

IS TTIP A GROWTH AND EMPLOYMENT ENGINE FOR SOUTHERN EUROPE?

by Sabine Stephan

It is not a coincidence that the European Union and the United States of America currently negotiate an ambitious free trade agreement. Seven years after the outbreak of the financial crises that led to the deepest crisis of the global economy since the 1930s, numerous EU countries – and the Southern European crisis countries in particular – are still suffering from the drastic consequences of the global economic crisis. The fact that they are unable to stimulate their economies by their own efforts due to strict austerity policies gives added weight to the claim that TTIP will generate considerable growth and employment opportunities for the countries involved. This claim is typically backed up with findings taken from “independent” studies. A closer look at the findings of two influential studies that present projections at the country level however reveals that even in the event of a comprehensive free trade agreement being signed, the anticipated effects on growth and employment in Greece, Portugal, Spain and Italy are minuscule.

Non è una coincidenza che l'Unione europea e gli Stati Uniti d'America stiano negoziando un accordo ambizioso di libero scambio. Sette anni dopo lo scoppio delle crisi finanziarie che hanno portato alla più grave crisi dell'economia mondiale a partire dagli anni Trenta, molti paesi europei – e in particolare quelli dell'Europa meridionale – risentono in modo ancora molto forte delle drastiche conseguenze della crisi economica globale. Il fatto che essi siano incapaci di stimolare in modo autonomo la loro economia a causa delle politiche di *austerità* corrobora l'affermazione secondo la quale il TTIP genererebbe considerevoli opportunità di crescita e occupazione per i paesi coinvolti. Quest'affermazione viene solitamente sostenuta facendo ricorso alle conclusioni di alcune ricerche “indipendenti”. Tuttavia, uno sguardo più attento ai risultati di due importanti studi che presentano delle proiezioni a livello di singolo paese rivela che, anche nel caso della conclusione di un accordo di libero scambio globale, gli effetti previsti sulla crescita e l'occupazione in Grecia, Portogallo, Spagna e Italia sarebbero minimi.

Since July 2013 the EU and the USA have been negotiating a Transatlantic Trade and Investment Partnership (TTIP) with the aim of creating the world's largest free trade area, with more than 820 million consumers. The world's two largest economies are already closely interlinked today: goods and services worth approximately two billion euros are traded each day. In order to intensify trade further, trade barriers are to be eliminated on both sides of the Atlantic within the framework of the TTIP. As tariffs on transatlantic trade today are already very low – import duty on industrial goods averages less than 4% in both economic areas – the focus of attention is on wide-ranging removal of what are known

as non-tariff barriers (NTBs)¹. In other words, this means that there is to be far-reaching deregulation and liberalisation of transatlantic traffic in goods and services.

1. WHAT ARE THE ECONOMIC EFFECTS OF THE TTIP?

Large-scale simulation studies have been conducted in an attempt to gauge the economic effects of a transatlantic free trade agreement. The key studies are from the Dutch research and consulting company ECORYS, the Centre for Economic Policy Research (CEPR), and the German IFO Institute². The IFO studies are particularly interesting, since they provide projections at the country level. What follows is a presentation of the findings of the two IFO studies with regard to the anticipated effects on growth and employment in the Southern European crisis countries (Greece, Portugal, Spain and Italy). All the findings are predicated on the highly optimistic scenario of a *comprehensive free trade agreement*. In other words, all their calculations are based on the assumption that all tariffs will be removed and the NTBs will be reduced to a large extent.

The German IFO Institute has drawn up two expert opinions on the economic effects of a transatlantic free trade agreement. One was commissioned by the German Federal Ministry for Economic Affairs (IFO, 2013a), the other by the Bertelsmann Foundation (IFO, 2013b). In the following we refer to them as IFO/BMWI study and IFO/Bertelsmann study respectively. The approach taken by the IFO authors differs significantly from that of other studies in that they attempt to circumvent a serious problem. The problem is that in other studies (ECORYS, 2009, CEPR, 2013) assumptions have had to be made as to the percentage by which trade costs will fall if NTBs are removed to a certain extent. As these assumptions are based on subjective assessments and strongly influence the findings, the studies are highly vulnerable to criticism on this point³.

The new approach of the IFO authors consists in implicitly determining the percentage by which the trade costs will fall. This is done by estimating by econometric means the percentage by which free trade agreements in the past have increased trade in the countries concerned. The logic behind this approach is as follows: if the extent of trade creation is known, then it is possible to reduce the trade costs in the model to a level at which the model exactly simulates the estimated extent of trade creation. In this way, the extent of cost reduction through the removal of NTBs is determined implicitly. At first glance this seems an elegant approach. At second glance it is problematic, because in this way the answer to the question *By what percentage will the TTIP increase the foreign trade of the countries involved?*, which is supposed to be the result of the study, is already anticipated.

