TTIP – The Growth and Employment Engine that Couldn't

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November 2014

At a glance

The story is that the transatlantic free trade agreement will open up substantial growth and employment opportunities to the participating countries. To back up this claim advocates of the agreement cite the findings of »independent« studies. Comparison of the findings of the three most influential studies shows that even if a comprehensive free trade agreement is eventually signed the expected growth and employment effects would be minimal.

Since July 2013 the EU and the United States have been negotiating a Transatlantic Trade and Investment Partnership (or TTIP, for short), with the aim of creating the biggest free trade zone in the world, with more than 820 million consumers. The two largest economic areas in the world are already closely interwoven economically: every day goods and services in the amount of 2 billion euros are exchanged. In order to step up trade even further the idea is, within the framework of TTIP, to dismantle trade barriers on both sides of the Atlantic. Because customs tariffs in transatlantic trade are already very low – import duties on industrial goods in both economic areas are below 4 per cent, on average – attention has been focused on the extensive dismantling of so-called non-tariff barriers (NTBs).[1] In plain terms, this means that transatlantic commerce in goods and services is to be radically deregulated and liberalised.

Attempts have been made by means of large-scale simulation studies to evaluate the economic outcomes of a transatlantic free trade agreement. In what follows we present the findings of the three most influential investigations – the study by the Centre for Economic Policy Research (CEPR) and the two studies by the ifo Institute – in terms of their expected growth and employment effects. All the findings refer to the very optimistic scenario of a *comprehensive free trade agreement*. That means that all calculations are based on the assumption that all customs duties will be struck down and NTBs largely abolished.

CEPR Study on behalf of the European Commission

The European Commission is an enthusiastic cheerleader for TTIP. Against the background of the continued sufferings of many EU countries from the dramatic consequences of the global economic crisis and their inability to kick-start their economies due to the shackles of austerity policy the European Commission is inevitably attracted by »a comprehensive agreement covering all sectors [which] 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.«[2] In arguing the case the European Commission relies on a study it commissioned from the CEPR,[3] whose findings concerning a comprehensive free trade agreement (what it calls the »comprehensive ambitious scenario«) we shall now look at.

1. This includes measures that restrict trade either directly or indirectly but which do not involve tariffs. NTBs include, for example, import quotas, technical standards, safety and industrial norms, labelling requirements, rules on emissions, statutory provisions on food and pharmaceutical products and many other things.

2. See: http://ec.europa.eu/trade/policy/in-focus/ttip/questions-and-answers/index_en.htm; accessed on 23.10.2014.

3. See Joseph Francois, Miriam Manchin, Hanna Norberg, Olga Pindyuk, Patrick Tomberger: Reducing Transatlantic Barriers to Trade and Investment. An Economic Assessment, London 2013.

Growth Effects

The CEPR study comes to the conclusion that in the event that a comprehensive free trade agreement is implemented the real gross domestic product (GDP) of the EU (US figures in brackets) in 2027 would be 0.48 per cent (0.39 per cent) higher than without a free trade agreement. These figures refer to the *overall effect at the end of the simulation period,* in other words, a *long-term effect*. The overall effect would not kick in immediately after the treaty had been signed, but would build up gradually over many years. Thus it makes sense to look also at the *short-term effect,* in other words, to consider how high the *additional average growth per year* would be that would arise from the free trade agreement. Based on the simulation period of 10 years TTIP would bring the EU and the United States additional average GDP growth per year of less than 0.05 percentage points, which is vanishingly small.

Employment Effects

On the European Commission's website it says, with reference to the CEPR study: »An independent report suggests that an ambitious agreement could result in millions of euros of savings to companies and create hundreds of thousands of jobs.«[4] In fact, the CEPR study makes no assertions about aggregate employment gains or losses. This is because the CEPR model assumes a fixed labour supply and full employment. That means that in this model employment can shift from one sector to another because rising demand for labour in expanding sectors will draw in labour from other sectors. Over the long term, however, the employment level will be constant. Thus the free trade agreement, based on the chosen model, will have *no* effect on employment in the long term.

