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The Rise of Mega-FTAs

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Introduction

Free trade agreements (FTAs) are negotiated so that countries and businesses can benefit from the possibilities that international economic integration offers. By eradicating barriers to trade, mutual gains can be generated. FTAs, in general, create a bigger market, increase competition, but at the same time reward economies of scale, which in turn induces companies and countries to allocate their time and resources more efficiently. Moreover, greater business competition arising from FTAs can catalyse economic reforms such as accelerating the adoption of existing technologies and stimulating the development of new ones (Krist, 2012).

Multilateral trade agreements mainly run through the World Trade Organization (WTO). But the latest negotiations, the Doha Development Round, have lasted for eleven years and no breakthrough or agreement is within reach. As the world economy becomes more interconnected and trade relations more complex, it appears to be harder to reach a global agreement on trade policies and priorities. With multilateral global negotiations stalled, there has been a distinct shift to bilateral and regional FTAs. These renewed negotiations could enhance global economic growth and offer a quicker route to free trade between countries. Major FTAs that are now being negotiated include the Trans-Pacific Partnership (TPP), Transatlantic Trade and Investment Partnership (TTIP) and the Regional Comprehensive Economic Partnership (RCEP). These mega-FTAs are likely to have implications for global trade and the multilateral trading system.

Trans-Pacific Partnership (TPP)

The precursor of TPP was the P4 forged among Brunei, Chile, New Zealand and Singapore in 2005. Currently the TPP counts twelve members namely Australia, Brunei, Chile, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. Japan was the latest member to join in July 2013, and its entry has given impetus to East Asian countries, in particular South Korea and China, who are still outside the TPP, to reconsider their possible participation in the future.

The TPP comprised both developed and developing economies giving this FTA much potential and many opportunities for its members but also challenges. As every member has concentrated on the development of specific sectors and have different development needs, the TPP negotiations can be distorted and difficult because of national lobby groups and entrenched political interests. Problematic sectors within TTP include the sugar, dairy, beef, textiles and apparel, and the car industries (Krist, 2012). Moreover, currency issues would have to be dealt with, as monetary and fiscal policy could have large implications for the competitiveness of certain countries and markets which operate within the TTP.

Although the collective GDP of the TPP grouping is heavily dominated by the United States, many member countries show higher real GDP growth rates, indicating that their economic significance is likely to increase in the coming years.

However, the diversity among the members and the entry of Japan to the TPP has further complicated the negotiation process with many sensitive issues now on the list, including those relating to agriculture. Despite the complexities, no one doubts the economic significance of the TPP, should it be concluded (see figure 1).

A study by Petri, Plummer and Zhai (2011) projected that the impact of the TTP rises from $104 billion to $862 billion in case of a Free Trade Area of the Asia-Pacific (FTAAP), an agreement including all potential TPP and ASEAN countries, plus China and Russia (see figure 2). For comparison, the benefits stemming from the Doha Round are estimated to be between $87 billion and $574 billion for the year 2015 (Fergusson, 2011). The authors outlined that strong economic incentives would initiate a region-wide trade agreement. For their analysis, they assumed that the TTP will consist of thirteen members including South Korea, Japan, Canada and Mexico by 2020. Canada and Mexico joined in 2012 and Japan in 2013, leaving only South Korea at this juncture. Hence, their analysis is a good approximation of the actual benefit that TTP can bring.

Figure 1: Trade among TTP partners and with other regions (Williams, 2013)

