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Transatlantic Trade and Investment Partnership: Perspectives, Obstacles,
and Implications for the Czech Republic

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Transatlantic Trade and Investment Partnership: Perspectives, Obstacles, and Implications for the Czech Republic

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Executive Summary

Although some preliminary work has been done by the US-EU High Level Working Group in 2012, real negotiations on a Transatlantic Trade and Investment Partnership (TTIP) should start in the second half of 2013. The new initiative is motivated not only by the prospects of direct economic gains but it is also hoped to reignite transatlantic political relations and maybe even the languishing multilateral trade negotiation process.

Neither the proposal to liberalize trade between the EU and the USA, nor the mix of economic and political motives is entirely new. The historical evidence from late 1990s suggests that negotiations about TTIP may not be easy and they are not guaranteed to lead to a successful and quick outcome. However, the recent experience with successful conclusion of negotiations on the EU-Korea FTA and US-Korea FTA, where the parties had to overcome similar issues as the ones which are likely to burden the TTIP negotiations and often opted for rather similar solutions, gives us some reasons to hope that the current proposal may succeed.

The proposal includes liberalization of trade in goods (basically a transatlantic free trade area encompassing both the EU and the USA), liberalization of trade in services, and facilitation of investment. The tariffs on merchandise trade between the US and EU have been mostly low or zero already (US average MFN tariff was 3.49 per cent, EU average was at 5.27 per cent in 2011), much of mutual trade in services has been liberalized as well. This substantially restricts the possible gains from trade liberalization (and motivation for it) and increases the risk of problems – as the sectors/products/services which are currently still enjoying higher level of protection are the sensitive ones.

The biggest hurdles are expected in the negotiation on non-tariff measures (especially geographical indications and principles of safety and health regulation – mainly the precautionary principle) on the EU side, and government procurement and some services (e.g. cabotage) on the US side.

Estimates of effects of TTIP differ according to (i) the type of effects considered and (ii) the optimism with respect to the achieved liberalization. In general they are fairly modest for both the EU and the USA. Typically the US are expected to gain more simply because the EU is a bigger market. The TTIP will not become the panacea able to restart fast growth and reduce EU unemployment drastically. At the same time it should be emphasized that there is no other proposed or recently negotiated FTA which could lead to comparable or better results for the EU; estimates for the TTIP are also higher than cautious preliminary evaluations of the opportunities presented by the withering Doha Round.



Estimates for the Czech Republic are very sober as well; both welfare and structural effects are likely to be small (less than 0.5 per cent of GDP in static scenarios). Nevertheless overall welfare effects are not negative; the Czech Republic cannot lose by supporting the TTIP. Even more importantly, if the work on the TTIP leads to further intra-EU liberalization, the resulting effects can be much more optimistic.

1. From the “New Transatlantic Agenda“ to the TTIP – via the “New Transatlantic Marketplace”

The USA and member countries of the current EU have rich traditions of cultural, political, and trade ties. And yet, when we look at a map depicting the global “spaghetti bowl” of EU association agreements, preferential trade agreements (PTAs), free trade areas (FTAs) and customs unions, there is a gap the existence of which will become even more surprising once the EU-Canada FTA has been negotiated. The USA and the EU, the two logical allies in the current complicated world, still do not have any special liberalization arrangement for their trade other than being members of the WTO and as such mutually enjoying the most-favoured nation (MFN) status.¹ As the prospects of the Doha Round are withering and as the two markets (i) intensively work on FTAs and similar projects² with other countries; and (ii) as they are expected to gradually lose their dominant position in global economy, this omission may seem to be dangerously wasteful and careless.

We cannot say that attempts have not been made. The closest predecessor of the current proposal was debated in late 1990s in the form of so called “New Transatlantic Marketplace (NTM)”. This plan was proposed by the European Commission in March 1998 and it was “effectively vetoed”³ by France in April 1998 mainly because of French concerns about liberalization of audio-visual services.⁴ The Commission did not give up immediately and proposed a diluted “Draft Action Plan for Transatlantic Partnership” (TEP) in September 1998. The wording of the TEP plan was much less ambitious than the NTM; its real results were disappointing. Later initiatives focused e.g. on attempts to reduce the burden posed by non-tariff barriers (NTBs) by means of joint recognition or harmonization did not lead to tangible results either – mainly because of deep differences in regulatory traditions between the EU and the US.

¹ This may seem to be a bit exaggerated claim given the existence of special institution focused on dealing with non-tariff measures, but it is true as far as FTAs and CUs are concerned.

² E.g. the Trans-Pacific Partnership (TPP) initiated by the USA.

³ Hidley (1999), p. 46.

⁴ Ibid.



We should therefore start by asking about possible new factors or motives, and about current odds that such a proposal can lead to a more fruitful result eventually.

1.1 Economic motives

When merchandise trade is considered, the USA are the main destination of EU exports (17% in 2011) and the third largest source of EU imports (10.9% in 2011). The situation is very similar on the US side: the EU constitutes the second most important export market for the US (18.2%), and the second most important source of imports (16.6%). Both markets are also top exporters of services. Together the two markets amount to slightly less than one half of world economy.