This example is symptomatic of how the European Commission is »informing« us about TTIP's benefits. The general public is being given the impression that TTIP would quickly give the participating countries a tangible growth and employment boost and that this evaluation is confirmed by an independent study. If one looks at what the study actually says, however, one finds no support for the Commission's assertion.

4. See: http://ec.europa.eu/trade/policy/in-focus/ttip/about-ttip/index_en.htm; accessed on 23.10.2014.

Studies by the ifo Institute on behalf of the Federal Ministry of Economics and Technology and the Bertelsmann Foundation

The two most influential studies in German-speaking countries are from the ifo Institute, which has produced two reports on the economic effects of a transatlantic free trade agreement. The first was on behalf of the Federal Ministry of Economics and Technology[5] (ifo/Federal Ministry of Economics study), the second on behalf of the Bertelsmann Foundation[6] (ifo/Bertelsmann study). The approach taken by the ifo authors differs substantially from that of other studies because they attempt to overcome a serious problem. The problem is that in other studies assumptions have to be made concerning by how many percent trade costs will fall if NTBs are reduced by a certain extent.[7] Because these assumptions are based on subjective valuations and exert a strong influence on the findings these studies are particularly vulnerable at this point.

The new approach taken by the ifo authors is based on their implicit determination of how many percent trade costs will fall, based on an econometric estimation of how many percent the conclusion of free trade agreements in the past increased the trade of the countries concerned. The logic of this approach is as follows: if the level of trade created is known then trade costs in the model can be reduced to the extent that the model exactly simulates the estimated scope of trade creation. In this way the extent of cost reduction due to the elimination of NTBs is determined *implicitly*. At first glance this approach is elegant. On more careful consideration, however, it starts to seem rather odd because it already anticipates the answer to the question »*by how many percent will TTIP increase the foreign trade of the participating countries?*«, which is what the study is supposed to find out.

5. See Gabriel Felbermayr, Mario Larch, Lisandra Flach, Erdal Yalcin, Sebastian Benz: Dimensionen und Auswirkungen eines Freihandelsabkommens zwischen der EU und den USA. Study commissioned by the Federal Ministry of Economics and Technology (since 2013 Federal Ministry for Economic Affairs and Energy), München 2013.

6. See Gabriel Felbermayr, Benedikt Heid, Sybille Lehwald: Die Transatlantische Handels- und Investitionspartnerschaft (THIP). Wem nutzt ein transatlantisches Freihandelsabkommen? Teil 1: Makroökonomische Effekte, Gütersloh 2013.

7. This applies, for example, to the studies by Ecorys, CEPR and CEPII. On this see: Werner Raza, Jan Grumiller, Lance Taylor, Bernhard Tröster, Rudi von Arnim: ASSESS_TTIP: Assessing the Claimed Benefits of the Transatlantic Trade and Investment Partnership (TTIP), Wien 2014.

The scenario which is the focus of both ifo studies is the comprehensive free trade agreement, known in the ifo/Federal Ministry of Economics study as the »NTB scenario« and in the ifo/Bertelsmann study as »deep liberalisation«. It is assumed that TTIP will increase the foreign trade of the participating countries on average by 76 per cent, which is an extreme assumption.

Growth Effects

The ifo studies made the headlines with their findings that a comprehensive free trade agreement would substantially raise real per capita income (measured in terms of real per capita GDP) in the participating countries over the long term. What the two studies do not make explicit is that in adjusting GDP for price changes the *old* prices are used (that is, prices as they stood before prices changed in the wake of the free trade agreement). However, because one of the main channels via which the free trade agreement exerts its macroeconomic effects are price changes GDP per capita should be measured in terms of the *new* prices that reflect these price changes. If one uses these figures the overall effect is considerably lower: as against the situation without a free trade agreement, GDP per capita in the EU and in Germany (US figures in brackets) at the end of the adjustment period of 10 to 20 years would be around 1.7 per cent (2.2 per cent) higher. If one divides this long-term effect over 15 years that gives an additional average growth per year of around 0.1 percentage points, which is very small.

