

**Contribution to the DEVE/INTA Meeting,
European Parliament,
Agenda Item 'TTIP's potential effects on developing countries'
21 June 2016, 16 – 17.15h**

Dr. Evita Schmieg

Stiftung Wissenschaft und Politik –
German Institute for International and Security Affairs

Preliminary note

It is the basic objective of Free Trade Agreements (FTA) to give preferential treatment to the participating members - which means at the same time a discrimination of those countries which are not members. A trade and investment partnership between the large trading blocks EU and USA will naturally be accompanied by consequences for third countries, although the depth of these consequences depends on the outcome which is not yet known. The analysis therefore at the moment has to stay either theoretical or based on assumptions.

A. Possible Effects of TTIP on Developing Countries

Displacement of Third Countries' Exports – Trade Diversion

Economic theory distinguishes between the positive trade creation between participating members of an FTA and the negative trade diversion as effects of FTAs. In the case of TTIP, trade diversion means that traditional imports from third countries will be replaced by imports from the US or EU respectively. The higher the tariffs eliminated in the FTA, the higher the risk of trade diversion. Since tariffs between the EU and the US are on average below 2%, the overall risk of TTIP diverting trade flows at the expense of developing countries is quite low. However, tariff peaks are still existing in textiles and clothing (up to 40%), shoes and some processed agricultural products (with an average tariff on prepared foods like prepared fruits, vegetables and nuts of 22%).¹ In a study on the effects of TTIP, the IFO-Institut e.g. points out that Guinea, Ivory Coast, Tanzania, Uganda and others have reason to fear part of their exports to the European Union being displaced by the United States.² Bangladesh is a country mentioned as possibly experiencing trade diversion in case textile tariffs will be cut. However, many poorer countries dispose of a product and export structure which is very different to the EU/US. Heavy effects are thus unlikely, even though that does not exclude the possibility of severe impacts on some sectors which are important in particular countries.

Possible Positive Effects

... from the participation in EU/US value chains

TTIP (and other mega-regionals) could also have positive effects on third countries. Three factors are especially relevant. New trade flows might emerge between the European Union and the United States and existing ones may grow (trade creation). To the extent that third countries are involved in the relevant value chains (for example Morocco as a supplier for European vehicle exports to the United States), they could also benefit. However, these effects will tend to affect the production of finished or semi-finished products and will therefore as a rule not apply to LDCs and countries with low diversification of their exports.

... in the area of TBT and SPS

Progress in this area seems very difficult to achieve, but there is scope to also facilitate third country market access in the EU and the US:

- Harmonisation of standards would mean that in future only one set of technical, sanitary and phytosanitary standards needs to be satisfied in order to export to both markets.
- Equivalence of standards or the mutual recognition of conformity assessments (i.e. the procedures and results which determine whether products comply with technical

¹ Kimberly Elliott, TPP Risks and TTIP Opportunities: Rules of Origin, Trade Diversion, and Developing Countries, CGD Policy Paper 078, March 2016.

² CESifo, *Mögliche Auswirkungen der TTIP auf Entwicklungs- und Schwellenländer, Studie im Auftrag des Bundesministeriums für wirtschaftliche Zusammenarbeit und Entwicklung (BMZ)* (Munich, 2014).

regulations) could have a similar effect, but only if TTIP includes an explicit clause extending that principle to third parties; i.e. if a third country producer has proved conformity of his product to EU (US) regulation this proof will also be accepted in the US under TTIP provisions.

- Increased transparency – like a public register on the standards referenced in technical regulations– would help to improve market information also for third countries.

Many authors point out that it will affect developing countries negatively, when EU and US will work towards higher standards, since countries with weak systems of infrastructure do have capacity and financial problems to meet high standards. But as long as standards are not introduced for protectionist purposes, they fulfill important objectives of protecting consumers, workers or the environment. Basically it is therefore also in the interest of developing countries to improve existing standards. Additionally, developing country exports to a large extent have to fulfill private voluntary standards (e.g. GLOBALG.A.P.) which are demanded by large supermarket chains. Already some years ago, about 80% of Kenyan agricultural exports had to comply with private standards. Developing countries are thus faced with the challenge of complying with high and rising standards on their export markets in any case.

... from overall growth

One of the objectives of TTIP is to contribute to economic growth in the EU/US that could translate in increased exports and economic growth in third countries. Even under more ambitious assumptions, this would only lead to an extremely modest increase in third country exports and world GDP,³ of which mostly more advanced countries would benefit, less LDCs and countries with less diversified export structures.

Systemic Effects

TTIP setting rules for the multilateral system?