Given the long history of previous economic contacts and cooperation (the role of the US in initiation of the process of European integration, the importance of both actors in GATT/WTO multilateral trade talks) it may indeed be rather surprising that they have not succeeded in creating the joint FTA earlier.

On the other hand, the high achieved level of trade liberalization (see appendices 7.1. and 7.2.) and table 1 means that there is not much additional trade that could be generated easily by eliminating tariffs on non-controversial items.

Table #1: Average barriers in merchandise trade

		MFN average tariff	Share of duty free exports	
			% of tariff lines	% of value
EU exports to the US	Agricultural	6.8	24.2	47.7
	Non-agricultural	3.5	46.2	69.0
US exports to the EU	Agricultural	13.9	15.3	47.5
	Non-agricultural	4.3	25.1	66.0

Source: WTO, data for 2010

The highest barriers (and the lowest share of duty free trade) survive mostly in the agrifood sector, which is also the sector very sensitive to any deeper changes to the level of protection and support.⁵ Nevertheless, if the TTIP is to bring real benefits, it must deal not only with tariff spikes in the protected sectors, it must also open the proverbial Pandora's box of much worse trade-inhibiting measures. Because a detailed survey of identified non-tariff measures

⁵ The same issues proved to be a problem already in the GATT Uruguay Round.



in EU-US trade and investment is provided in the Ecorys (2007) study, let's mention here just a few basic issues.

Non-tariff measures are for most of the trade even more important than the tariffs. They include technical barriers to trade, sanitary and phytosanitary measures (SPS), rules related to intellectual property rights protection, rule on government procurement.

The government procurement liberalization is likely to be a tough problem for the US side, as it directly contradicts the popular “buy American” principle. Even more importantly, the federal government has limited means how to convince the states to accept the liberalization.

Intellectual property rights protection includes the very sensitive issue of geographical indications (GI) which some European countries (France among them) consider to be crucial for the protection of not only their industries but also of cultural heritage and identity.

Technical barriers and SPS are likely to be a very tough problem too. Many of these topics have proved to be relatively resilient to previous attempts⁶ mainly because of the very different nature of approach to regulation in the EU and the USA. While the USA (especially in the case of SPS) prefers the “sound science principle” which insists that scientific evidence of harmful effects be required for introduction of new safety regulation, the EU became the champion of the “precautionary principle” which finds it acceptable to introduce regulation even if scientific evidence has not been available yet. All that is necessary is the existence of a reasonable concern over possible harmful effect. The topics included concern not only the already famous “chlorinated chickens” but also genetically modified organisms, the agricultural use of hormones, etc. The two parties have clashed over these topics repeatedly in the WTO.⁷ What makes the issue even more complicated is the fact that both parties consider their approach to be correct (and better). We are dealing not with the case of unequal partners in which the weaker one is forced to accommodate, but with two more or less equal partners required to find a compromise.

Service sector is in general more open, but sensitive barriers still exist both on the US side (cabotage restrictions, financial services) as well on the EU side (French concerns over audio-visual services).⁸

We are therefore facing an interesting dilemma: if we want the TTIP to have a chance to bring really motivating outcomes, we must open very sensitive issues which may threaten

⁶ E.g. the Transatlantic Economic Council, TEC, has been trying to remove some of the trade barriers since 2007 – without major success.

⁷ E.g. a complaint by the US against the EU related to the use of hormones in livestock farming was filed in 1996 and continued to be discussed there till 2009.

⁸ France already declared that it does not want this sector to be subject to TTIP negotiations.



the success of the negotiations or even alienate EU member states already divided by the EMU crisis. We also should not forget about balance in the resulting concessions – if the EU requires significant liberalization of service sector access and of government procurement on the US side, can it really afford to eliminate the audio-visual sector from the debate?

If liberalization succeeds, then TTIP would lead to lower prices, higher efficiency, more intensive competition, and more efficient allocation of resources. Finding a common denominator in their attitude to regulation could have an additional side effect – the EU and the USA could become the norm setters for global economy with possible positive effects on the competitiveness of their companies.

1.2 Non-economic motives

This set of motives was already mentioned in late 1990s, and it was again clearly, loudly and repeatedly voiced e.g. by Zbigniew Brzezinski in 2013.⁹ The 1990s version of the argument consisted in providing the EU and the USA some new common goal that would motivate them to promote deeper cooperation after the end of the cold war. The current version focuses on geopolitical arguments which come in two forms:¹⁰

- 1) The EU and the USA should try to create a common trade bloc which can act as a sufficiently strong counterweight to newly emerging power such as China.
- 2) The EU should motivate (by intensive work on the TTIP) the USA not to divert their attention from the transatlantic cooperation.

The reasons motives are clear enough; however, it is questionable whether the TTIP proposal alone is able to play this historical role. Trade and investment ties facilitate mutual understanding but we fear that coherence of opinions (even within the EU alone) and shared understanding of threats of opportunities in the new global situation is of much more importance. Nevertheless, for countries such as the Czech Republic or Poland which used to be strong proponents of closer ties with the USA this may constitute another and fairly powerful argument to support the TTIP.

1.3 Can the TTIP succeed?

The answer to this question is far from simple. Some of the problems which terminated the previous attempts at either creation of the FTA or at least reduction of non-tariff measures still exist. However, several new factors have emerged, some of which can influence the chances of the TTIP also positively:

⁹ E.g. in April 2013 during the Globsec conference in Bratislava.