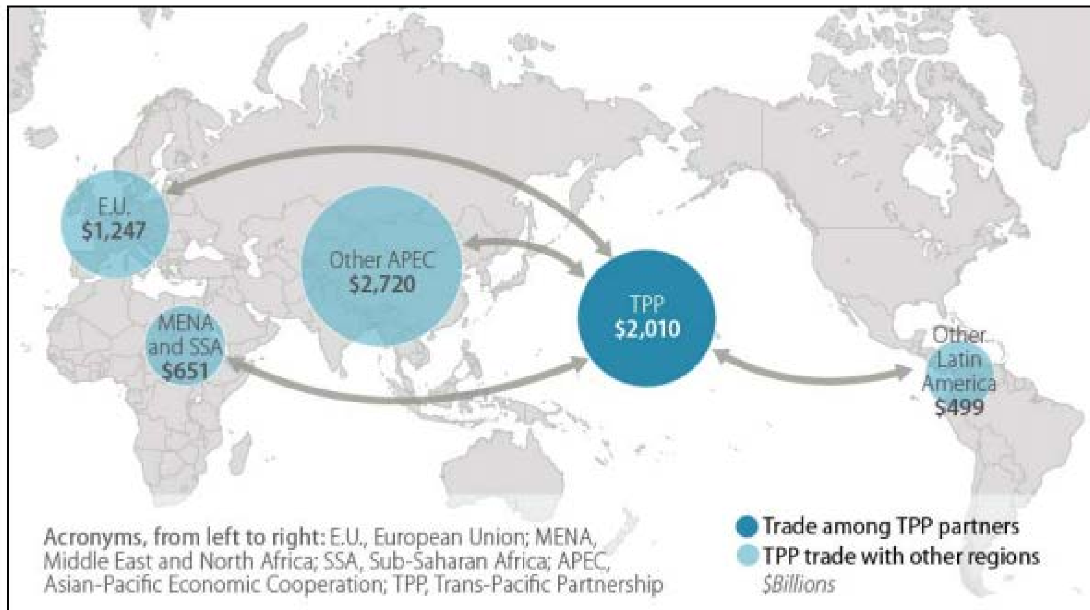
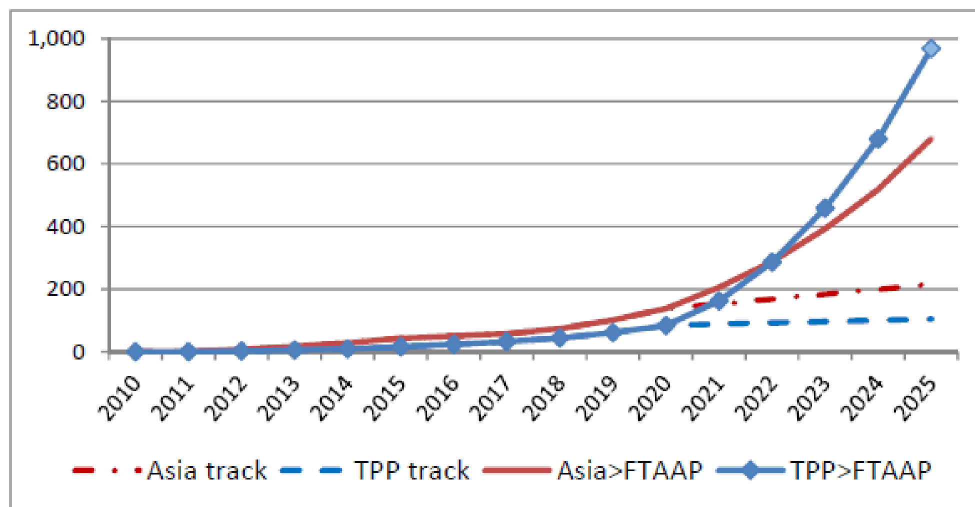


Figure 2: World welfare on alternative tracks in billions of US dollars (Petri et al., 2011)



Transatlantic Trade and Investment Partnership (TTIP)

The idea of creating a transatlantic free trade area (TAFTA) between EU and the US was first raised with the launch of the New Transatlantic Agenda in 1995. While the New Transatlantic Agenda heralded a comprehensive framework of cooperation between the EU and the US, the idea of TAFTA did not come to fruition. Attempts by the George W. Bush administration to revive the free trade agreement during his second term also ran into difficulties.

The need for the developed economies, the EU and the US to find new sources of growth in the aftermath of the global financial crisis led to this new attempt to relaunch the free trade agreement between the EU and US. This was announced in February 2013.

In his State of the Union address in February 2013, President Obama announced that Washington would launch negotiations with the EU for a comprehensive Transatlantic Trade and Investment Partnership (TTIP), making it the most ambitious economic agreement in the world. The importance of this FTA had been analysed by many scholars. Together the EU and US constitute around 50% of global output, 30% of global merchandise trade and 20% of global foreign direct investment (OECD, 2013). The announcement of TTIP was therefore hailed by many as a potential game changer for global trade governance.

