Implications of the TTIP on the Global Economic Integration of Central and Eastern Europe

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Abstract

Impact analyses and empirical results of existing studies on the economic impacts of the TTIP (Transatlantic Trade and Investment Partnership) show significant benefits for the participating countries. 11 out of the 28 members of the European Union (EU) are from Central Europe ("new" member states) and they are mostly small countries with open economies. The impact on less developed member states of the Central European region can be double. It can contribute to their deeper integration into the global economic networks through investments, but their underdevelopment rightly calls for caution. The implications and the direction of potential policy responses are even less clear in the rest of Eastern Europe. According to some studies, third countries would be facing losses and little has been said about the potential impacts on Eastern Europe. Russia, one of the largest emerging countries, has formulated very ambitious foreign economic and policy objectives. It is trying to restore its economic and political sphere of influence. Russia and other countries from the region might forcefully respond to possible trade diversion effects and worsening competitiveness if the agreement was to contain significant changes.

Introduction

Central and Eastern Europe (CEE) has started integrating into the global markets only recently after the breakup of planned economic systems. This region has been compared to Latin American countries several times from the early seventies in terms of its international economic integration pattern. Latin-America and Eastern Europe shared important macroeconomic characteristics in the final third of the twentieth century. In this period, both regions displayed similar economic performances, although their economic and political systems were vastly different. A common feature of the two regions was that they were at the periphery of the international economy and were facing comparable structural challenges while international economic developments exerted identical external pressures on them. Economic growth subdued, the terms of trade deteriorated, trade balances worsened. All these had led to dynamically increasing foreign debt and its servicing consumed large parts of the export revenues. Rising indebtedness did not serve to speed up structural change (Berend 1994). In both regions the nineties had brought about significant transformation, deep economic changes, and renewed efforts to achieve quicker economic growth. On average, Latin America and Eastern Europe went through significant transformation, Russia and Brazil and other countries have been considered as rapidly growing large emerging markets. At the same time, regional integration efforts as well as WTO membership became important drivers of international economic integration for several countries in both regions. Despite the remarkable growth performance in international comparison and the major advances in catching up with developed countries, their peripheral/semi peripheral position has not changed significantly. In many respects, they are facing the same challenges of globalization, regional integration, closing the gap and economic sovereignty.

After the collapse of the planned economic system, most advanced Central European countries managed to adopt the key institutions of a market economy and liberal democracy. The European Union has become the most important trading partner for all of them, but policy orientations, economic growth and democratic transformation showed big differences across the region. Today, there are two fundamentally different and distinct country groups in Eastern Europe. The first group consists of countries that have either become members of the European Union, or were intending to enter the EU and are already negotiating membership. Some other countries in this group have association agreements with the EU.[1] These countries have chosen the path of global integration through integration into a large single market by giving up several instruments of their external economic policy. The other group mostly comprises countries that do not possess a realistic perspective of EU membership, or nations that do not intend to join at all (Novak 2014: 1).[2]

EU member Central European countries may be viewed as a broadly coherent group that shares similar interests although their economic and political strategies may vary from time to time. Russia, after more than a decade long decline, is the largest emerging economic and political power in Eastern Europe today, and has a clear intention to shape the future of the region. This country is gaining more and more importance in the Eurasian space and pursues a dissimilar strategy to what is followed by the EU members. In recent years Russia has initiated an ambitious integration project with the final objective of creating a Eura-

[1] In the region, negotiations are currently underway with Serbia and Montenegro. Candidate or potential candidate countries are Former Yugoslav Republic of Macedonia, Albania, Bosnia and Herzegovina, and Kosovo.
[2] The European Union has its Eastern Partnership (EAP) policy aimed at creating deep free trade with post-Soviet states: Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine.

sian Economic Union.[3] In addition, it has also sought to expand its influence westwards by using its natural resources and capital investments.

Impacts of the TTIP and Economic Theories

Advantages of this agreement are supposed to be similar to those that were forecast before the creation of the European Single Market (SM). The internal market in a simple form is based on the neo-classical approach: eliminating trade and investment barriers = increasing trade and investment activity because of bigger expected returns, efficient labor market, etc. These advantages are supposed to come from eliminating the distortions of competition. In theory, consumers in each country gain from lower prices and any losses to the local producers will be more than compensated by the gains from greater competition. Increased competition and enlarged market opportunities stimulate the development and use of new technologies that improve productivity, decrease costs, increase living standards, etc. By doing so economic growth rates will be higher and new jobs will be created (Vetter 2013: 4).