¹⁰ It is also present e.g. in Garcia-Legaz & Quinlan (2013).



1. Schott & Cimino (2013) emphasize the recent **experience with the FTAs with Korea** negotiated and successfully passed by both the USA and the EU. While the FTAs were negotiated independently, the talks successfully dealt with many of the problems which are expected to plague the TTIP negotiations. What is more important, some of the solutions were similar, which suggests that future compromises may not be unattainable.
2. Effects of all the **other negotiations on FTAs and PTAs** initiated or concluded in the past few years. Achieving a similar quality of relationship with the USA (as the main export market for the EU) may be thus more urgent.
3. **The EMU crisis and debt crisis.** This factor may have ambiguous implications. The need for budget consolidations can facilitate the debates on elimination or reduction of farm subsidies and the prospects of helping poor population by reducing some of the import prices may act in favor of the liberalization. Even more importantly, any successful solution to the debt problem requires economic growth. On the other hand, the possible unequal distribution of expected gains may lead to harmful bargaining within the EU.¹¹
4. Modification of decision-making mechanisms such as higher role of **qualified majority voting** should theoretically reduce the risks of obstructions. However, the position of France on audio-visual services already demonstrated that this kind of benefits may not fully materialize.
5. **The presence of new member states** who are mostly dependent on trade and who often have the tradition of being close allies of the USA.
6. **Concerns about further development of EU-skeptical attitudes in the UK.** While it seemed that the UK might seek a refuge in a TTIP-like agreement after an exit from the EU, this option seems to be unlikely at present because the USA signaled their disagreement with similar scenario.

Do we already have some real evidence on changes in the parties' attitude? Schott & Cimino (2013) argue that the EU and the USA pursued several "confidence building" measures in recent negotiations and that the EU has been able to address two of the three US priority items relatively fast.¹² Perhaps we have therefore indeed better chances of concluding the TTIP project successfully this time.

¹¹ Interestingly enough, results in Felbermayr, Heid, Lehwald (2013) suggest that in some respects the weaker countries (PIIGS) may profit as much or even more than Germany in some indicators (such as the real incomes per capita) which could reduce similar tensions. This set of results suggest that France would profit less (than other influential players).

¹² Schott & Cimino (2013), p. 3.



2. Estimates of effects on the EU

A number of early estimates of possible effects of the proposed trade liberalization on both the EU and selected individual member countries have been published already. The most interesting and relevant of these are Erixon & Bauer (2010) ECIPE study which focuses on effects on the US and EU; detailed study by Francois et al (2013) for the EU Commission; a detailed Bertelsmann Foundation study by Felbermayr, Heid B., Lehwand S. (2013) which analyzes both the aggregate effects as well as impacts on individual member countries; Francois and Pindyuk (2011) which analyzes possible effects on Austria, Kinnman & Hagberg (2012): analysis focused on Sweden, Fontagne & Gourdon (2013) who analyzed the case of France.

The published results share several common features which seem to be consistent with general economic logic:

- a) Methodological emphasis on computable general equilibrium modeling (often at least partially linked to the GTAP database). This is a sound approach considered to the state-of-the-art approach.
- b) Effects on both the US and the EU are positive, both in terms of expansion of exports and in terms of growth of GDP. This is a logical outcome consistent with the assumed trade creation effect of liberalization.
- c) The US often tends to gain slightly more than the EU on average. This is a feature typical for similar types of situations; typically it is the smaller market gains more.
- d) Effects on both the EU and the US are small, especially when conservative scenarios are considered (where conservative means being cautious about being too optimistic with respect to elimination of non-tariff measures and with respect to assumed cumulative effects, pro-competition effects and spill-over effects of trade liberalization). Such scenarios often lead to positive effects on GDP lower than 1 per cent of GDP, sometimes as low as 0.01 per cent of GDP. Given our poor ability to measure economic activity precisely this kind of outcomes should rather be described as a “positive zero”. This is not surprising – with the current low level of tariff protection in most sectors it is impossible to achieve dramatic changes in trade flows unless we assume fairly high levels of price elasticities.
- e) Effects on the rest of the world (China, the rest of NAFTA, ASEAN, etc.) are mostly very small as well, but they tend to be more sensitive to the precise specification of the model. Mostly the effects on their GDP can be best described as “negative zero”.¹³

2.1 Brief methodological note

¹³ Francois et al. (2013) find a positive effect on global trade.



While Applied general equilibrium (AGE) models or computable general equilibrium (CGE) are mostly recommended by trade economists as the best approach to applied analysis of especially complicated liberalization programs, they are not bulletproof. The results can be sensitive to:

- **Specification/closure of the models.** For the Czech Republic it is especially the treatment of trade in intermediate products which is likely to be very important.¹⁴
- **Estimates of the achieved liberalization.** In the case of the TTIP we are actually not quite sure what will be achieved in the resulting agreement, especially as far as non-tariff measures are concerned. In addition to this, there are some real barriers (geographical and cultural distance, differences in law and law enforcement, exchange rate volatility¹⁵) which will always persist.
- **Scenarios concerning additional effects of liberalization**, such as the effects on productivity via spillovers, economies of scale and increased competition.¹⁶ There are countless possibilities, so this is the area where model building again resembles rather art than science.