The first round of negotiations was launched in July 2013. The goal of the latest talks held on 8-12 July 2013, included negotiations on abandoning the remaining tariffs on agricultural and industrial goods, reducing non-tariff barriers (including quota and mutual recognition of standards and procedures), opening of public procurement at different government levels, and unifying policies in the field of intellectual property rights.

The potential gains of the TTIP are substantial. Although the conclusions of various studies differ, the consensus is that the TTIP will be beneficial for both the EU and the US. Estimates for the increase in global GDP range from 0.5 to 3.5%. The estimates differ due to different approaches and assumptions used by the researchers. However, given that both the EU and US have not fully recovered from the global financial crisis and that economic growth is still weak, intensifying bilateral trade seems to be a welcomed option to stimulate economic growth.

A study conducted by Felbermayr, Heid and Lehwald (2013) predicted that TTIP will lead to more intense trade between the US and the EU which could have serious implications for the rest of the world.

Firstly, looking at the benefits for the EU and US, the study concluded that the effects on real income per capita for US and EU would be marginal if only tariffs are eliminated. The estimated increase in real GDP per capita ranges from 0.03% to 0.58% (see figures 4 and 6). The reason for this slight change is that levied tariffs between the USA and the EU are already at a low level (weighted average 2.8%). Only in case of a comprehensive trade liberalisation, that is, the elimination of all non-tariff barriers would the potential gains be significantly higher (see figure 3).

In case of a comprehensive liberalisation scenario, EU countries will on average experience a 4.95% rise in real GDP per capita and the USA a 13.4% rise (see figures 5 and 7). The more an EU country trades with the USA, the more it benefits from comprehensive liberalisation. Furthermore, the openness of a country's economy is also positively related to its gains in case of any trade liberalisation.

When the global effects of TTIP are considered, a mixed picture reveals itself. Other than the US and the EU, almost no other country in the world benefits, except important suppliers of raw materials to the EU and the US such as Indonesia and Brazil. The main losses are borne by developing countries, whose trade is halted by increased competition from either USA and/or EU competitors. Thus, reducing trade tariffs will worsen the economic situation of these countries and thereby hinder these countries' prosperity. On the whole, global real income per capita would rise by 0.1%.

In particular, traditional trading partners of the EU and the US such as Canada, Australia and Norway will experience major setbacks in their real income (Felbermayr et al. 2013). However, this study only investigates the effects in a ceteris paribus situation – that is; it is assumed that other countries do not change their trade policies. In practice, however, it can be expected that other countries would alter their policies as well which likely lowers the losses that they might incur. These countries will likely enter in new trade agreements and trade diversion will result. The eventual effects are therefore complex and difficult to predict.

A similar pattern can be observed when looking at the effects on employment. Jobs appear to decline in traditional trading partners of the US and the EU and increase in the US and the EU themselves. The decline in employment in the rest of the world directly follows from the worsened relative competitiveness of these countries leading to a lower demand for their products and services. The only exception to this is the United Kingdom. Due to its "special relationship" with the US it actually benefits from a decline in tariffs between the EU and the US.

In the case of deep liberalisation, the potential effects show the same signs as in the tariff reduction scenario; however, the magnitude of the changes is larger. Altogether, deep liberalisation will increase employment to a larger extent just as the percentage change in real wages is much higher. Table 1 shows the ultimate result – deep liberalisation would create two million jobs within the OECD, which is almost four times as much as in the tariff scenario.

The research conducted by Felbermayr et al indicates major benefits from trade liberalisation. However, another report indicates smaller benefits from an ambitious and comprehensive trade and investment agreement – Francois et al. (2013) have projected gains for the EU to be €119 billion a year, and for the US, €95 billion a year, which is equal to a 0.2 to 0.5% rise in GDP for the EU and the US. Moreover, their study indicates that this gain in trade would not be at the expense of the rest of the world. The authors estimate a rise in global income close to €100 billion. Although the numbers differ, both reports outline that the reduction of non-tariff barriers is vital for these gains to be realised.