This strong belief in market forces and the positive sum game of liberalization for each participant seems to be a bit strange at first sight soon after an economic crisis when more cautious approaches of economic thinking are on the rise. The benefits of market forces and external liberalization have been questioned weakening the unconditional mainstream belief in them.[4] As far as the benefits of single market type integration are concerned, we may argue from the opposite perspective as well in terms of costs: the single market idea involves channeling the negative implications of globalization, including (1) loss of jobs, because of increased competition; (2) disappearing industries because of weaker, smaller domestic economic actors; (3) negative impact on structurally weak regions. This last impact was expected to be eased by regional and structural policies, though these are seemingly without success as reflected in intensifying regional differences within the EU.

The objective of the EU Single Market was to deliver higher growth rates to keep up the pace and successfully compete with fast growing emerging regions. Its impacts are not entirely about success and assessments are only superficially addressing these problems (Straathof et al. 2008; Boltho, Eichengreen 2008; Copenhagen Economics 2012). Even if there are arguments to support that the current problems of the EU have not all been caused by the operation of the

[3] The EurAsEC Customs Union became increasingly important for Russia since the launch of EAP. Its members: Russia, Kazakhstan, Belarus. Armenia and Kirgizstan is expected to join the Union soon.

[4] As Joseph Stieglitz writes: "Neo-liberal market fundamentalism was always a political doctrine serving certain interests. It was never supported by economic theory. Nor, it should now be clear, is it supported by historical experience. Learning this lesson may be the silver lining in the cloud now hanging over the global economy." accessed at: http://www.project-syndicate.org/commentary/the-end-of-neo-liberalism-

SM, several politicians and the public perceive the SM as a failure.[5] During the past two decades, in relative terms, in comparison with the rest of the world, the EU's economic performance has deteriorated, which may suggest that the primary objective of the SM has not been fulfilled. It is clear that all of the *ex-ante* assessments were unrealistically optimistic about the positive impacts of the Single Market (Cecchini, Catinat, Jacquemin 1988)[6] and were unable to properly address the negative impacts the less developed members would face.

Impact assessments to date generally show that each country participating in the TTIP gets benefits; the only question left to answer is the extent of such benefits as they may vary from country to country and be largely a function of the content of the agreement (CEPR 2013; Felbermayr, Heid, Lehwald 2013; Felbermayr, Larch 2013). If problem areas (agriculture, culture, etc.) were taken out of the deal, most of the benefits could not be felt and the advantages would be significantly lower (CEPR 2013: 2). Disregarding the fact that none of the impact assessments is capable of grasping the implications entirely, and even less able to calculate with unexpected political and economic changes, not to mention unpredictability of the reactions of third countries, the case of the EU internal market – and experiences of other FTAs (Free Trade Agreements) – prove that less developed countries may loose with the liberalization and the opening up of markets. The case of Greece and other southern countries of the EU clearly prove that problems with FTAs and other integration initiatives can be numerous. Less developed countries of the European Union, or those that are not competitive enough, would not gain as much as is forecasted; what is more, the risk of losing is not negligible, especially if inappropriate economic policies are pursued. The prospect of gaining less or even sustaining losses by underdeveloped countries is in line with economic theories that do not believe in positive sum impacts of international economic liberalization.[7]

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[5] According to Commission calculations, between 1992 and 2008 an additional 2.13% GDP growth and 2.77 million jobs were created (European Commission 2012). It would be interesting to see how much more jobs and GDP was lost because of the deep integration among the countries. "The Single Market (...) is less popular than ever, while Europe needs it more than ever.... The Single Market is seen as 'yesterday's business' compared to other policy priorities." (Monti 2010: 6)

[6] The Cecchini Report calculated a potential wealth effect of 4.25-6.5% of GDP for the twelve member states in the Single Market. None of the ex-post assessments proves more than 2 percent, and "…an economic assessment of the Single Market…brings with it the conceptual difficulty of separating the impact of the Single Market not only from the consequences of globalization, but also from the introduction of the euro." (Vetter 2013: 3)

[7] This strategy proved successful for example in the US and Germany (when they were less developed than their trading partners), and much later in some of the emerging far Eastern regions. "In the first stage they must adopt free trade with the more advanced nations as a means of raising themselves from a state of barbarism and of making advances in agriculture. In the second stage they must resort to commercial restrictions to promote the growth of manufactures, fisheries, navigation, and foreign trade. In the last stage, after reaching the highest degree of wealth and power, they must gradually revert to the principle of free trade and of unrestricted competition in the home as well as in foreign

