

Regulatory Diversion and Third Country Effects from Regional Agreements

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Overview

- The New Regionalism
 - Drivers
 - Expanded cope for third country effects
- NTM levels and scope for reduction in megadeals
 - Discrimination
 - Ambition
- TTIP-based examples: why discriminatory or non-discriminatory approaches to NTMs matter

The New Regionalism

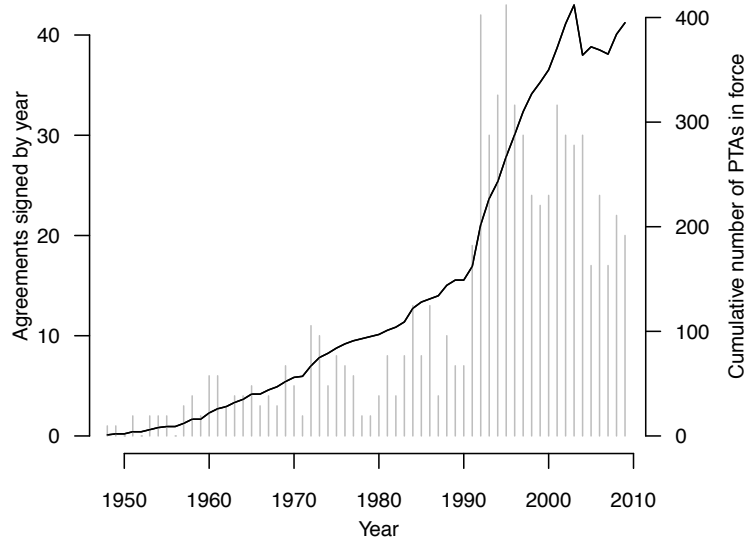
The New Regionalism

- Regional production networks and cross-border trade in parts and components (now almost 80% of world trade is intermediates)
- MNEs operating in multiple regulatory regimes
- Demand for progress in areas outside WTO (hence Baldwin's call for WTO 2.0)
 - Regulation of MNEs
 - Behind the border measures
 - Increased importance of NTMs (aka NTBs), and impact on policy calculus (political cost-benefit analysis)
 - Trade-related IP issues (overlap with competition)

Coverage of Regional Agreements

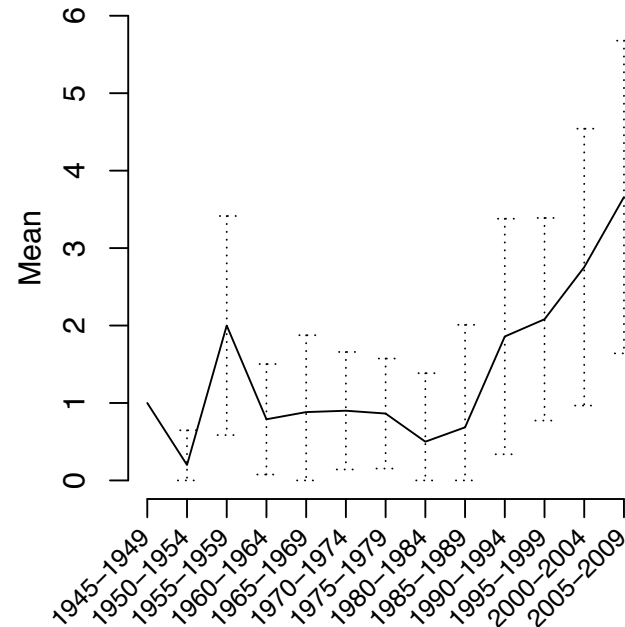
There is a trend toward deeper preferential agreements (DESTA)

Figure 1a: PTAs over time



Source: Dür et al (2014)

Figure 1b: Depth of FTAs over time



Depth indexed 0-7. Source Dür et al (2014).
Vertical bars indicate standard deviations.

DESTA scores FTA depth based on the structural elements of agreements. source: Dür, Baccini, Elsig (2014)

Coverage of Regional Agreements

Summary of trade and PTA depth

Depth of FTA	dyad count	trade million USD
1	162	383,618
2	666	1,067,643
3	289	376,583
4	322	227,156
5	223	500,067
6	149	178,809
7	680	3,882,378
total FTA pairs	2,491	6,616,254
non FTA paris	9,706	7,022,810
total	12,197	13,639,065

DESTA scores FTA depth based on the structural elements of agreements. source: Dür, Baccini, Elsig (2014)