Figure 3: Changes in trade costs from TTIP (Petri et al., 2011)

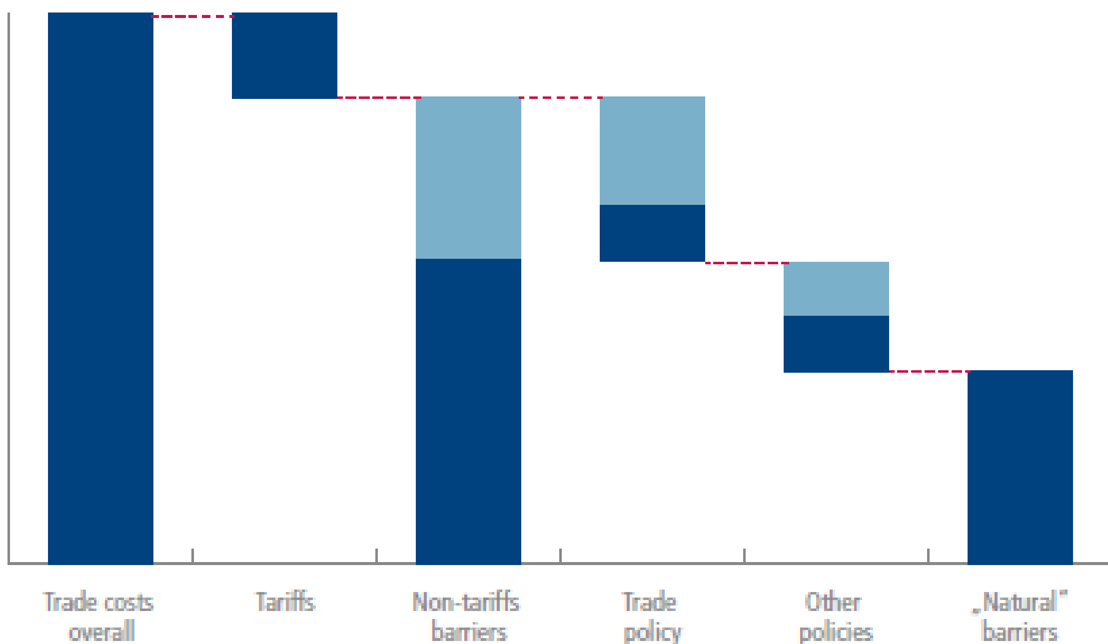


Figure 4: EU27 changes in real per capita income, tariff scenario (Felbermayr et al., 2013)

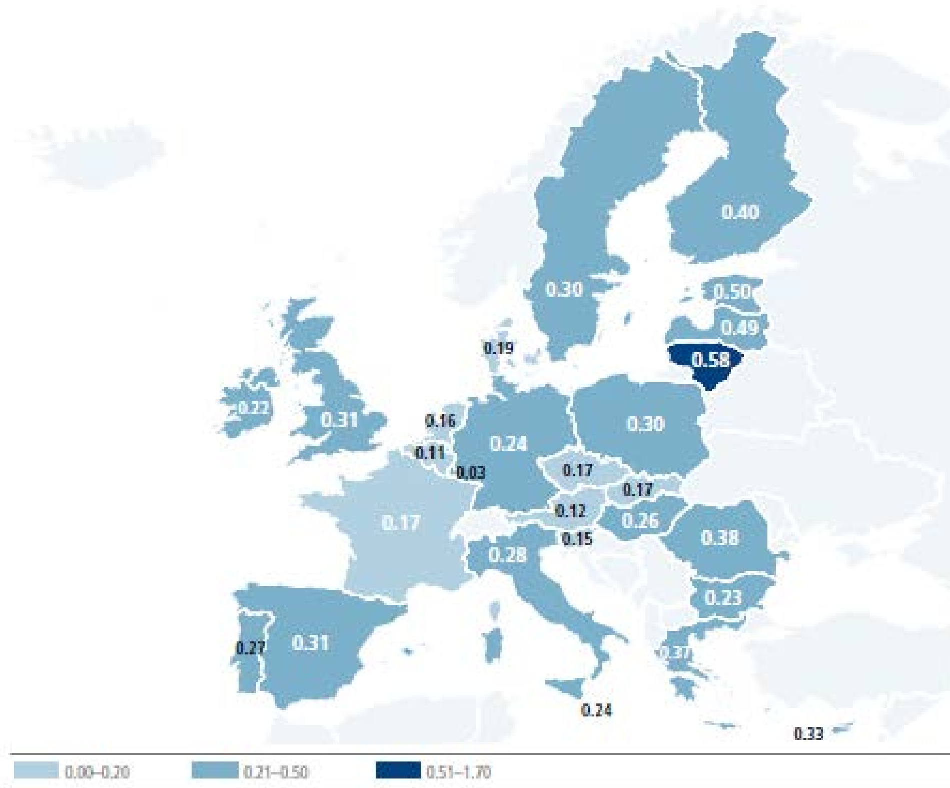


Figure 5: EU27 changes in real per capita income, deep liberalisation (Felbermayr et al., 2013)