EU Members from CEE

The potential benefits of small, open economies that deeply integrated into the international division of labor, such as the “new EU members” that joined the EU in 2004, 2007, and 2013 are believed to be significant. Some of them have export openness indicators above the 75-80% range (export/GDP) and their import activities are also significant because of the high import intensity of their export production. This integration into the international division of labor and openness to trade explains why the calculations on the effects of TTIP indicate above average benefits for them. Apparently, they are interested in liberalization and trade facilitation that helps to further expand their exports. Increasing foreign sales are essentially important for their sustainable growth. Because of the small domestic market and the limited local purchasing power, if firms in these countries aim at increasing sales and creating more jobs, they simply have no alternatives to internationalization. Their exports are mostly based on the performance of FDI-related manufacturing and services firms, and they need to elaborate strategies that preserve and strengthen export orientation. (This should not mean the negligence of domestic demand factors – consumption and investment – but their primary role is to balance the growth pattern, rather than replace export orientation with domestic demand driven strategy, at least at the current level of economic development). The success of export-led growth strategy depends on several factors and there are a number of risks and challenges of such a strategy as well (Inotai 2013: 5). But the countries that implement strategies which attempt to disregard export orientation will soon face sustainability problems.

Because Central European countries cannot compete with really low wage countries from the Far East (though their wages are still low in international comparison), long-term sustainable strategies cannot avoid upgrading technological capabilities by attracting more FDI. If the conditions of doing business are improved, the rule of law is upheld, productivity is increased, they could count on increasing investment from US firms already before the TTIP enters into force (Hamilton 2013: 308). Increased FDI from US production and services firms is the most important source of possible benefit of the TTIP in the Central European member states. The realistic and sustainable economic strategy of these countries should focus on the further modernization of their export structure and the upgrading of technology. This, however, would require large investments in human and physical infrastructure and the improvement of the business environment. If these conditions are fulfilled, theoretically, TTIP would again open a window of opportunity for several countries to utilize the agreement for the purpose of accelerating economic growth.

An additional benefit may be related to investments made by third countries. Participation in integration initiatives influences transaction costs for third

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markets, so that their agriculturists, manufacturers, and merchants may be preserved from indolence and stimulated to retain the supremacy which they have acquired.” (List 1916: XX) countries that raise the question of production within the integration area or export there. Integration initiatives (even in their simplest form, i.e. free trade area) are creating incentives for third countries to invest within integrated areas in order to avoid trade-related costs. Theoretically, they can encourage firms – that may eventually want to export to the USA – to invest in Central Europe (Hamilton, Quinlan 2013: VI). An investment boom of this kind was evident prior to the EU accession of the Central European countries. The impact of FDI was largely tangible before the accession took place, not least because of the extra-EU investments (Bevan, Estrin 2004: 777). The volume of such investments would not be too large, but it is potentially reckoned with.

On the other hand, however, the risk of smaller than expected impacts is high, which makes the picture for "new members" and other peripheral EU countries a little more obscure (CEED 2013: 5). The problem is that in several countries the economy has a dual structure; a few large transnational firms are integrated into the international production chains, while the rest of the economy is unable to participate in international trade, because it lacks exportable, competitive products. In addition, not least because of the internal problems of the European Union and the increasing Russian influence in the region, the regional political commitment to liberal economic order and democracy is not at all guaranteed. And this is an increasingly serious issue in a region, where economic and political transformation was thought to firmly integrate countries into the system of western institutions and values. The changes in political and economic policy strategies may increase business risks in certain countries. All factors taken into consideration, benefits for the less developed Central European countries in terms of export, FDI and GDP growth is probably larger than the disadvantages (CEPA 2013: 6). It is explained by their pattern of division of labor that is based on export orientation of foreign owned firms. All these favorable impacts, however, can be utilized only if the business environment is favorable enough. There is, however a substantial risk that policies in the region may become inward looking and more protectionist. This risk is strengthened by the weak performance of the European economy and the unfulfilled expectations of the EU membership in terms of catching up.