Value added and value chains

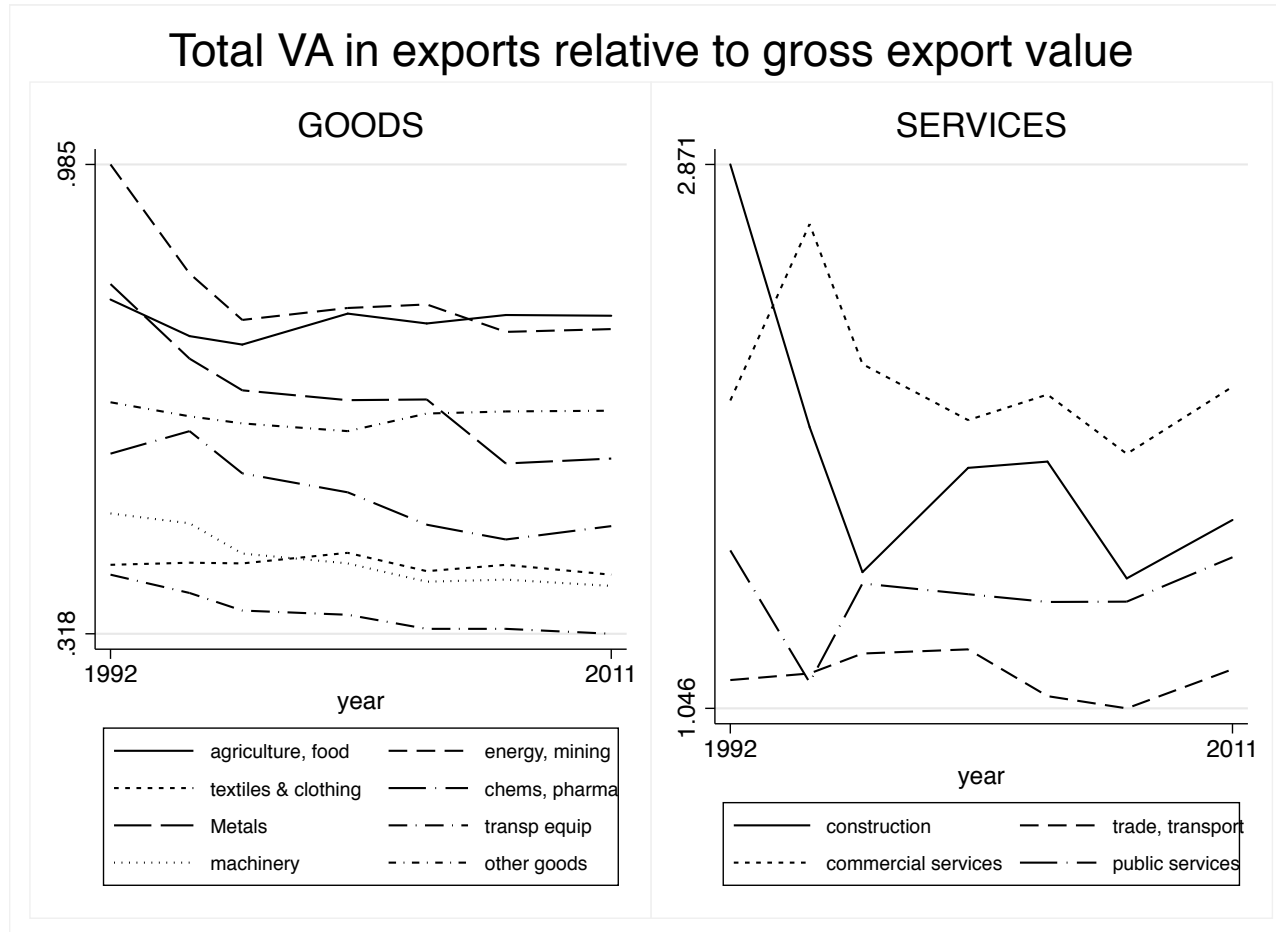
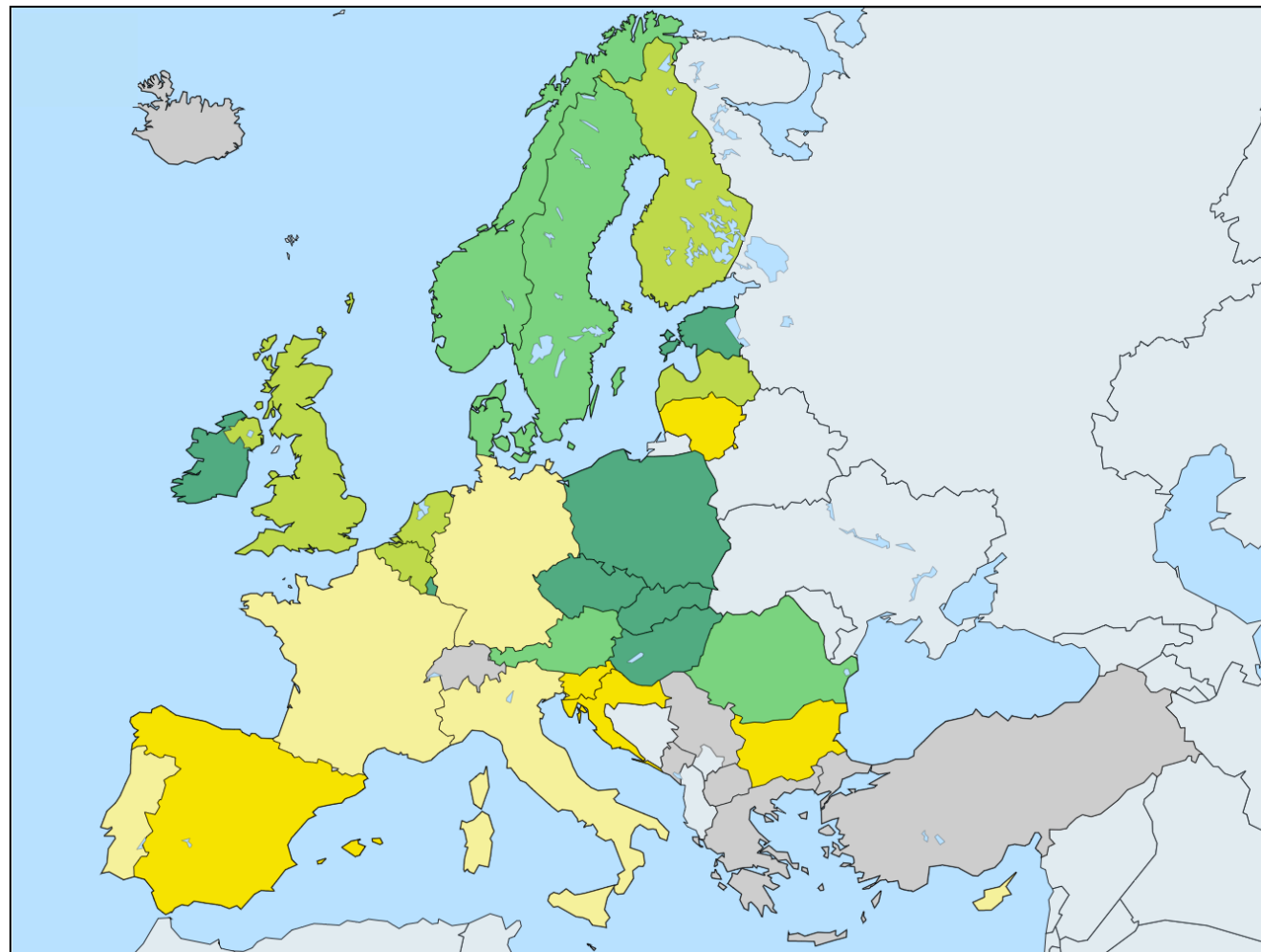


Figure 1: Value added (VA) and the gross value of trade
 Source: Francois, Manchin, and Tomberger (2015)

Production and firms are also linked across the Atlantic

Employment in foreign controlled enterprises as a share of total domestic employment

Foreign affiliate statistics (fats) deal with enterprises that control enterprises abroad



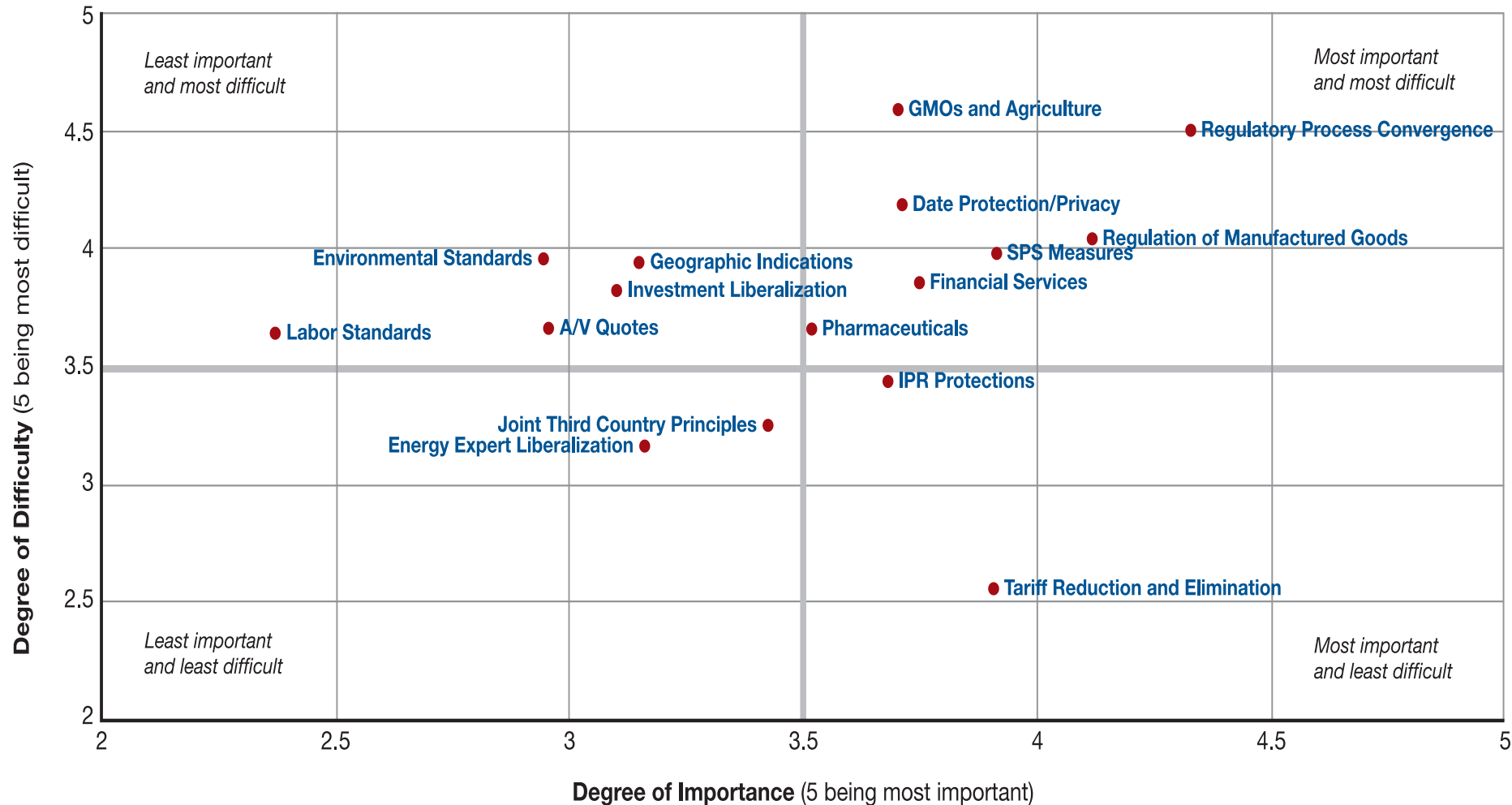
2.8% of EU employment, 6 million jobs, are in US controlled firms. Another 3.7 million produce for exports to the US (counting indirect and direct jobs). 15% overall work for foreign controlled firms.