Free trade agreements between important trading blocks also have wider systemic effects. To some extent these are explicitly desired, with some proponents in the European Union and the United States hoping that TTIP will establish rules that can later serve as a model for multilateral arrangements (specifically in relation to the sustainability chapter, public procurement and investment dispute settlement). Whether EU and USA will succeed in creating far reaching model regulation is completely open in the first place, looking at the difficulties the EU and US are having in bridging partly contradictory positions. Then, it is everything but given that any model regulation will succeed on a multilateral level. Especially where the European Union and the United States agree on rules, this can generate mistrust on the part of the developing countries. The OECD's experience in 1998 with its proposal for a multilateral investment agreement (MAI) and the responses to it do not bode well. Additionally, one can doubt, whether such rule-setting in the scope of bilateral agreements is ultimately helpful for developing countries, who have not been participating in the formulation of the rules and whose restrictions and needs are thus not reflected.

³ The CEPR study commissioned by the European Commission calculates gains in world GDP of 0,14% and an increase in third country exports of 1,04%, cf. Manrique GIL/Lerch (2015), p. 13.

Geopolitical impact

The formation of mega-regionals could potentially have a major geopolitical impact, given that TPP and TTIP create two economically powerful blocks representing between them a large part of the global economy. Most of the poorer developing countries are left outside – as are the so-called BRICS states: Brazil, Russia, India, China and South Africa. Recent years have witnessed great differences of opinion within the World Trade Organisation (WTO), especially between the BRICS and the industrialised countries. The industrialised countries believe that the BRICS states have demonstrated insufficient willingness to assume greater responsibility within the global economy in line with their growing economic weight – in the sense of more market opening or interest in formulating new rules in the WTO. To that extent, the formation of regional economic blocks that create new rules for themselves and advance liberalisation internally represents an attempt to respond to the weakness of the WTO.

If the mega-regionals turn out to be economically successful, this will lead to marginalization of non-participants. As a consequence, the latter, above all the BRICS states, might show greater motivation to achieve results in their own interests at the multilateral level and to engage correspondingly in the WTO framework. In this sense the mega-regionals can be understood as geopolitical projects that could in the medium term perhaps even revive the significance of the WTO. Of course, there is also a possibility of the BRICs concluding their own trading blocks and thus undermining further the multilateral system. This solution, however, does not seem politically likely, since their hesitance to open further their own markets is not only resulting from a fear of the competitiveness of EU/US products but also from one another and in some areas especially China.

B. Possible action to be taken

Maximise the possible benefits in the area of standards

This area, which is bearing a potential for positive effects on third countries, is one where adequate text has to be included in the TTIP agreement itself. TTIP should therefore include an explicit clause extending the principle of mutual recognition or equivalence between the EU and the USA to third parties.

Also, co-operation between the EU and US on standards should not go at the expense of international co-operation within well-established frameworks, e.g. the International Standards Organisation (ISO) in this field, where third countries do have the possibility to participate in discussions and influence the outcome.

Not too strict rules of origin under TTIP

The formulation of less strict rules of origin is a starting point to dampen negative trade effects for third countries. Rules of origin define the conditions under which products from the partner within the Free Trade Area receive preferential treatment. They are considered necessary to avoid circumventing trade flows. More liberal rules of origin within TTIP would facilitate increased imports of intermediate products from third countries into the EU/US.

Broadly defined cumulation zones to minimize negative effects on traditional trade partners

One possibility to minimize negative effects for those countries that have already established preferential trade agreements with the EU/US or benefit from unilateral preferences (GSP) would be

to allow under TTIP rules of origin for a broadly defined cumulation zone that includes these countries⁴. This suggestion would help avoid trade diversion away from traditional preferential trade partners without opening the EU/US markets worldwide.

No rules of origin under TTIP - mixed effects for third countries

Several authors⁵ propose not to define rules of origin within TTIP at all or to define them least restrictively. This could lead to increasing imports of intermediate products from the most competitive third country producers (like China, but not exclusively) into EU and US; that is also why the proposal seems politically unrealistic. Such a free trade approach might balance negative trade diversion effects for these countries, but it would not, however, support poorer countries mainly in Sub-Sahara Africa in coping with negative TTIP effects. Firstly, because their production structures do not contain a large number of intermediate products, and second because it would expose them to competition with stronger countries by indirectly reducing their preference margins in the US and EU markets.

