economy – not through coercion but through market forces.

A welcome result of the TTIP debate would be if Europe – driven by public scepticism and recent scandals about car emissions testing and dangerous medical devices – discussed its own approach to regulation more critically, and improved the transparency and accountability of regulators. TTIP would be a forum to improve regulation, not water it down. Europe should not stick its head in the sand and assume that it has the best, or highest, standards in every sector. A European discussion on regulation would benefit from the frank exchange of views and experiences with the US.

Public resistance has led to some positive changes in the Commission's approach to TTIP. There is now a higher degree of democratic scrutiny of the negotiations; all the EU's parliaments – including the European Parliament – will likely have to ratify any final agreement and most negotiating texts are public. The Commission's proposal for a reformed ISDS, driven by public criticism of the old model, is useful. Given that ISDS is unlikely to produce any economic gains for the EU, it can contribute to setting a new global standard for investment protection – a standard that reduces legal uncertainty, while protecting a government's right to set policies.[33] These concepts are now also enshrined in the EU's new trade strategy. [34]

The next step is for TTIP supporters and critics alike to acknowledge its global dimension. For example, there needs to be a broader debate in Europe on how TTIP can best be made open to third countries in Europe's neighbourhood. Moreover, the process of regulatory co-operation across the Atlantic should be made transparent, contain rigorous impact assessments, and include public consultations with stakeholders both from TTIP countries and beyond. Citizens on both sides of the Atlantic rightly want reassurances that their rights to regulate health, safety and the protection of the environment are not compromised. But it would be a mistake if legitimate public concerns turned into misguided resistance to the entire project.

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33: European Commission, 'Why the new EU proposal for an Investment Court System in TTIP is beneficial to both States and investors', November 2015.

34: European Commission, 'Trade for all – New EU trade and investment strategy', EU Commission, October 2015.