The choice of economic and political models of Central European governments may be influenced by the economic performance of advanced and emerging countries. There is a danger that regional governments and politicians see the EU as a weak economic center whose economic and political model is inadequate to respond to current and future global challenges. The increasing skepticism may lead to the conclusion that, instead of the European model, they should follow potentially more successful strategies. Anti-EU economic and political strategies in the countries shattered by economic difficulties, characterized by relatively poor economic outlook, and declining standards of living, however, are on the increase. Developments over the past few years could easily lead to the introduction of measures that are shockingly different from European traditions and that would probably weaken the ties that have developed over the past more than two decades. Economic integration can be considered "too deep" because the original objective of economic and political transformation has not been achieved[8] and, instead of convergence on the living standards of more developed countries, a more complicated balance has been experienced. The situation could easily worsen. Tempted by the almost unlimited power of leaders in some post-Soviet countries, democratic systems could morph into something "new", into very destructive, obsolete structures in which country identity is defined in opposition to the European development model. If that happens, the possible favorable implications of TTIP will not be felt in the affected countries.

Russia

The original idea that the TTIP agreement can be beneficial for each country in the long run relies on the presumption that "the economic importance of the EU and the US will mean that their partners will also have an incentive to move towards the new transatlantic standards" (European Commission 2013). In other worlds, third countries would face such immense losses that it would be their very interest to join the TTIP. This is an overly optimistic forecast of the prospective developments. Turning to the third countries in Central and Eastern Europe, the key question is Russia, which would definitely take the TTIP for what it really means for this country – a geopolitical aspiration that may threaten Russia's positions in Europe. The important political objective behind the TTIP is that this large-scale bilateral agreement increases the incentives of third parties to achieve further liberalization steps at the multilateral level. This way the TTIP (the advanced countries) becomes a rule setter in international trade for third countries. It would lead the EU and the USA to regain a leading position in international trade and economic development. This expectation is realistic only if third countries feel that it is in their interest to accept the rules elaborated by developed economies. This situation would be similar to the decades preceding the economic rise of large emerging countries, when developing or less developed countries were not able to defend their interests against the advanced countries in international economic organizations. This is also the fundamental issue concerning countries such as China, Russia, India and Brazil or other large emerging markets.

None of the scenarios in the existing analyses calculate openly with potential counter steps taken by third countries. A more realistic approach is to count with three scenarios: (1) large emerging countries may think that they will not lose too much if the agreement finally remains limited in scope; (2) the TTIP may be a strong incentive for new agreements and instruments within the framework of WTO negotiations with the objective of reducing the negative implications; (3) third countries will increasingly look for countermeasures. The first two alternatives are clearly far more beneficial for the advanced world. Regarding the third choice, this would result in the intensification of creating trade blocks (that

[8] The argument of too deep integration is not only a way of thinking of Central Europe, but similar dilemmas are worded in more developed EU members too.

may lead to the increasing disruption of global trade) and/or instruments which make export and investment from advanced countries more difficult. In addition, more concerted efforts and steps from large emerging countries cannot be ruled out if international economic relations are aggravated. Closer cooperation between large emerging countries regarding international trade would suffice to establish a common ground for asserting similar interests. Should that eventuate, it will probably disrupt global trade and its currently existing institutional system.

Russia has been able to strengthen its position in international relations and become strong enough to try to regain and increase its influence in some parts of the CIS (Commonwealth of Independent States). Russia's efforts to reintegrate a part of the CIS will continue and strengthen as a number one priority in its foreign policy. Regarding economic issues, Russia is becoming an increasingly important player in the eastern part of Europe and in Asia (Berman 2013). In recent years, the country has become one of the most important capital investors in the world, mostly through state-owned enterprises, though obviously not independently from politics, and it has become the number one investor in the East European region (UNCTAD 2013: 8; 13). In the coming years its efforts to be involved in European business will most likely further strengthen. In addition to achieving economic penetration, it is also more and more in its interest to stop the spread of Western-style democracy, perhaps even in countries where it seemed to be solidly rooted. [9]

In addition to geopolitical considerations, the most important issue for Russia relates to the energy sector. If TTIP eases access to US gas, it will benefit both European consumers and the industry. (On the other hand, the cheap gas exports to Europe would erode the competitive advantage of US firms over European competitors.) At the same time, this new source of natural gas would substantially diminish the Europe's dependence on Russian gas, which is disadvantageous to Russia from macroeconomic and geopolitical perspectives. As European demand decreases, Russia will be increasingly forced to reorient its energy exports to other markets, and gain influence mostly through investments in the European energy and financial sectors. There are clear signs that Russia seeks to put its hand on as much European assets as possible. The biggest opportunity for Russia to do that is in the Central European region with which it can partly substitute its losses in natural gas exports provided that US gas is imported more easily. In addition, Russia can restrict its imports from Europe in response, since this country uses trade policy as a political tool, despite its recent WTO membership. If Russia considers that its loss is too big in Europe and it is not possible to regain a share of it in other parts of the globe, then it can use its imports from Europe as a bargaining power.