Data for 2011

Legend	Cases
5.28 to 10.85	5
10.85 to 14.68	5
14.68 to 18.67	5
18.67 to 22.29	5
22.29 to 39.96	7
Data not available	9

The new trade agenda

Potential Sticking Points

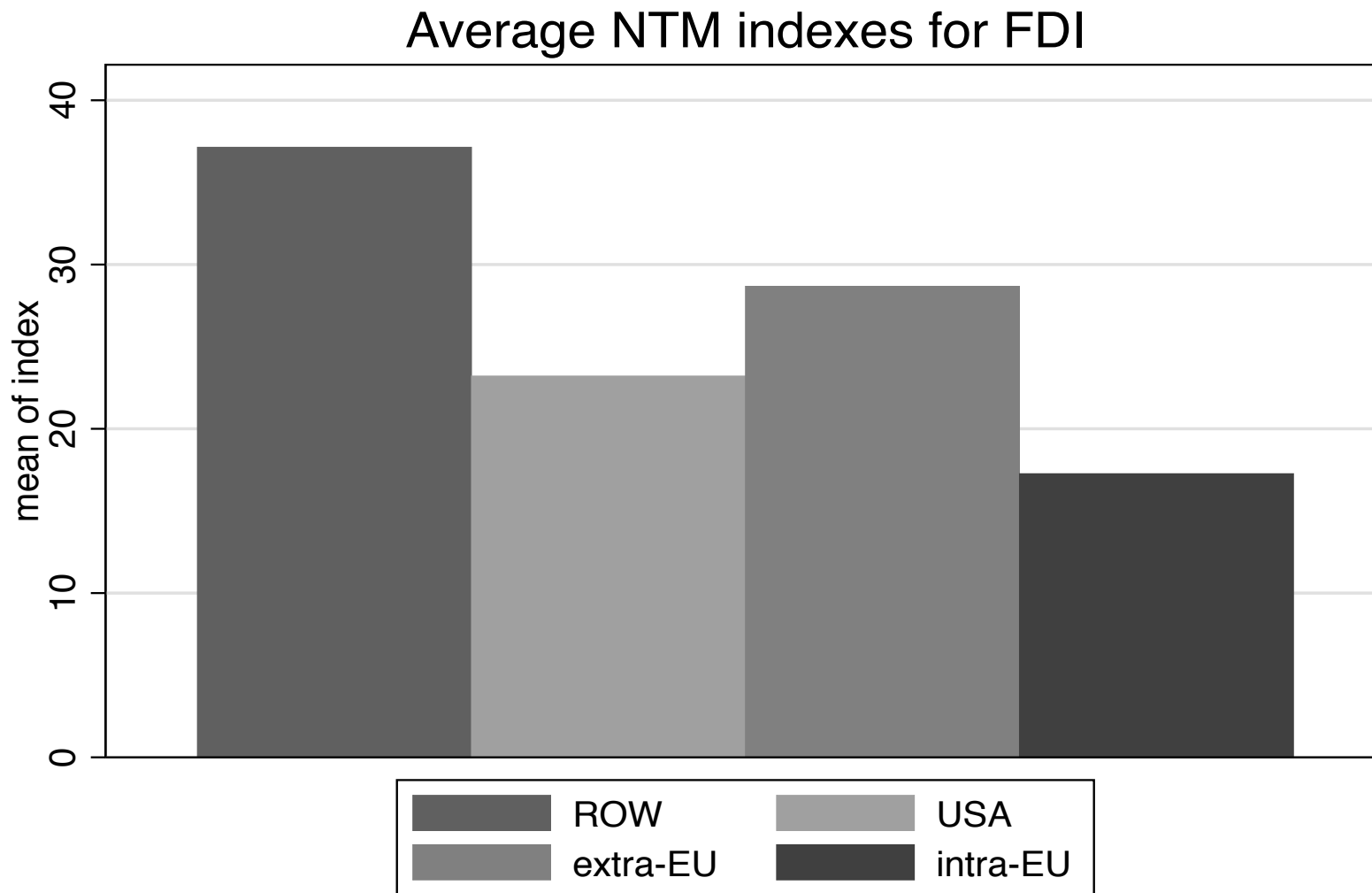


Source: Stakeholder survey, Atlantic Council and Bertelsmann Foundation (2013).
Sticking points: GMOs, data protection, regulatory convergence.

Benchmarking barriers: non-tariff barriers

- Example: Ecorys (2009) study represented a concerted effort to triangulate barriers
 - Firm surveys – including overall rankings and detailed barriers
 - Industry, legal, regulatory experts
 - Econometrics, fed into CGE modeling
- Some basic findings
 - The origin of barriers is not always deliberate. Legitimate goals can be reached in different ways. This in turn can lead to regulatory divergence. Examples include regulation of chemicals and motor vehicles.
 - Not all regulatory barriers can actually be negotiated and reduced. For example, the Japanese require legal documents in Japanese. This concept is called actionability.
 - Barriers can be grouped broadly into those are cost raising barriers, and those that instead are rent generating barriers (i.e. they generate rents by limiting competition and market access).
 - Semantics matter: NTBs and NTMs.

Benchmarking barriers: investment barriers



source: NTB survey data.