The scenario focused on by both IFO studies is the comprehensive free trade agreement, referred to as *NTB scenario* in the IFO/BMWI study and as *deep liberalisation* in the IFO/Bertelsmann study. In both cases it is assumed that the TTIP will increase the

¹ This refers to measures which directly or indirectly restrict trade and which are not duties. NTBs include import allocations and quotas, technical standards, safety and industry standards, labeling regulations, emissions regulations, pharmaceutical and food legislation, etc.

² In the public debate the studies have for convenience named after the research institutes which have conducted the study. In the references the ECORYS (2009) study is listed as Berden *et al.* (2009), the CEPR (2013) study as Francois *et al.* (2013), and the IFO (2013a, 2013b) studies as Felbermayr *et al.* (2013) and Felbermayr, Heid, Lehwald (2013) respectively.

³ This aspect is discussed in detail in Raza *et al.* (2014, Chapter v.b., p. 31ff.).

foreign trade of the countries involved by an average of 76 per cent, which is a very strong assumption.

1.1. *Growth effects*

The two IFO studies are essentially identical: the central step in both cases is the econometric estimate of the trade creation effects of existing free trade agreements. Trade diversions are then simulated and the GDP effects calculated on the basis of the estimates. As both studies start out from exactly the same level of trade creation, they logically arrive at identical growth effects⁴. However, this is not immediately obvious, because a different terminology is used. The IFO/BMWI study speaks of welfare effects, the IFO/Bertelsmann study, on the other hand, of changes in real per-capita income.

The IFO studies caused a sensation with their conclusion that *in the long term* a comprehensive free trade agreement would significantly increase real per-capita incomes (measured in terms of real GDP per capita) in the countries involved. For Portugal, Italy, Greece and Spain an overall increase of 5-6 ½ per cent was anticipated⁵. What is not clearly expressed in the two studies is that the prices used for price adjustment of GDP are the *old* prices (i.e. the prices that applied before they changed as a result of the free trade agreement). However, since one of the principal channels through which the macroeconomic effect of the free trade agreement develops is the change in price level, per-capita GDP should be measured in terms of the *new* prices in which these price changes are reflected. If these figures are used, the long-term effect is very much smaller: compared with the situation without a free trade agreement, per-capita GDP in Portugal, Italy, Greece and Spain would only be 1.1-1.8 per cent higher⁶. It should be noted that the figures refer to the *long-term effect*, which is the *overall effect at the end of the adjustment period of 10-20 years*⁷. Since the overall effect is not the immediate consequence of the agreement, but is instead a gradual culmination over the adjustment period, it is advisable to consider the *short-term effect*, i.e. to examine the *additional average growth per year* that would result from the free trade treaty. Based on an average adjustment period of 15 years, the TTIP would produce additional average GDP growth in the Southern European countries under consideration of 0.08-0.1 percentage points per annum, which is tiny.

1.2. *Employment effects*

Despite the fact that both IFO studies report identical growth effects, they arrive at dramatically different employment effects. In the IFO/Bertelsmann study they are higher than in the IFO/BMWI study by a factor of 12 for the EU, 16 for the United States and 7 for Germany. The decisive reason for these differences is the fact that the labour market is modelled differently. In the IFO/BMWI study, the model used is one with heterogeneous companies with different levels of productivity. In this case, the employment effects are substantially based on reallocation, i.e. the movement of labour from less productive to more productive companies. The employment effect is consequently the balance of reduction and growth in employment. This impact channel is not included in the IFO/Bertelsmann

⁴ Cf. IFO (2013a, Table A.II.6 column 5, p. 159ff) and IFO (2013b, Fig. 5, p. 24).

⁵ Cf. IFO (2013a, Table A.II.6 column 5, p. 159ff) and IFO (2013b, Fig. 5, p. 24).