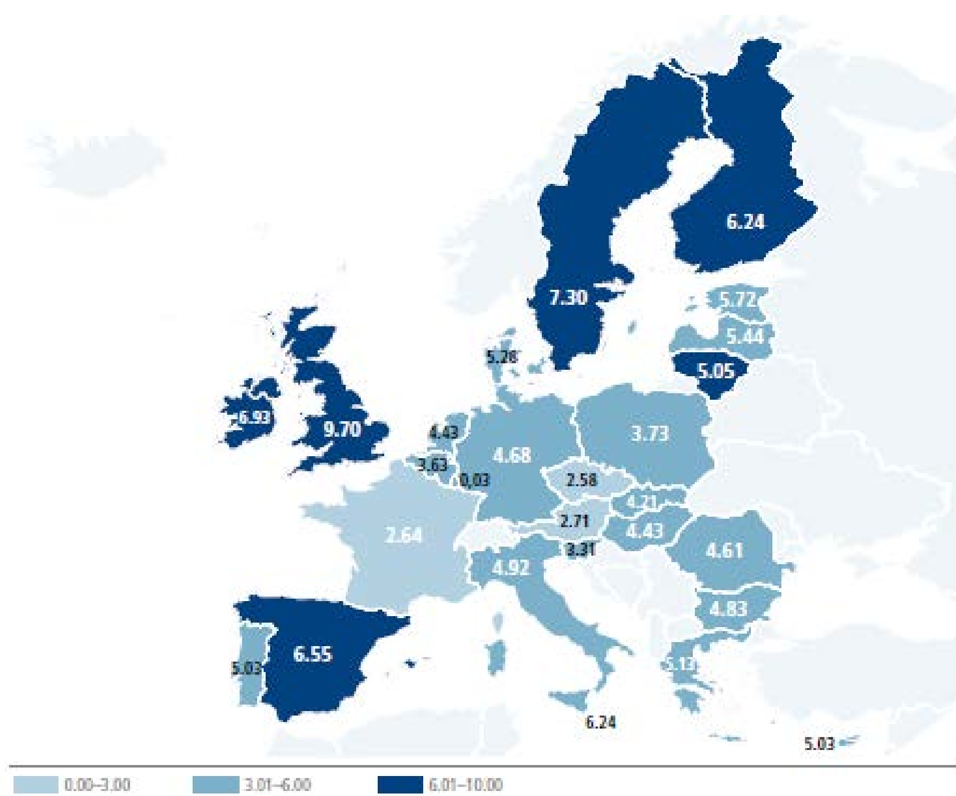


Figure 6: Changes in global real per capita income, tariff scenario (Felbermayr et al., 2013)