Evidence of EU preferences linked to regulatory convergence

NTB indexes	Europe		United States		third country average
	intra-EEA	extra-EEA	intra-NAFTA	extra-NAFTA	
ISIC 27,28 metals	13.33	29.68	*	36.83	31.23
ISIC 17-19 textiles, clothing	30.94	49.92	22.00	44.45	44.71
ISIC 20 wood products	22.61	45.64	*	26.63	49.75
ISIC 21,22 paper, pulp printing	22.61	45.64	*	26.63	49.75
ISIC 24,25 chemicals	21.54	53.66	31.00	47.67	48.98
ISIC 30, 32 office machinery (electronics)	15.40	31.17	*	36.29	46.70
ISIC 29,31,33 other machinery	14.79	42.21	*	38.19	40.63
ISIC 34 motor vehicles	16.27	36.76	*	36.49	51.92
ISIC 35 other transport equipment	33.43	54.73	35.00	64.63	50.43

Services barriers: smoke and mirrors

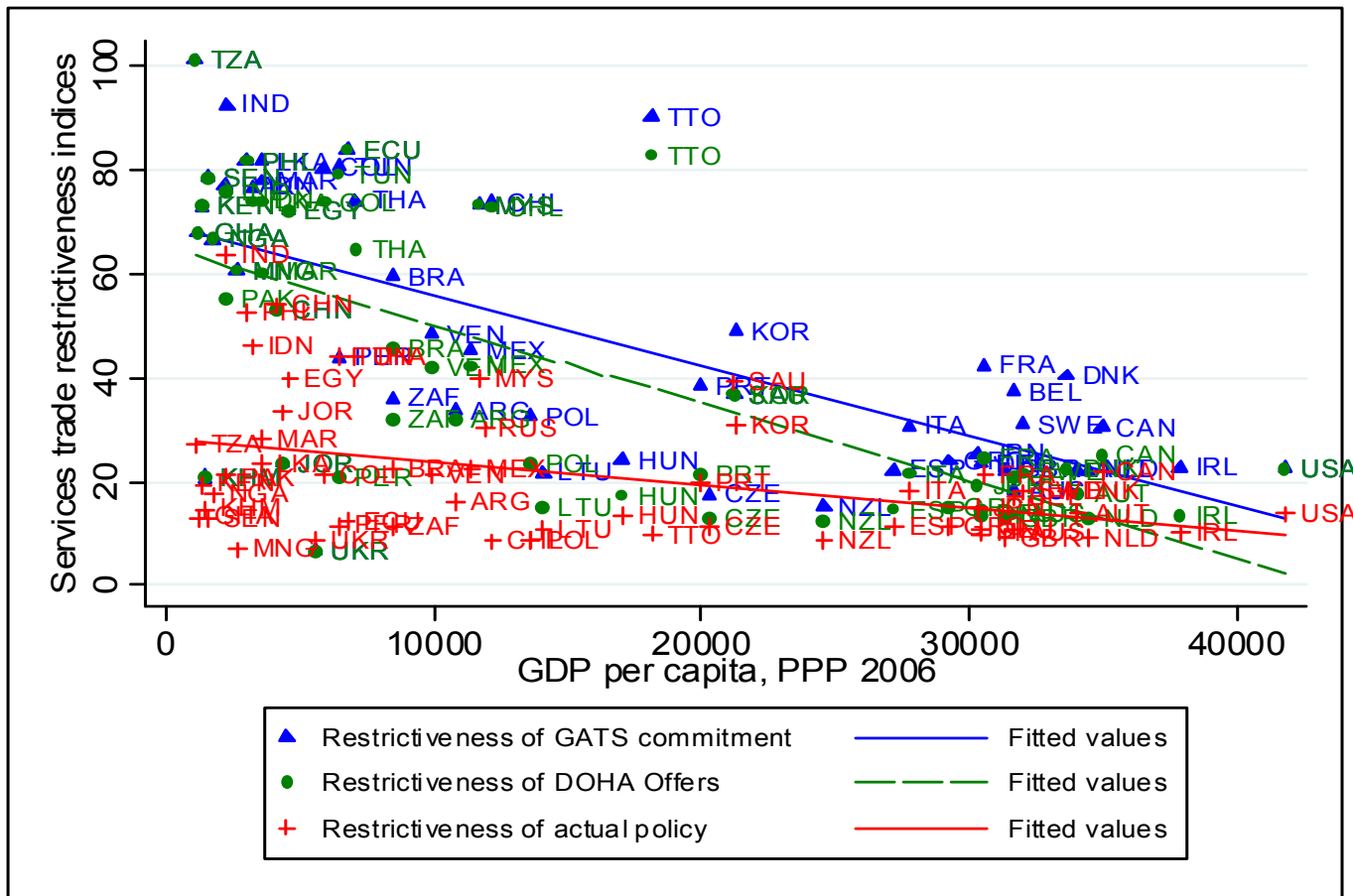


Figure illustrates the gap between market access bindings and actual access.

source: Borchert, Ingo; Batshur Gootiiz and Aaditya Mattoo (2011)

Diminished Expectations for Services?