Fortunately for us, the differences are typically relatively small for reasonably set scenarios, time spans, and smaller changes in trade barriers if the models are specified and calibrated correctly – as exemplified by the structural similarity of the afore-mentioned result.

AGE/CGE models are not the only way how to estimate possible results of trade liberalizations. At least three other methods can be used, their implementation is often easier, but they typically have even more methodological shortcomings than the CGE models:

1. **Opinion surveys** amongst experts and businessmen (possibly run as Delphi method). No real simulations are done in this case, usefulness of the results is very sensitive to the choice of participants.
2. **Partial equilibrium estimates** of effects of liberalization on individual markets. This approach was used e.g. by Messerlin (2001) in his evaluation of EU commercial policy. The main problem of this approach is the neglect of feedback effects between the individual markets. However, these partial results (e.g. estimated elasticities can be used as inputs for CGE models.
3. **Gravity models and estimates of trade potentials/trade policy sensitivity based on gravity models.** While this approach is fast and seemingly very easy to use, it struggles with underestimation of endogeneities and often also with misspecification.¹⁷

¹⁴ Czech Republic appears to have a significant volume of indirect trade with non-EU markets due to its economic integration with German economy. Czech Republic exports intermediate products to Germany where they are completed into finished products and exported to third markets (e.g. China) – more on this effect e.g. Semerák (2012).

¹⁵ Exchange rate volatility may lead to differentiation of results between EMU members and the rest of the EU. Volatility of the Czech currency (CZK) to USD is typically higher than the volatility of the euro, which means that after the liberalization is achieved, the Czech exporters will be still struggling with a slightly higher burden than their counterparts from the EU.

¹⁶ New trade theory such as Krugman (1979) suggests that both improved economies of scale and increased competition can be achieved at the same time with possible very significant (but sector-dependent).

¹⁷ See e.g. Baldwin & Taglioni (2006).



2.2 Survey of selected simulations

Available estimates are not easy to categorize and compare because of the number of choices available to researchers. Let's therefore focus just on the most interesting outcomes:

For the EU

1. ECIPE (2010) expects 0.01% increase in GDP in the static case (tariffs only), and 0.32-0.47% increase in GDP in dynamic scenarios.
2. Francois et al. (2013) expect 0.10% increase in GDP if only tariffs are eliminated (services per se would lead to 0.02% increase).

For the USA

1. ECIPE (2010) expects 0.15% increase in GDP in the static case (tariffs only), and 0.99-1.33% increase in GDP in dynamic scenarios.
2. Francois et al. (2013) expect 0.04% increase in GDP if only tariffs are eliminated (services per se would lead to 0.03% increase).

2.3 So - is the TTIP really worth it?

The estimated numbers are rather low and in some cases we may even rightfully doubt their statistical significance, there are two facts that remain solid:

- a) The sign of the effects on both the USA and the EU (on their total GDP and exports).
- b) The fact that the less conservative estimates of the achieved scope and degree of liberalization (and of the possible dynamic effects of liberalization) we assume, the better results we get.

These two facts mean that neither the USA, nor the EU can lose by creating the TTIP. This conclusion becomes even more significant, as soon as we take into account two further facts:

1. Comparisons with simulations for other proposed FTAs, such the already concluded FTAs with Korea, Columbia & Peru, or the negotiated FTAs with Japan¹⁸, Thailand, India, Canada, Malaysia, Vietnam, Georgia, Armenia, Moldova, etc. lead to an interesting conclusion – all these other FTAs (individually) are likely to be even less beneficial than the TTIP.
2. There also additional further reaching consequences of the successful completion of the TTIP – e.g. Schott & Cimino (2013) argue that the TTIP may generate the momentum needed to reignite the WTO Doha Round.

The conclusion thus seems to be simple. Unless we assume that the negotiation process can threaten the stability of the EU, the TTIP should be given a chance.

¹⁸ New initiative launched on March 25th, 2013.



3. Czech economic relations with the USA

While Czech economic relations with the USA are not particularly strong in general, the US are still a very important partner if we consider only extra-EU trade. The USA account for slightly over 2% of Czech merchandise exports (12.2% of extra-EU exports) and 5.4% of exports of services (i.e. almost 20% of extra-EU exports of services).

Table #2: US role in Czech foreign trade in 2012 (%)

	Share of total (%)	Share of extra EU (%)
Merchandise trade	2.3	12.2
Services	5.4	19.9

Source of data: CNB

Mutual investment appear to be relatively weak as just 3.4% of the total stock of foreign capital in the Czech Republic came from the USA; and only 0.2% of the stock of outward Czech direct investment ended in the US market.¹⁹

3.1 Implications of Czech trade patterns for the methodology of estimates

Czech foreign trade especially with non-EU countries is a bit specific, which should be reflected in the design of the CGE model. We suggest that the CGE model should respect the following 5 features:

- 1) Czech Republic has much less developed service sector, and with the exception of tourism and transportation it has fairly low ratio of exports of services to exports of merchandise. While for the USA services amounted to more than 27% of merchandise trade in 2012 (the number was even higher for the EU, 33.6%), the Czech Republic exported services amounting to 16.2% of its merchandise imports. This was the second lowest relative role of services after Romania. Consequently we focus just on merchandise trade in our first estimates.
- 2) Czech trade statistics with non-EU countries are distorted by the Rotterdam effect. This is very typical for trade with Asian countries.²⁰ We should therefore make sure that we are working with correct data on trade flows.