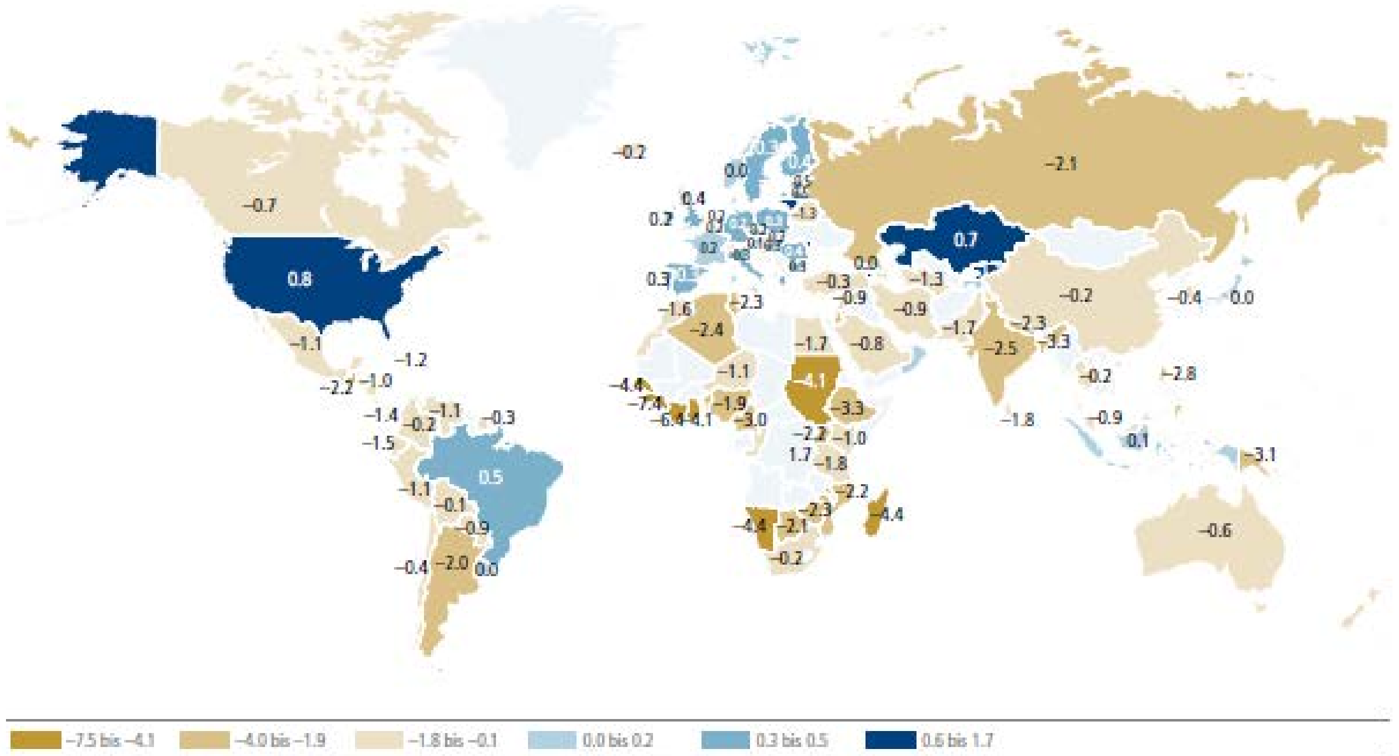
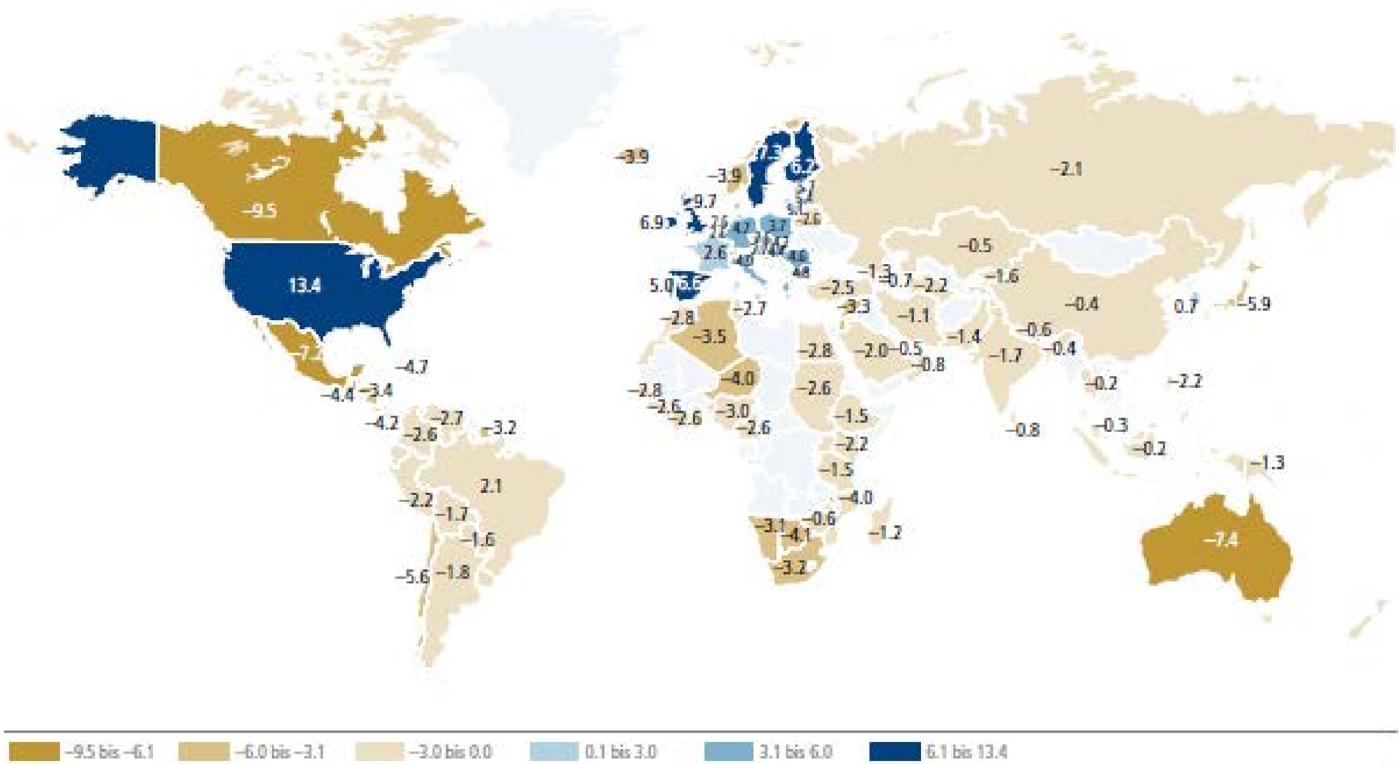