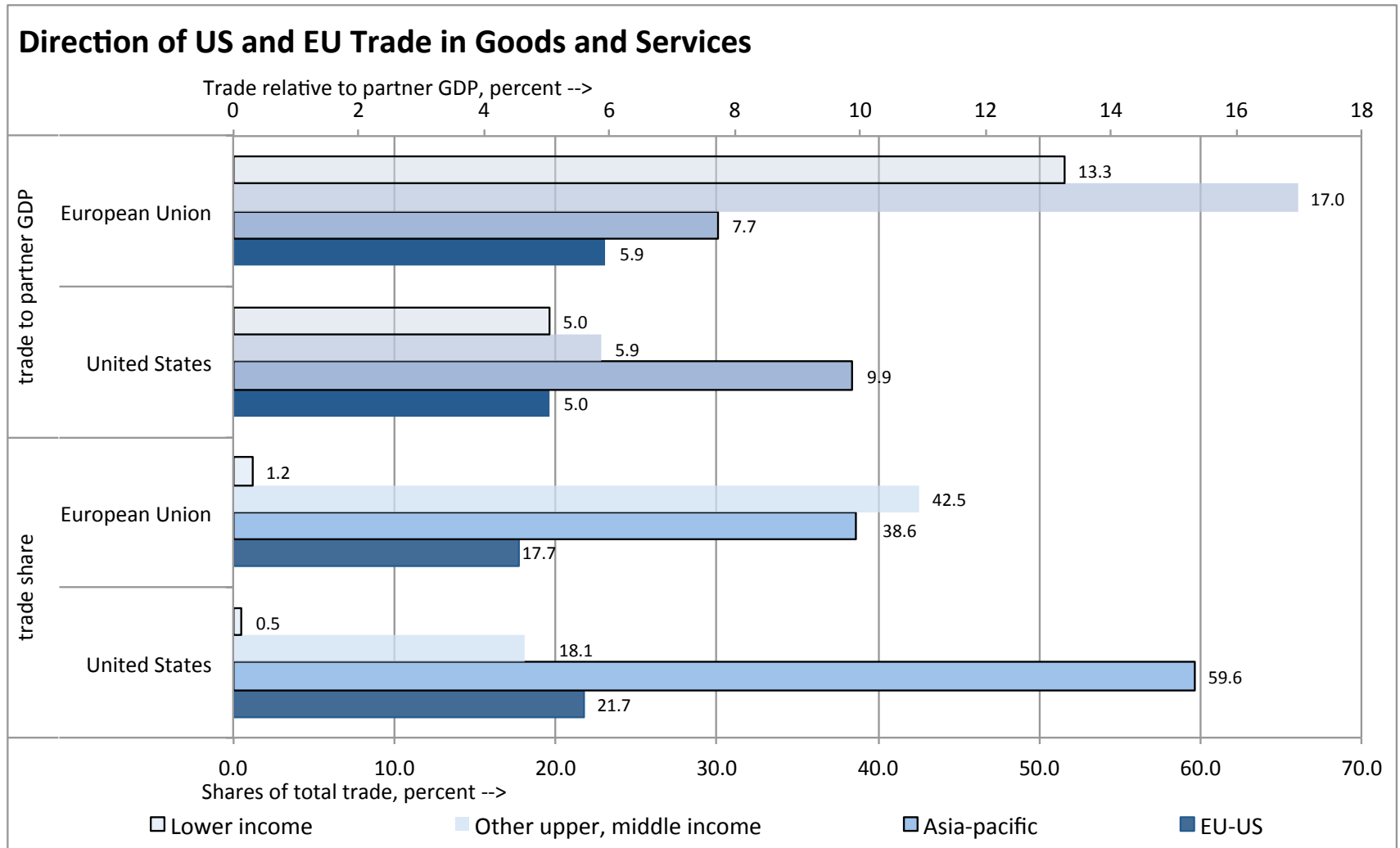
	A	B	C	D	E
	AVEs of current policies		GATS, and best RTA		Share of bilateral trade
	EU	US	EU	US	
SERVICES	12.79	12.94	55.3, 64.4	55.4, 55.4	29.4
Construction	na	na	70.8, 83.3	83.3, 83.3	0.4
Air transport	25.00	11.00	66.3, 72.5	5.0, 28.8	3.1
Maritime	1.71	13.00	47.6, 63.1	0.0, 44	0.1
Other Transport	29.73	0.00	57.1, 71.4	42.9, 64.3	3.1
Distribution	1.40	0.00	71.9, 87.5	100, 100	1.0
Communications	1.10	3.50	75.0, 78.1	78.3, 78.3	1.1
Banking	1.45	17.00	42.7, 42.7	29.2, 33.3	5.0
Insurance	6.55	17.00	57.5, 57.5	40.0, 50.0	2.7
Professional and business	35.43	42.00	58.8, 62.5	57.5, 62.5	8.1
Personal, recreational	na	na	47.6, 50.9	91.5, 91.5	1.3
Public services	na	na	32.5, 36.7	19.2, 31.7	3.5

CAVEAT: RTA based services liberalisation is not seen "in the wild".

Regulatory Trade Diversion and Spillovers (with a T-TIP example)

THIRD COUNTRY CHALLENGES:

Approach to regulatory convergence will be



Underlying Trade Costs

Sector	Total trade barriers: EU barriers against US exports	Total trade barriers: US barriers against EU exports
Food and beverages	56.8	73.3
Chemicals	13.6	19.1
Electrical machinery	12.8	14.7
Motor vehicles	25.5	26.8
Other transport equipment	18.8	19.1
Metals and metal products	11.9	17.0
Wood and paper products	11.3	7.7
Other manufactures	N/A	N/A
<i>average goods</i>	21.5	25.4
Transport		
Air	2.0	2.0
Water	8.0	8.0
Finance	11.3	31.7
Insurance	10.8	19.1
Business and ICT	14.9	3.9
Communications	11.7	1.7
Construction	4.6	2.5
Personal, cultural, other services	4.4	2.5
<i>average services</i>	8.5	8.9

Source: ECORYS (2009), Annex Table III.1

Some Analytical Considerations with NTBs

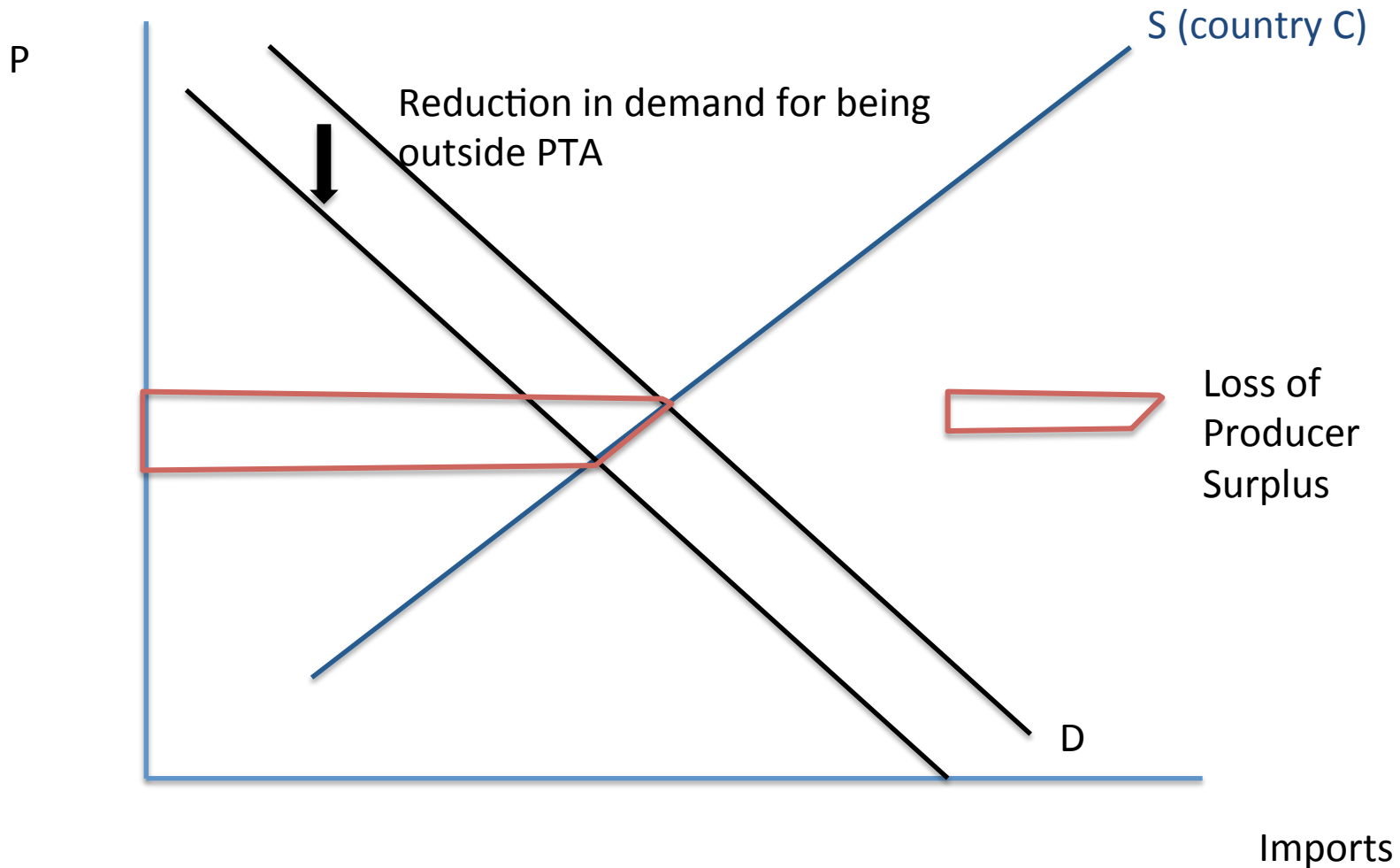
STANDARD ISSUES

- Large countries imply terms of trade effects as well as volume effects
- With imperfect substitutes (so buying from “high cost” countries) spillovers may then matter