¹⁹ However, it should be emphasized that the origin and final destination of the investment flows are often recorded incorrectly because of the effects of subsidiaries and tax havens.

²⁰ See e.g. Semerák (2012) for more details and examples.



- 3) Indirect trade is rather important for the Czech Republic, e.g. German owned subsidiary produced in the Czech Republic components which are exported to Germany where they are used to produce e.g. a car which will be later exported to the US market. Trade liberalization between the EU and the USA can thus also increase Czech exports to Germany. The CGE model must be multiregional and it should make it possible to analyze a similar type of indirect trade flows.
- 4) The main nominal trade barriers change in the same way as for the trade between the USA and the “old” EU countries. However, some of the real barriers may
- 5) On the other hand, intra-industry trade seems to be a slightly less important for the mutual trade flows between the US and the Czech Republic (about 45% of US-Czech trade in comparison with 74% in the case of EU-US trade).²¹ This may reduce the importance of pro-competitive effects of trade liberalization, consequently we should be more conservative when specifying the possible dynamic effects of trade integration.

4. Effects of TTIP on the Czech Republic: Tentative estimates

In this section we are presenting first tentative conclusions on future effects of the TTIP on the Czech Republic. They should be considered with caution because:

1. The final form of the agreement has not been negotiated yet.
2. This is our first shot at the model (more detailed versions will follow).
3. We focus only on merchandise trade flows and tariff protection; trade in services, investment provisions and non-tariff measures have not been included.

We attempted the estimates by two methods: (i) evaluation of sensitivity of Czech trade flows to trade policy variables by means of a gravity model, (ii) a crude CGE model. The resulting estimates are rather conservative, based on outcomes of other studies we expect the forecasts of more detailed models with dynamic effects to be much more positive.

4.1 Implications of gravity models

The estimated gravity model of Czech exports as well as additional information on the sample are provided in the appendix (7.7). This test as well as previous estimates suggests that the current Czech export patterns correspond rather well with the gravity model. Contribution of additional variables used to measure effects of trade policies is mostly

²¹ See appendix 7.4 for details on the method and data used for this estimate.



insignificant. The implications are simple – the current pattern of exports (albeit very EU-centric) seems to be an equilibrium outcome and not a bias. Changes in trade policies, especially if they remain low key (such as elimination of tariffs without a reduction of NBTs) are unlikely to transform Czech exports profoundly.

4.2 First shot at CGE modeling

The presented results are based on a very simple CGE model based on the GTAP (v. 7 database). The GTAP database was not extended to include the latest data yet, more detailed results will be provided in a more detailed technical paper published later this year.

The model only considers elimination of visible tariff protection and it does not consider the dynamic effects. Therefore its results should be considered as very conservative, most probably they underestimate the contribution of TTIP significantly. However, the model more explicitly focuses on the likely redistribution of trade flows between the Czech Republic and the rest of the EU due to the presence of multi-country production networks. The model therefore includes 11 regions (2 of these are individual countries, the CR and the USA) and 10 sectors.

The resulting effects are very mild, but positive in principle. We can assume that addition of additional dynamical effects and extension of the underlying data may lead to higher positive gains with more or less similar structure.

Estimated effects on the Czech Republic	
Change in GDP (%)	+0.01
Change in merchandise exports (%)	+ 0.06
Change in ratio of trade balance to regional income (%)	+ 0.00

Source: own estimates

For comparison, the estimates published in Felbermayr, Heid & Lehwand (2013) suggest higher gains for the Czech Republic in the case of elimination of all tariffs (0.17% increase in real income p.c.) and especially in the case of really deep liberalization, i.e. elimination of both tariffs + NTBs (2.58% increase in real income).



5. Conclusions and policy implications

TTIP is unequivocally a great project which is worth pursuing. Indeed, it is a project well overdue. Bringing the attempt to a more successful result than the 1990s NTM proposal will not be easy, but the experience with EU-Korea and US-Korea FTAs suggest that it is not impossible. At the same time, differential impacts of the agreement on individual EU member countries can lead the quest for intra-EU compromises into a quagmire.

While the estimates of especially conservative scenarios can seem to be fairly low for policy-makers used to talk about trillion dollar rescue packages, there does not seem to be any other trade policy initiative able to achieve more than what the TTIP promises. We also should not forget, that the conservative estimates are likely to be exceeded by real achievements and that also the achieved liberalization may eventually be higher (especially in the territory of non-tariff measures). Additional positive effects may follow from effects of internal liberalization in the EU (or at least from creating a barrier to excessive regulation in future). This kind of additional positive effects is especially in the interests of new member countries.

There is also another possible indirect outcome of the TTIP - there is a non-zero probability that successful completion of the TTIP may help break the deadlock over the Doha Round. This would further improve the expected estimates of the welfare gains.