Figure 7: Changes in global real per capita income, deep liberalisation (Felbermayr et al., 2013)



Country	Deep liberalization	Tariff scenario
Australia	–52,332	–13,591
Austria	11,638	2,828
Belgium	4,062	873
Canada	–101,854	–26,176
Czech Republic	22,278	5,527
Denmark	14,623	3,646
Finland	20,066	5,134
France	121,566	29,921
Germany	181,092	44,831
Greece	34,277	8,766
Hungary	22,613	5,691
Iceland	–769	–201
Ireland	18,115	4,549
Italy	140,979	35,538
Japan	–71,833	–19,030
Netherlands	29,535	7,121
New Zealand	–6,606	–1,748
Norway	–11,541	–3,001
Poland	93,333	23,466
Portugal	42,521	10,878
Slovakia	12,995	3,259
South Korea	–29,841	–7,912
Spain	143,098	36,457
Sweden	32,515	8,241
Switzerland	–18,224	–4,640
Turkey	–94,831	–24,625
United Kingdom	400,203	106,134
United States	1,085,501	276,623
Jobs created in the OECD	2,043,178	518,558

Table 1: Number of jobs created in both scenarios (Felbermayr et al., 2013)

Regional Comprehensive Economic Partnership (RCEP)

The RCEP, driven in part by China and supported by ASEAN, was initiated in November 2012. The first round of RCEP negotiations took place in Brunei in May 2013, and the second round of negotiations have been scheduled for September 2013 in Australia (ASEAN, 2013). Currently, the RCEP includes sixteen members, namely Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam (these being the members of ASEAN) plus China, Japan, South Korea, Australia, India, and New Zealand. These economies have a combined GDP of approximately $17 trillion, accounting for approximately 40% of global trade (Hiebert, 2013).

Vast development gaps within ASEAN, however, hinder the RCEP from achieving aggressive trade liberalisation. The guiding principles of the RCEP acknowledge the diverse circumstances in developing countries such as Cambodia, Laos, Myanmar, and Vietnam, and include flexibility for special and differential treatment. The RCEP also mandates economic and technological cooperation to reduce development gaps.

Although the RCEP has to deal with great diversities, the potential of this FTA is substantial. As shown in the figures below, the participating countries would benefit greatly from the RCEP. The estimates range from a 2.3% increase in GDP for RoSEAsia (Rest of South East Asia, which includes Timor Leste) to a 13.4% rise in Vietnam's GDP (Fukunaga & Isono, 2013). Similar to the TPP and the TTIP, comprehensive trade liberalisation will further boost the economies. The difference, though, is that because tariffs levied by the RCEP member countries are still relatively high, the economic benefits from reducing these tariffs will be greater than in case of the TPP and the TTIP.