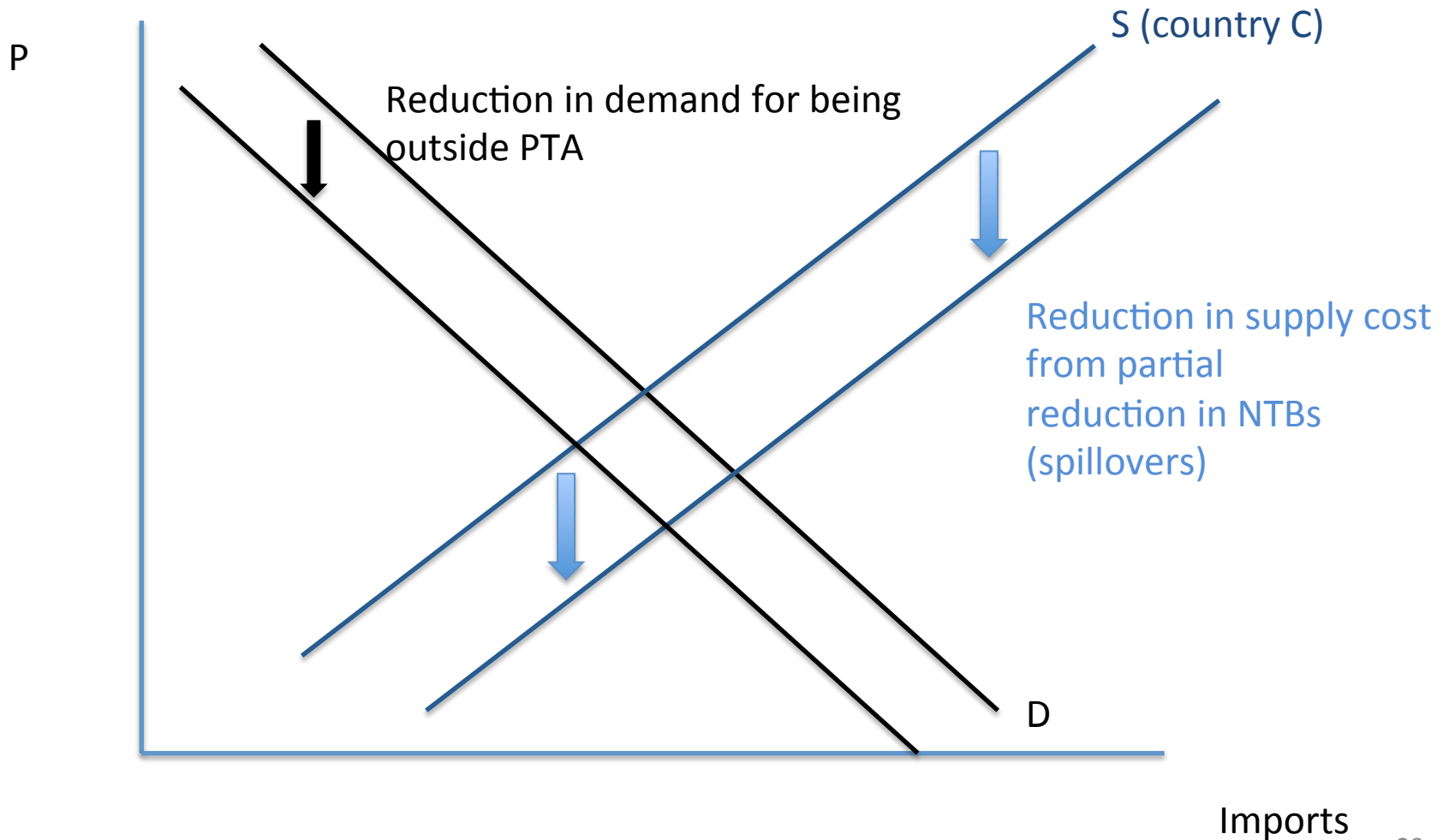
NEW ISSUES

- Who gets the cost savings?
- Who gets the rent savings (as in loss of quota rents)?
- Do regulatory changes also affect domestic firms (e.g. EU-Japan)
- ➔ To answer this, we typically to turn to numerical models with data on production, trade, etc.
- ➔ In such models, cost savings are usually shared (depending on shares in production, consumption, etc)

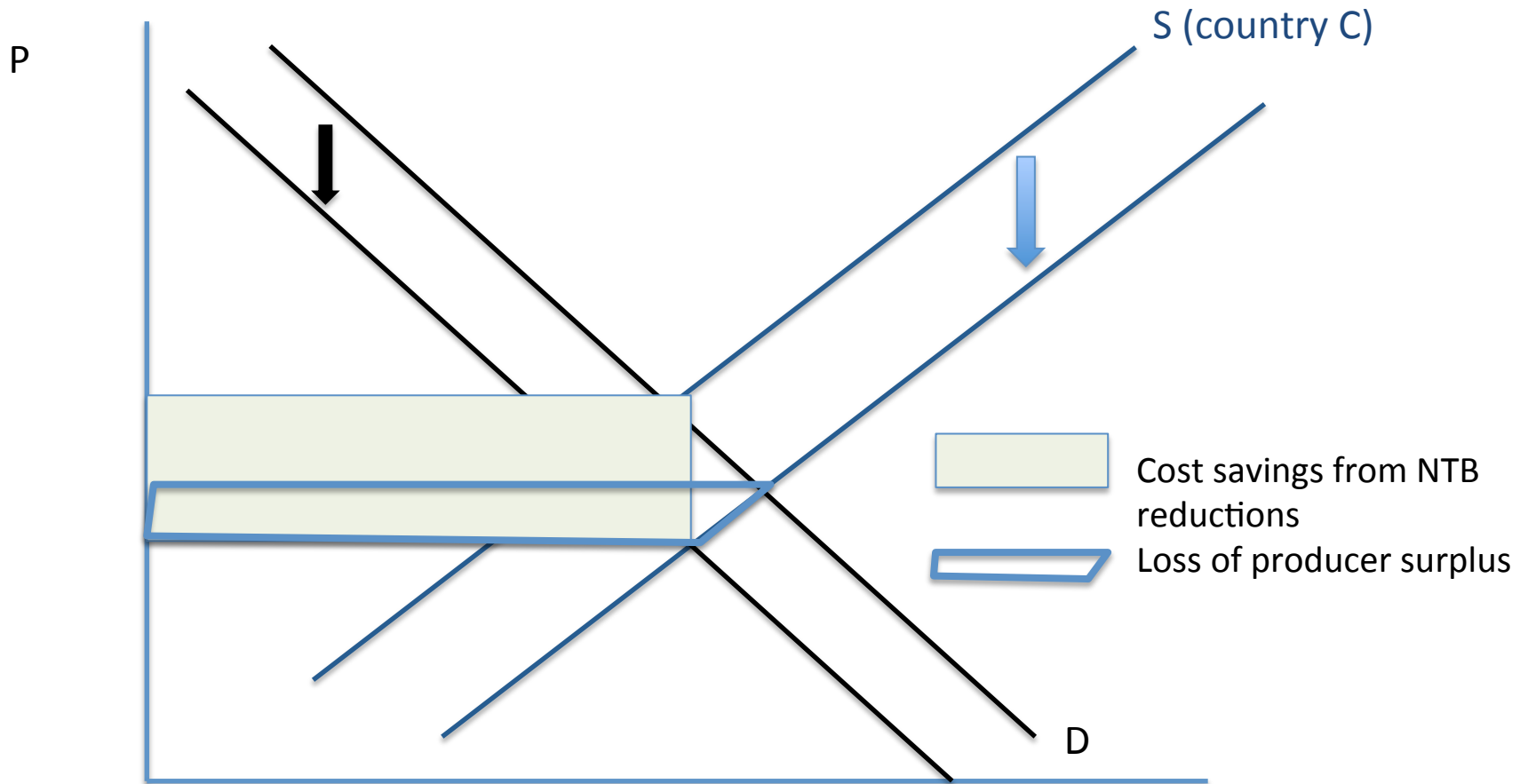
Traditional FTA: FTA between countries A,B Third country C is left out