The sobriety of the current estimates has an additional advantage – it has happened in the past that politicians had promised to the public exaggerated effects on trade, growth, and wages. Both the EU and the USA need to return to credible economic policies, therefore their politicians should resist the lure of overpromising.

The economic estimates suggest relatively modest, but positive welfare gains for the Czech Republic. This is due to (i) small initial levels of trade with the USA, (ii) concentration of Czech exports on sectors with often relatively low reduction in nominal barriers (and presumed persistence of at least some NTMs and real barriers²²). At the same time, Czech interests are unlikely to be too harmed even by substantial concessions in problem areas²³; indeed some of the concerns of the US producers (preliminary caution principle) are relevant for Czech companies too. In short, the Czech Republic can expect some gains and there is a very tiny risk of adverse effects.

The Czech Republic is likely to experience gradually expansion of its exports to the USA, but the effects on diversification of Czech exports can be ambiguous.

²² Exchange rate volatility, specific requirements of the national markets – this is the case of car industry.

²³ With possible exception of software patents and related issues.



The political/geopolitical ambitions of the project as voiced e.g. by Zbigniew Brzezinski may not be fully met. While the TTIP can make US and EU companies more competitive and while the joint market can indeed grab the position of global trend-setter (and standard-setter), harmonization of standards will help anyone who sells in the new large market, including Chinese, Indian, Russian and other producers. This becomes even more obvious when we realize that they supply many of the inputs used in US and EU exportable products and services. From the long run perspective it would therefore be advisable to avoid any attempts to search for shortcuts by means of not respecting or undermining the position of the WTO and of achieved principles of multilateral trade liberalization. Also – as direct gains from the liberalization process are likely to be modest, we should not be surprised that alternatives such as the “Pivot to Asia” will still attract attention of US policymakers, especially if the EU remains too divided.

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6.1. Sources of data:

CNB – Czech National Bank, balance of payments statistics

COMEXT – Trade database of the Eurostat

COMTRADE - U.N. International Merchandise Trade Statistics

GTAP – Global trade analysis project, database by Center for Global Trade Analysis of Purdue University's Department of Agricultural Economics.

STAZO – Trade database of the Czech Statistical Office

WTO – Trade Profiles Database



7. Appendix

1. EU MFN tariffs and the share of duty-free items
2. US MFN tariffs and the share of duty-free items
3. Czech Current Account with the US in 2012 (mil. of CZK)
4. Intra-industry trade analysis
5. US-Czech investment (stock of investment, 2011)
6. Comparison of exchange rate risks (% , 2011)
7. Simple gravity model for Czech exports



7.1. EU MFN tariffs and the share of duty-free items

Product groups	Final bound duties				MFN applied duties			Imports	
	Average	Duty-free	Max	Binding	Average	Duty-free	Max	Share	Duty-free
		in %		in %		in %		in %	in %
Animal products	24.3	20.6	140	100	23	23.8	140	0.4	8.3
Dairy products	57.6	0	226	100	55.2	0	205	0	0
Fruit, vegetables, plants	10.4	22.8	170	100	11.5	18.8	170	1.5	12.5
Coffee, tea	6.2	27.1	25	100	6.2	27.1	25	0.9	77.1
Cereals & preparations	20.3	6.3	167	100	16.3	12	167	0.4	2.3
Oilseeds, fats & oils	6.6	48.2	171	100	7.1	43.5	171	1.4	72.7
Sugars and confectionery	28.3	0	131	100	29.1	0	131	0.1	0
Beverages & tobacco	21.8	23	175	100	19.2	19.8	162	0.6	16.8
Cotton	0	100	0	100	0	100	0	0	100
Other agricultural products	4.4	65.9	131	100	4.8	65.1	131	0.4	68
Fish & fish products	10.9	12.3	26	100	10.3	16.4	26	1.3	6.3
Minerals & metals	2	49.6	12	100	2	49.9	12	16.6	72.3
Petroleum	2	50	5	100	2.7	29.7	5	20.3	87.4
Chemicals	4.6	20	17	100	4.6	21.7	17	9.5	46.5
Wood, paper, etc.	0.9	84.1	10	100	0.9	81.2	10	2.8	86.3
Textiles	6.5	3.4	12	100	6.6	2.1	12	2.2	2.3
Clothing	11.5	0	12	100	11.5	0	12	4.4	0
Leather, footwear, etc.	4.2	27.8	17	100	4.2	22.7	17	2.4	17.8
Non-electrical machinery	1.7	26.5	10	100	1.9	21.4	10	10.9	56.4
Electrical machinery	2.4	31.5	14	100	2.8	20.4	14	12.3	59.8
Transport equipment	4.1	15.7	22	100	4.3	12.7	22	5.1	27.1
Manufactures, n.e.s.	2.5	25.7	14	100	2.7	20.5	14	6.4	52.6