A study by Mitsuyo (2009) also showed that trade liberalisation would stimulate growth within the region. The authors reported a rise in real GDP growth by 0.09% up to 2.11% for the RCEP members on average, depending on the degree of trade liberalisation. Individual benefits range from 0.54% increase in real GDP growth for Japan to a 9.92% increase for Vietnam in the most optimistic scenario. This scenario includes full trade liberalisation and various facilitation measures, plus technical cooperation to the least developed countries in all sectors. Global GDP growth increases only marginally – 0.47% in the equivalent scenario. The welfare effects of these scenarios are positive for the engaged members as well. Per capita welfare is projected to rise the most in Singapore – by $2527, due to open character of Singapore's economy,. In general, the developed countries within RCEP benefit the most in monetary terms in Mitsuyo's analysis. However, they do so at the expense of the rest of the world.

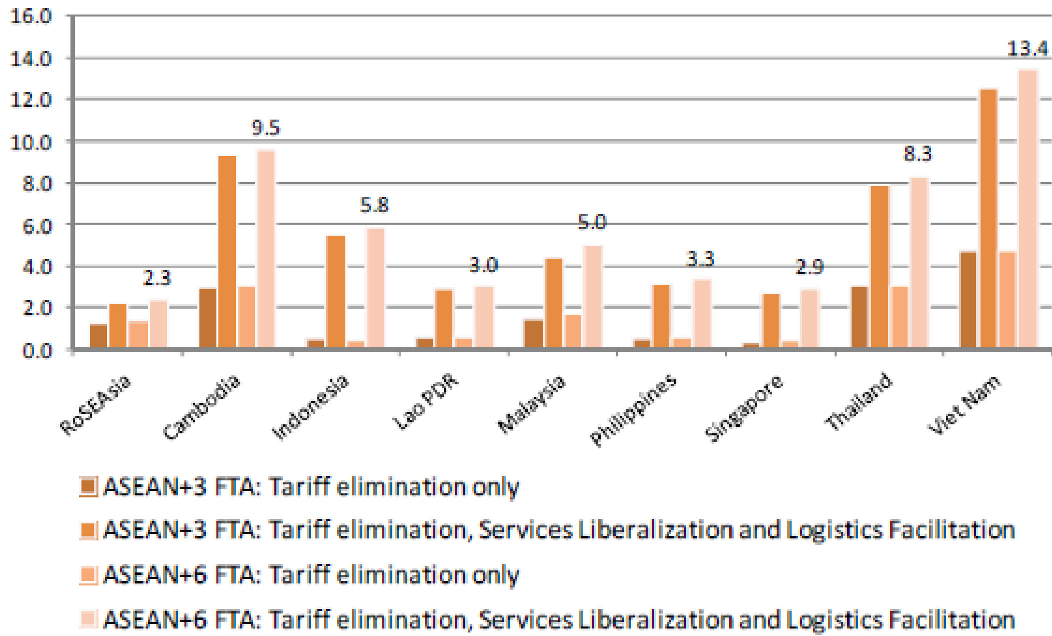
The results of this study are confirmed by a research that has been conducted more recently by Itakura (2013). Like the other studies discussed, this research projected the effects on GDP growth for merely tariff elimination and for a full implementation of FTA, including reduction of service trade barrier and trade cost of time. The outcomes of Itakura's study suggest that Vietnam's GDP growth will rise with 13.4% compared to the baseline. Countries like Cambodia, Thailand and Malaysia show similar growth rates, though less stellar than Vietnam's (see figure 8).

A research conducted by Dean and Wignaraja (2007) predicted similar outcomes. An ASEAN+6 FTA, equivalent to the RCEP, will have a positive economic impact of $285 billion for its members, while non-member economies will lose $25 billion, which typically is less than a one percentage point change compared to the baseline. The paper also considers the effect on unskilled labour. For the majority of the FTA's members, wages for unskilled workers are expected to rise, due to the likely increase in demand for the countries' products as precipitated by the FTA.

All in all, the RCEP would boost all the participating countries' economies and the ASEAN countries in particular. On average, GDP growth is expected to be moderate at around 2.11% (Urata, 2008).

Figure 8: Economic impact of ASEAN FTAs, comparison of tariff reduction only and tariff reduction with other liberalisations, percentage point accumulated from 2011 to 2015

(Itakura, 2013)



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