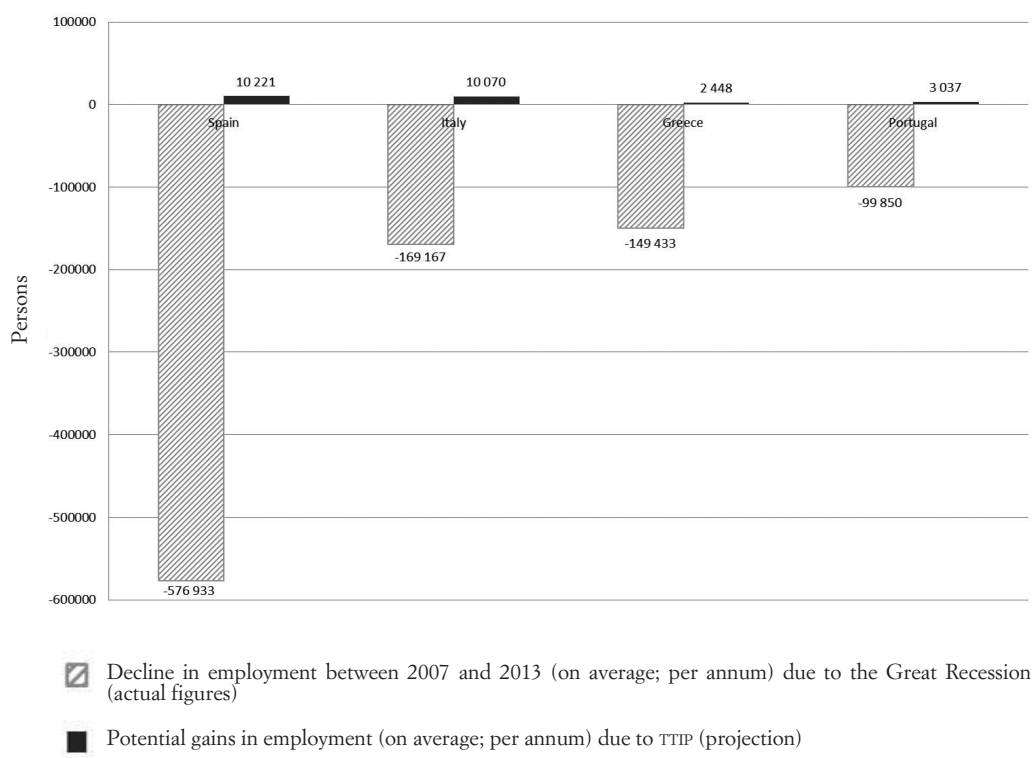
⁶ IFO (2013a, Table A.II.6 column 4, p. 159ff).

⁷ Cf. IFO (2013a, p. 69).

study, which is very surprising, because in the IFO/BMWI study the authors explicitly refer to the significance of reallocation: «Other studies wrongly neglect the reallocation effect and interpret additional employment in the export sector as job creation in the economy as a whole»⁸. This would suggest, however, that the significantly larger employment effects in the IFO/Bertelsmann study are based on this very error.

Against this background, it is even more remarkable that the employment effects reported in the IFO/Bertelsmann study are quite small: a total of 143.098 new jobs are expected for Spain, 140.979 for Italy, 42.521 for Portugal and 34.277 for Greece⁹. It should be noted that once again these figures refer to the overall effect at the end of the adjustment period. On an annual basis, there would be approximately 10.000 new jobs in Spain and Italy respectively and 2.500-3.000 new jobs in Greece and Portugal. This is equivalent to an average additional increase in employment in these countries of 0.04-0.06 percentage points per annum, which is minuscule.

Figure 1. Changes in employment in Southern European countries



Source: EUROSTAT; IFO (2013b, Table 11, p. 41); own calculations. Data accessed on 29.8.2014.

⁸ IFO (2013a, p. 86), own translation.

⁹ Cf. IFO (2013b, Table 11, p. 41).

Finally, it is illustrated how unrealistic the argument of the proponents of the TTIP is, the transatlantic free trade treaty would boost employment in the Southern European countries helping them to significantly reduce unemployment. FIG. 1 shows how many jobs on average have been lost per annum in Spain, Italy, Greece and Portugal since the beginning of the great crisis and how many new jobs could be created on average per year due to the TTIP according to the IFO/Bertelsmann study which of all studies forecasts by far the greatest employment effects. A comparison shows that even if the underlying assumptions are extremely favourable, the employment effects that can be expected are tiny and, in the light of the enormous crisis-related job losses, are at best a drop in the ocean.

2. CONCLUSION

With Europe still suffering from the drastic consequences of the global economic crisis, the question of how to stimulate economic growth and employment in the EU and in the Southern European crisis countries in particular remains the top priority for the EU Commission. The fact that numerous EU countries are unable to stimulate their economies by their own efforts due to strict austerity policies, gives added weight to the EU Commission's claim that «a comprehensive agreement covering all sectors would be overwhelmingly positive, opening up trade and bringing a welcome boost to economic growth and job creation on both sides of the Atlantic. [...] The TTIP would be the cheapest stimulus package imaginable»¹⁰. In the public discourse the claim that the TTIP would be a growth and employment engine and that the Southern European countries in particular would benefit from this agreement is often backed up with findings of “independent” studies, which gives the claim the aura of objectivity and reliability. A closer look at the findings of these studies however reveals, that even with exceptionally optimistic assumptions, the anticipated effects on growth and employment in Spain, Italy, Greece and Portugal are tiny.

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¹⁰ Cf. http://ec.europa.eu/trade/policy/in-focus/ttip/questions-and-answers/index_en.htm; accessed on 4.7.2014.