Source: WTO



7.2. US MFN tariffs and the share of duty-free items

Product groups	Final bound duties				MFN applied duties			Imports	
	Average	Duty-free in %	Max	Binding in %	Average	Duty-free in %	Max	Share in %	Duty-free in %
Animal products	2.4	31	26	100	2.4	31	26	0.4	25.3
Dairy products	19.2	0.3	92	100	19.1	0.3	92	0.1	13.7
Fruit, vegetables, plants	4.8	23.3	132	100	4.9	20.1	132	1.2	25.5
Coffee, tea	3.2	53.5	24	100	3.2	53.5	23	0.5	75.9
Cereals & preparations	3.5	20.8	54	100	3.5	21	54	0.6	32.4
Oilseeds, fats & oils	4.2	27.6	164	100	4.5	24	164	0.3	38.7
Sugars and confectionery	16.9	2.9	123	100	16.6	2.9	123	0.2	5.1
Beverages & tobacco	16.3	27	350	100	15.4	27.3	350	1	52.2
Cotton	4.7	38.3	19	100	4.6	38.3	19	0	78.3
Other agricultural products	1.1	62	67	100	1.2	59.1	67	0.3	65.4
Fish & fish products	1	80.5	35	100	0.9	81.9	35	0.8	90.7
Minerals & metals	1.7	59.9	38	100	1.7	61	38	12.6	74.2
Petroleum	1.4	0	7	80	1.3	0	7	14.6	0
Chemicals	2.8	40	7	100	2.8	40.7	7	10.3	67.5
Wood, paper, etc.	0.4	91.8	14	100	0.5	90.2	14	3.5	92.6
Textiles	7.9	16	42	100	7.9	15.1	42	2	11.5
Clothing	11.4	3.4	32	100	11.7	2.8	32	3.9	0.8
Leather, footwear, etc.	4.3	38.4	56	100	4	38.9	56	2.5	19.7
Non-electrical machinery	1.2	66.3	10	100	1.2	65	10	13.8	82.1
Electrical machinery	1.7	48.8	15	100	1.7	48.4	15	13.4	66.6
Transport equipment	3.1	54.8	25	100	3	55.7	25	11.1	13.5
Manufactures, n.e.s.	2.1	49.6	46	100	2.3	45.1	46	6.9	73

Source: WTO



7.3. Czech Current Account with the US in 2012 (mil. of CZK)

Content	USA		
	Credit	Debit	Net
CURRENT ACCOUNT	86,395.4	87,069.6	-674.3
GOODS	58,790.6	51,054.8	7,735.7
SERVICES	23,502.0	22,828.7	673.3
Transport	1,894.2	2,561.7	-667.6
Sea transport	89.2	155.5	-66.4
Air transport	806.0	747.7	58.4
Space transport	0.0	0.0	0.0
Rail transport	319.2	166.6	152.7
Road transport	594.4	1,468.7	-874.4
Inland waterway transport	0.0	0.0	0.0
Pipeline transport	0.0	0.0	-0.0
Other supporting and auxiliary transport services	85.4	23.2	62.1
Travel	6,970.5	5,554.8	1,415.7
Business travel	4,066.3	1,368.8	2,697.5
Personal travel	2,904.2	4,186.0	-1,281.9
Other services	14,637.3	14,712.1	-74.8
Communications services	330.3	4,780.7	-4,450.4
Construction services	16.0	0.8	15.2
Construction abroad	16.0	0.5	15.5
Construction in the compiling economy	0.0	0.3	-0.3
Insurance services	66.8	276.2	-209.4
<i>of which:</i>			
Reinsurance	1.1	114.6	-113.5
Financial services	89.9	372.5	-282.6
Computer and information services	5,593.2	2,492.7	3,100.5
Royalties and license fees	1,824.1	2,476.8	-652.7
Other business services	6,488.4	3,210.5	3,278.0
Merchandising and other trade-related services	77.2	306.2	-229.0
Operational leasing services	27.7	39.8	-12.2
Miscellaneous business, professional and technical services	6,383.6	2,864.4	3,519.2
Personal, cultural and recreational services	221.0	1,024.7	-803.8
Government services, n.i.e.	7.7	77.2	-69.5
Services not allocated	0.0	0.0	-0.0
INCOME	2,783.8	11,989.6	-9,205.8
Compensation of employees	569.0	981.0	-412.0
Investment income	2,214.8	11,008.6	-8,793.8
Direct investment income	-140.2	10,789.9	-10,930.0
Income on equity	-145.1	10,770.3	-10,915.4
Dividends	0.0	653.7	-653.7
Reinvested earnings and undistributed profits	-145.1	10,116.6	-10,261.7
Income on debts (interest)	4.9	19.6	-14.7
Portfolio investment income	975.0	0.0	975.0
Income on equity	354.6	0.0	354.6
Income on debts (interest)	620.4	0.0	620.4
Other investment income	1,380.0	218.7	1,161.3
CURRENT TRANSFERS	1,319.0	1,196.5	122.5
General government	419.0	232.4	186.6
Other sectors	900.0	964.1	-64.1

Source: Czech National Bank, Current account of the Czech Republic - territorial breakdown



7.4. Intra-industry trade analysis

Analysis of the role of industry trade in trade relations between the Czech Republic and the USA, and of the EU and the USA respectively, was carried out on trade data in HS4 classification for 2012. The data came from the COMEXT database.