Improvement of unilateral trade preferences to open new opportunities for third countries

Harmonization of preference systems politically unrealistic

Another suggestion on the table to mitigate negative effects is to harmonise under TTIP European and American unilateral trade preferences for LDC/low income countries.⁶ Through the African Growth and Opportunity Act (AGOA), the United States grants far-reaching trade preferences for about 6.000 specific products to 39 African countries. The European Union, under the Everything-But-Arms initiative, grants all LDCs duty-free and quota-free market access for all products, likewise to its Economic Partnership Agreement (EPA) partners. In view of the difficulties the TTIP negotiations are already causing for both partners, and of the very different approach to unilateral preferences, it is politically unrealistic that the issue of preferences for developing countries will also be tackled.

Options for unilateral improvement of GSP

In order to balance the possible negative consequences of TTIP, however, the European Union and the United States could undertake unilateral steps to improve their GSPs. Options are:

- The US still has to expand duty-free, quota-free import treatment to all LDCs.
- Expand the number of beneficiaries of DFQF to low income countries (EU/US).
- Improvement of rules of origin: Further relaxations including through more generous cumulation rules, especially concerning countries and sectors/products affected by TTIP.
- Expanding trade preferences on services including the provision of services through the movement of natural persons (mode IV) for clearly defined and selective services exports (although this is politically sensitive).

⁴ Kimberly Elliot, TPP Risks and TTIP Opportunities: Rules of Origin, Trade Diversion, and Developing Countries, CDG Policy Paper 078, Washington, March 2016.

⁵ Cf. summary of discussion in Manuel Manrique Gil, Marika Lerch (2015), The TTIP's Potential Impact On Developing Countries: A Review Of Existing Literature And Selected Issues, European Parliament, DGEXPO/B/PolDep/Note/2015_84, Brussels.

⁶ With regard to TTIP this has been promoted amongst others by Evelyne Herfkens, going back to the original proposal to merge and improve the two systems from Paul Collier/Anthony Venables.

Support developing countries in improving their trade position

Individual country analysis of trade effects

The possible impact in individual countries will differ strongly according to the specific outcome of TTIP negotiations and the trade structure of the respective third country. In order to allow for adaptation or countermeasures it is important for third countries to be able to analyze economic and social effects on their respective countries at an early stage. The EU could support developing countries in doing so. Such analysis should be extended to other developments in the trade field, e.g. the impact of the Economic Partnership Agreements (EPA) and of the Transpacific Partnership (TPP), since third countries have to tackle challenges arising from all these developments with their policy formulation at the same time.

Support developing countries' quality infrastructure

Quality infrastructure systems of poorer countries are often weak, human as well as technical capacities are lacking. Support (Aid for Trade) to cope with rising sanitary and phytosanitary standards – not only, but possibly also as a consequence of TTIP - is thus necessary.

Strengthening the multilateral trading system and developing countries' role in it

Especially Sub-Sahara-African countries are becoming more marginalized through the evolving mega-regional agreements. A strong multilateral trading system would help them to safeguard their own interests. The EU should be strongly committed to multilateral approaches. Even plurilateral approaches within the WTO are a double-edged sword, since poorer countries mostly do not participate in setting the rules by which they will eventually be affected.⁷ Flexible approaches within the WTO, that take into account capacity restrictions of developing countries like the Trade Facilitation Agreement bear thus greater chances for developing countries to participate actively in the rule-setting, and then to implement agreements. Aid for Trade plays an important role in supporting developing countries in analyzing their interests and participating actively in negotiations as well as improving their competitiveness and export capacities in regional and international trade.

Conclusions

Although the danger of negative effects of TTIP on third countries might not be very high, the European Union is obliged to avoid these by its commitment to policy coherence and the SDGs. Possible options include precautions within TTIP as through rules of origin that are extended to traditional FTA partners and GSP beneficiaries and through respective text in the area of standards. The EU should also support third countries to prepare for side effects, deal with those and improve their overall trade position. It is important to bear in mind, however, that fundamental structures of the international economic system as well as domestic framework conditions in developing countries play a probably larger role in determining their respective trade performance in the long run than TTIP or other free trade agreements. The long-term effect of a further marginalisation of countries which are not participating in the mega-regionals is particularly negative for Sub-Sahara Africa. This is a strong argument for Africa to speed up and to implement its' planned Continental Free Trade Area and for all regions to put more emphasis in looking for multilateral solutions. The implementation of the SDGs will be crucial for improving domestic and international framework conditions in order to achieve sustainable development of all countries.

⁷ Cf. Evita Schmieg, „Africa's Position in Global Trade – Free Trade Agreements, WTO and Regional Integration, unpublished manuscript, http://www.swp-berlin.org/en/scientist-detail/profile/evita_schmieg.html.