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[9] See for example the citation from an interview with Francis Fukuyama: "I think that's right, that Russia doesn't have an interest in having a healthy democracy on its borders because that's going to give the wrong signals to its own people. So I think it's probably right that Russia would prefer to have other authoritarian neighbors around it." (Fukuyama 2013)

To sum up, energy is a sensitive issue for the Russian economy and the danger of worsening Russian positions in the European market may cause Russia to control as many countries as it is possible through oil, gas, nuclear power generation or financial sector investments. The TTIP could be an important element in the changes of the global energy landscape. After the conclusion of the TTIP, sooner or later US natural gas exports will definitely and significantly increase. It could have serious geopolitical implications for Europe's own relationship with Russia.

Table 1
Geographical pattern of Russian merchandise trade
(% of total export or import)

	Export			Import	
	2005	2012		2005	2012
Total	100.00	100.00	Total	100.00	100.00
EU	53.63	48.96	EU	42.79	40.34
Germany	8.17	6.79	Germany	13.45	12.11
Netherlands	10.19	14.63	Italy	4.47	4.24
Italy	7.89	6.18	France	3.72	4.36
CEE6*	10.59	8,41	CEE6*	5.91	6.98
CIS	13.51	14.94	CIS	19.24	13.77
China	5.40	6.81	China	7,36	16,39
USA	2.62	2.47	USA	4,62	4,85
Rest of the	24.84	26.82	Rest of the	25.99	24.65

Source: Own calculation, Central Bank of Russia
*Bulgaria, Czech Republic, Hungary, Poland, Slovakia, Romania

Table 2
Russia' trade with the EU by SITC section 2012 (% of total export or import)

		Export	Import
0	Food and live animals	0.6	6.7
1	Beverages and tobacco	0.0	1.3
2	Crude materials, inedible, except	0.9	1.4
3	Mineral fuels, lubricants and related	76.3	1.1
4	Animal and vegetable oils, fats and	0.2	0.4
5	Chemicals and related products,	3.0	15.8
6	Manufactured goods classified	6.4	10.3
7	Machinery and transport equipment	0.9	49.6
8	Miscellaneous manufactured articles	0.2	11.9
9	Commodities and transactions n.e.c	2.8	0.8

Source: European Commission, Directorate-General for Trade

Conclusion

Impacts of the TTIP on Central and Eastern Europe depend on the details of the final agreement. There are three scenarios; each has very different implications both for members and third countries.

(1) Since the aim of the TTIP is political, the discussion will concentrate on regulations and standards (trade, consumer safety, environment, etc.), but because of the conflicts between the EU and the US concerning the underlying principles, without achieving sizeable results.

(2) The TTIP breaks away with international trade because it leads to new standards that are protectionist against third countries such as China, India, Russia, etc. Global trade becomes fragmented with intensifying role of regional blocks.

(3) The third alternative is an open TTIP that encourages third countries to join. As a result, the TTIP would become the core of a new global trading system where the rule setters are once again the most advanced economies.

It is impossible to see today which of these alternatives will become a reality. If it develops into a deep, comprehensive agreement, the impacts will be far bigger. In this case Central European member countries of the EU would theoretically gain a lot due to their integration into the division of labor mostly through transnational firms at different levels of their supplier chain. Had the governments of these countries pursued outward looking economic policies and improved business environment, this would attract additional foreign direct investments from mostly US firms, but an increase in investment from third countries can also not be ruled out entirely. However, the risk of inward looking policies in this region is intensifying, which would render the utilization of opportunities even more difficult.

Regarding third countries from the region, the strategy Russia chooses to adopt seems to be the most important. The negative implications of a deep TTIP would be intense. The first impact would be related to trade diversion in the short run. The long term implication is, however, much more serious and relates to Russian energy exports that make up around 75% of Russian sales to the EU. As the TTIP would improve the market access of US energy to Europe, Russian energy exports would be seriously hit. To counterbalance these negative implications, in addition to export reorientation towards other countries, this country may want to increase its influence in other sectors through investments into European assets. In an extreme case, the TTIP may trigger stronger cooperation among large emerging countries to formulate concerted efforts to neutralize negative consequences of the agreement.

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