Employment Effects

The two ifo studies are largely identical: both pivot on the econometric estimate of the trade creation effects of existing free trade agreements. Based on these estimates trade diversions are simulated and the GDP effects calculated. Because both studies set out from exactly the same trade creation naturally enough they come up with identical growth effects.[8] But in that case, how can the two studies derive such dramatically different employment effects? In the ifo/Bertelsmann study these effects are twelve times bigger for the EU, sixteen times for the United States and seven times for Germany than in the ifo/Federal Ministry of Economics study.

The differences are due largely to the fact that the labour market is modelled differently. The ifo/Federal Ministry of Economics study uses a model based on heterogeneous firms with different productivity levels. In this case the employment effects are due mainly to reallocation; that is, employment shifts from less productive firms to more productive ones. The employment effect is thus the balance between employment reduction and increase. This impact vector is not found in the ifo/Bertelsmann study, which is surprising because the authors of the ifo/Federal Ministry of Economics study make explicit reference to the significance of reallocation: »Other studies wrongly neglect the reallocation effect and interpret additional employment in the export sector as an employment gain in the overall economy.«[9] That leads to the conclusion, however, that the major employment effects in the ifo/Bertelsmann study are based precisely on this error.

The ifo/Federal Ministry of Economics study calculates a total of 25,220 new jobs for Germany – the ifo/Bertelsmann study comes up with 181,092. It is important to note, however, that in both instances we are dealing with the overall effect. On a year by year basis this represents, in the first case, only 1,700 new jobs in the whole German economy; while in the second case the figure is around 12,000 new jobs, which still amounts to an additional average employment increase per year of only 0.03 percentage points. Even the United States, which according to the ifo Institute would benefit from TTIP much more than the EU, would enjoy only an additional average employment growth per year of 0.05 percentage points. That means that, even based on extraordinarily favourable assumptions, the employment effect would be minuscule.

Summary

The results of these major studies have substantial impact in the public debate because they bestow a sense of objectivity and reliability. What can easily become lost

8. This is not immediately apparent because different terms are used. The ifo/Federal Ministry of Economics study talks about welfare effects, while the ifo/Bertelsmann study, by contrast, talks about changes in real per capita income.

9. Gabriel Felbermayr, Mario Larch, Lisandra Flach, Erdal Yalcin, Sebastian Benz 2013, p. 86.

from view is that the figures they contain are not hard facts but the results of model calculations that are closely dependent on the underlying assumptions. The findings of the studies are unequivocal, however: even with extraordinarily optimistic assumptions the expected growth and employment effects are tiny.

It is remarkable that none of the studies looks seriously at the costs of a comprehensive free trade agreement. Rather the macroeconomic costs are downplayed with the argument that they are no more than temporary adjustment costs. However, no mention whatsoever is made of the social costs that could arise from substantial deregulation in the wake of a comprehensive free trade agreement. The European Commission assumes that the dismantling of non-tariff barriers automatically means the elimination of *unnecessary* regulations and thus would be good in itself. But who is to decide which regulations are unnecessary and, above all, for whom? Many regulatory measures – for example, in the areas of environmental and consumer protection – are aimed at averting costs for society in general, or at least limiting them. If, on evaluating the planned free trade agreement, one took into account the fact that considerable costs would arise for society from abolishing such regulations and that they would have to be paid for by, for example, tax rises, which in turn would dampen growth and employment, then the already insubstantial gains from a transatlantic free trade agreement would look even more paltry.

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ISBN 978-3-95861-008-8

Originally published by the Division for Economic and Social Policy:
Stephan, Sabine (2014): TTIP – Das Märchen vom Wachstums- und Beschäftigungsmotor,
http://library.fes.de/pdf-files/wiso/10969.pdf

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