

# Development in Brief



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## What are the Implications of the Planned US-EU Free Trade Agreement for Developing Countries?

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This week the EU and the US launched the second round of official negotiations on the new Transatlantic Trade and Investment Partnership (TTIP). If the negotiations will be concluded successfully, this free trade agreement, which is supposed to be the world's biggest, will cover around one third of all global trade. A reduction in barriers to trade would be a positive move given the efficiency gains it entails on a global level. A recent study conducted by the Ifo Institute<sup>1</sup> found that, depending on its coverage, the agreement could have positive net effects of 0.1 to 3.3 percent of global per capita income. On the other hand, the agreement may have negative implications for developing and emerging countries in particular.

### Trade diversion effects – Negative consequences for developing countries

A reduction in the costs of trade between the US and EU would result in both trading blocks stepping up trade with each other and importing less from other countries. The scope and geographical distribution of these diversion effects would depend on how extensive the new agreement is. As transatlantic trade tariffs are already very low, just reducing them would give rise to only minor net welfare benefits. Whereas the economic gains for the EU and US would partly come at the expense of the countries of North and West Africa, there would also be some third-country winners such as Brazil and Indonesia. More significant than tariffs are non-tariff barriers to trade (NTBs) such as quality, environmental or safety standards or rules of origin. If these would be largely eliminated by the agreement, the net gains would be significantly higher and

the negative diversion effects more severe. According to the Ifo study virtually all developing and emerging countries would suffer marked losses, especially the traditional trade partners of the US such as Mexico and Chile.

### New standards – Challenges for developing countries

There is far more on the TTIP negotiation agenda than merely reducing tariffs and other barriers to trading in goods. The EU and US aim to renegotiate the rules governing cross-border investment, competition policy, intellectual property and a wide spectrum of domestic (or behind the border) regulations. This negotiation package goes far beyond the initiatives of the US and EU in the moribund Doha Round, which encountered the bitter resistance of emerging countries. The implications for companies in third countries depend on whether the EU and US are merely bent on the mutual recognition and harmonisation of their own standards or whether they agree on a higher or lower standard of harmonisation (or a compromise). Developing countries would have problems fulfilling higher standards in a number of areas. In contrast, the trading opportunities of third countries would be improved if the US and the EU would agree on the mutual recognition of standards. In such a case, producers from developing countries that meet the less stringent standards e.g. for food safety of the US would be able to sell their products in the EU too. However, if mutual recognition would not be expanded to include third countries, diversion effects at the expense of developing countries would have to be expected.

### A reformulation of the rules for the global economy

The actual challenge for TTIP lies in the fact that the US and EU are seeking to reformulate

the rules for the global economy - which will have far-reaching implications, one of which is the possible future amalgamation of various regional agreements. The US is also currently involved in negotiating a *mega-regional* agreement with Asia-Pacific countries that is similar to the TTIP. The result of amalgamation would be an enormous transatlantic-transpacific free trade agreement with common rules. The negotiation of these mega-regionals would be equivalent to the introduction of quasi multilateral rules through the back door. Irrespective of the technical difficulties that would be involved in the multilateralisation of regional agreements, the actual problem of such a strategy has much broader implications: If developing and emerging countries wish to enter into the group, they would not be rule-setters but rule-takers. This gives rise to important questions of legitimacy from the point of view of developing and emerging countries, and what's more, it appears questionable whether major emerging countries such as Brazil, India or China would agree to assuming the role of a rule taker. A scenario in which opposing trade blocks emerge might be more likely in the end.

### Conclusion

Because it is as yet unclear how far-reaching TTIP will be, its effects are difficult to estimate. What is clear is that while TTIP could herald in positive net effects at a global level, it may also lead to substantial income losses for a number of developing countries. These losses could be mitigated if developing countries were provided with more simplified access to the US and EU markets. Such possibilities would include the expansion of the mutual recognition of standards to include third countries in combination with the reform and simplification of trade preferences (for instance, reduction in the exceptions granted for certain goods, simplified rules of origin, and expansion of the list of countries that would benefit). From a development perspective, the successful conclusion of the multilateral negotiations of the Doha Round would be the preferable way forward because the developing countries all sit at the same negotiation table with the same rights. This is, however, unlikely to take place in the near future. ■

<sup>1</sup> G. Felbermayr et al., "Dimensionen und Auswirkungen eines Freihandelsabkommens zwischen der EU und den USA" [Dimensions and effects of a free trade agreement between the EU and the US], Ifo Institute, Munich, 2013.