NTB reductions: FTA between countries A,B Third country C is left out



NTB reductions: FTA between countries A,B Third country C is left out



Some examples (TTIP assessments on EU, US, and third countries)

- Swiss example:
 - outside TTIP
 - deep integration with EU
 - possible policy responses
- Broader example of third countries
- Illustration of “Docking Clause” implications

Basic CGE Modelling of TTIP

- Reduction in NTBs based on econometric estimates
- Breakdown in
 - tariffs
 - goods NTBs
 - services NTBs
- Spillovers (defined as 10% of direct NTB reductions)
 - without spillovers
 - with spillovers
- Does NOT include 3rd country spillovers (idea of regulatory hegemony).

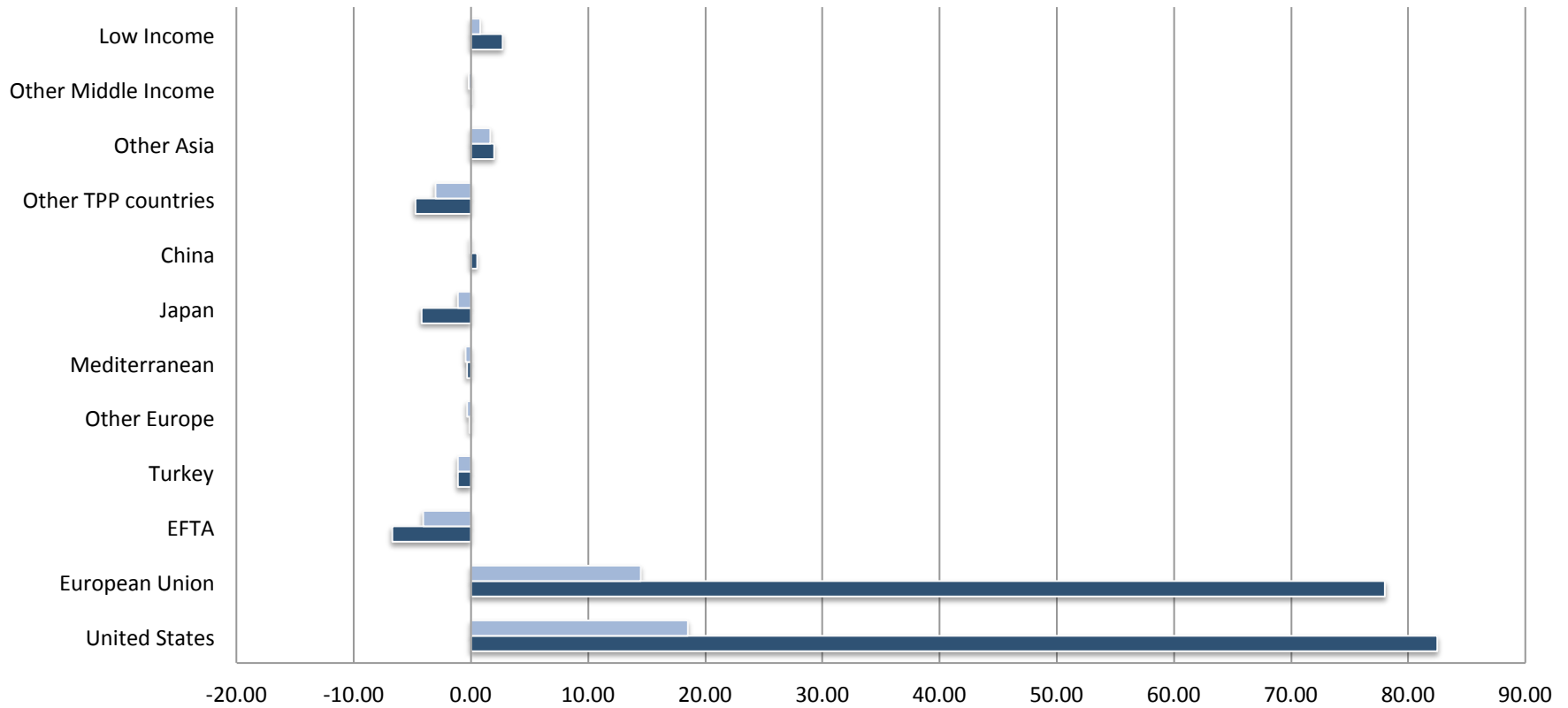
The Model(s)

- Benchmarked to 2011
- Based on GTAP database
- 20 sectors, multiple regions
- Tariffs and NTBs
- NTBs a mix of rent and cost generating NTBs
- Spillovers modelled as a share of direct liberalization

References: CEPR (2013), WTI (2014), Egger et al (2015)