In order to avoid the well-known problem of the traditional Gruber-Lloyd index (double classification of trade in situations when export of a commodity equals e.g. 60% of the commodity's imports) we decided to apply the approach recommended in Fontagne & Freudenberg (1997). In this case trade in a commodity group i is considered an intra-industry trade (IIT) if the following condition is met:

$$\frac{\min(X_i, M_i)}{\max(X_i, M_i)} > 10\%$$

The share of intra-industry trade was then calculated as the ratio of turnover in these commodity groups to total turnover of trade between the two markets.

Results of the analysis for 2012 data:

The number of HS4 commodities exported from the Czech Republic to the USA: 2899

The number of HS4 commodities imported to the Czech Republic from the USA: 1875

The role of intra-industry trade in Czech trade: 45.4 per cent.

The number of HS4 commodities exported from the EU to the USA: 5004

The number of HS4 commodities imported to the EU from the USA: 4747

The role of intra-industry trade in EU trade: 73.8 per cent.



7.5. Stocks of US investment in the Czech Republic and vice versa (end of 2011)

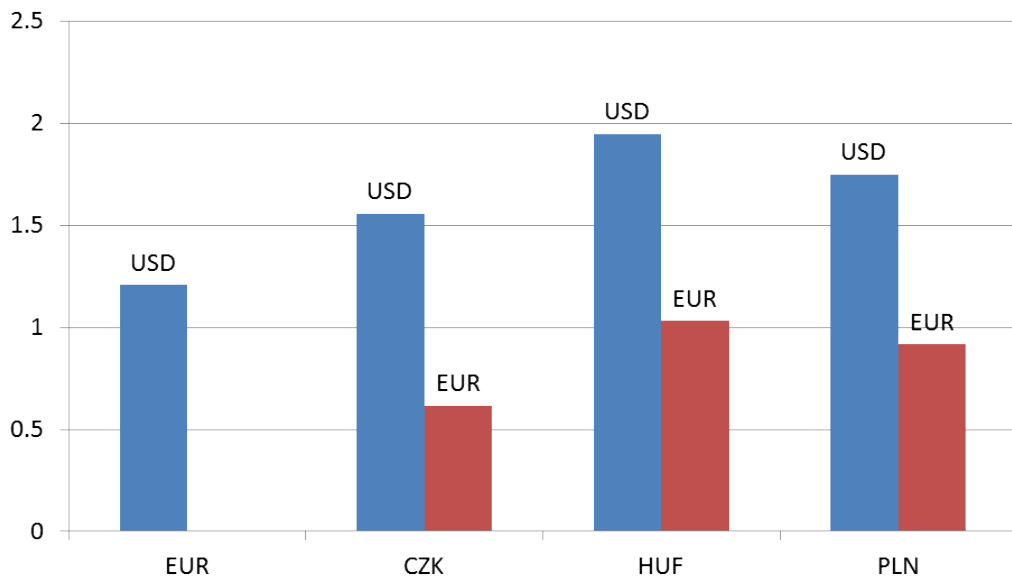
Czech DI abroad	Equity capital	Reinvested earnings	Other capital	Total
Total (thous. Euro)	4,367,108	5,170,378	675,474	10,212,960
United States (thous. Euro)	16,542	-6,001	8,363	18,905
Share of the USA (%)	0.4	-0.1	1.2	0.2
FDI in the Czech Rep.	Equity capital	Reinvested earnings	Other capital	Total
Total (thous. Euro)	48,052,336	35,656,417	9,475,411	93,184,164
United States (thous. Euro)	1,252,692	1,768,594	121,756	3,143,043
Share of the USA (%)	2.6	5.0	1.3	3.4

Source: CNB



7.6 Comparison of exchange rate risks (% , 2011)

Average volatility based on 20-day variation of coefficients calculated from daily exchange rates.



Source: Own calculations based on Pacific Exchange Rate data



7.7 Simple gravity model for Czech exports

The gravity model is based on data for years 1995-2009 and 177 trade partners (basically complete population of trade partners of the Czech Republic)

The final version uses a simple panel method: random effects specification

Specification of the estimated version (logs + dummy and additional variables):

$$\ln(X_{it}) = \beta_0 + \beta_1 \cdot \ln(Y_{dt}) + \beta_2 \cdot \ln(Y_{it}) + \beta_3 \ln(d_{ij}) + \sum_j (\beta_j \cdot D_{jt}) + \nu_i + \varepsilon$$

	Basic Version	Extended Version
Constant	- 8.144*** (2.094)	-5.359** (2.116)
Ln Y_{it} (GDP of a trade partner)	1.063*** (0.039)	0.901*** (0.066)
Ln Y_{it}^{CR} (Czech GDP)	0.955*** (0.173)	0.811*** (0.178)
Ln d_i (distance)	-1.511*** (0.091)	-1.551*** (0.106)
Slovakia	1.943* (1.132)	2.242** (1.132)
Ln L_{it} (population)	---	0.163** (0.069)
Ln $ERDI_{it}$	---	-0.732** (0.114)
CU_FTA (dummy for FTA)	---	0.012 (0.121)
EU_EEA (EEA dummy)	---	-0.123 (0.184)
Bus (business environment)	---	0.005** (0.002)
Gov (government effic.)	---	0.007*** (0.002)
C_{it} (currency factors)	---	0.213** (0.092)



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and Implications for the Czech Republic

—
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