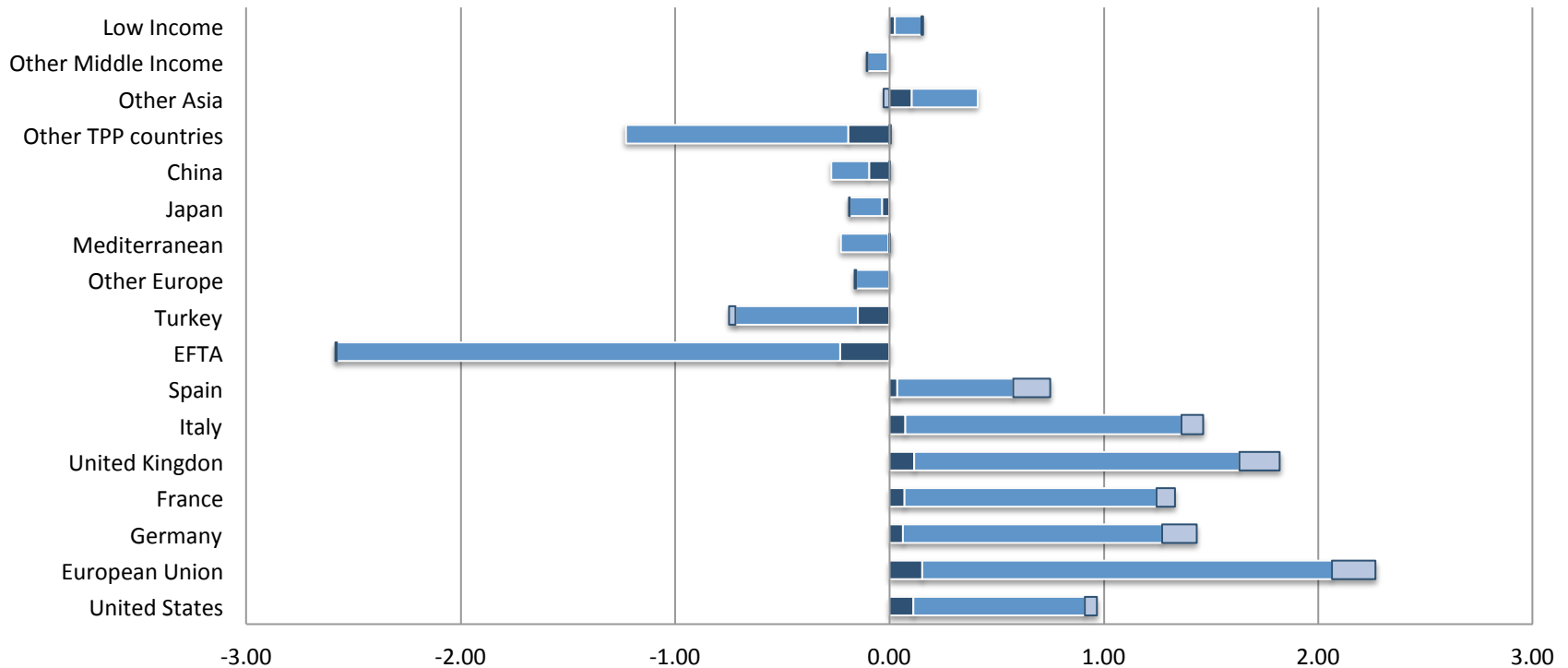
GTAP: www.gtap.org

% change in exports to EU,US and in total



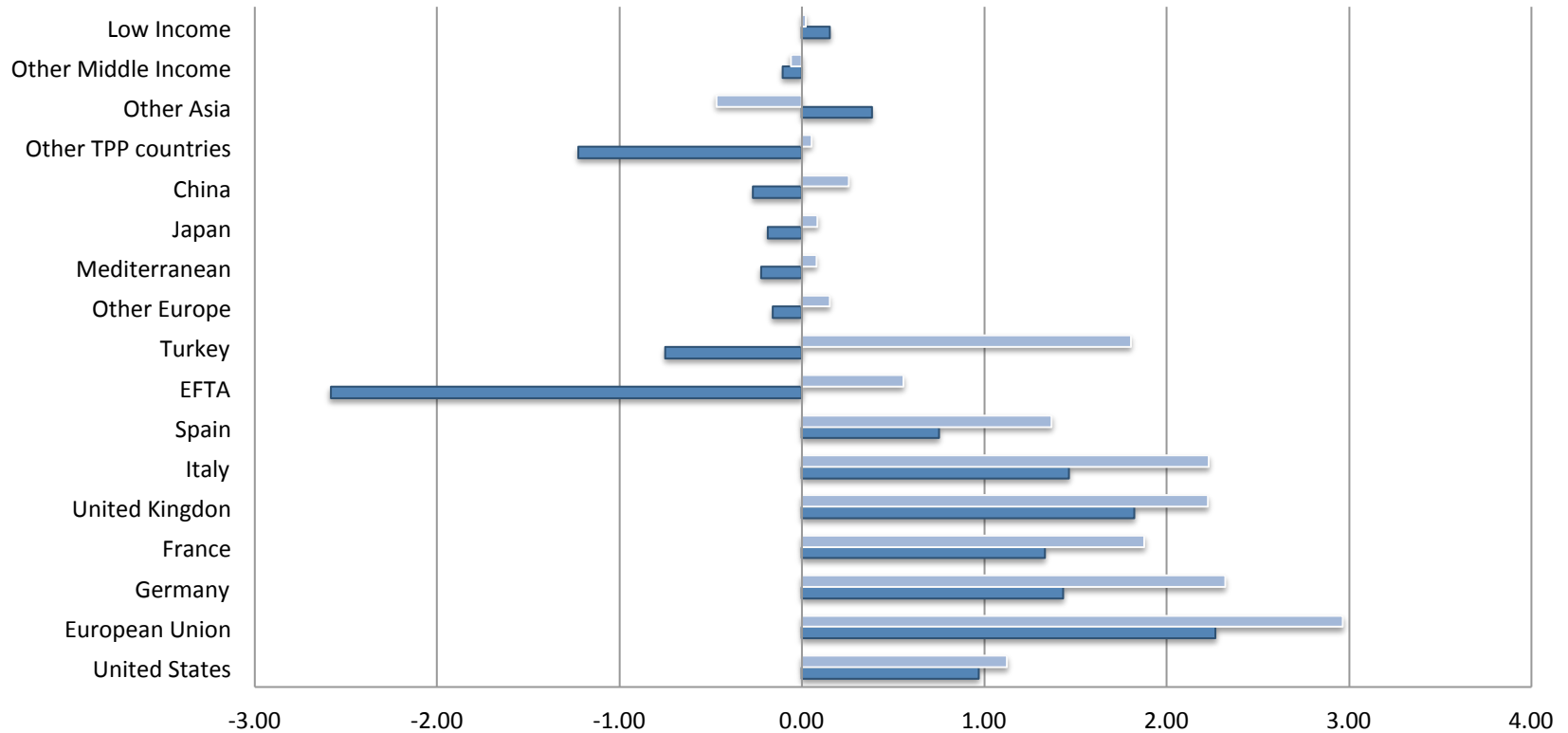
	United States	European Union	EFTA	Turkey	Other Europe	Mediterranean	Japan	China	Other TPP countries	Other Asia	Other Middle Income	Low Income
■ total exports	18.49	14.47	-4.07	-1.12	-0.32	-0.45	-1.14	-0.06	-3.01	1.66	-0.21	0.78
■ exports to EU,US	82.45	78.00	-6.72	-1.13	-0.15	-0.36	-4.24	0.50	-4.77	2.00	0.05	2.71

% change in annual GDP level, with regulatory discrimination



	United States	European Union	Germany	France	United Kingdom	Italy	Spain	EFTA	Turkey	Other Europe	Mediterranean	Japan	China	Other TPP countries	Other Asia	Other Middle Income	Low Income
■ tariffs	0.11	0.15	0.06	0.07	0.12	0.07	0.04	-0.23	-0.15	0.00	-0.01	-0.03	-0.10	-0.19	0.10	-0.01	0.02
■ NTBs goods	0.80	1.91	1.21	1.18	1.51	1.29	0.54	-2.34	-0.57	-0.15	-0.22	-0.15	-0.17	-1.04	0.31	-0.09	0.12
■ NTBs services	0.06	0.20	0.16	0.08	0.19	0.10	0.17	-0.01	-0.03	-0.01	0.00	0.00	0.00	0.01	-0.03	0.00	0.01

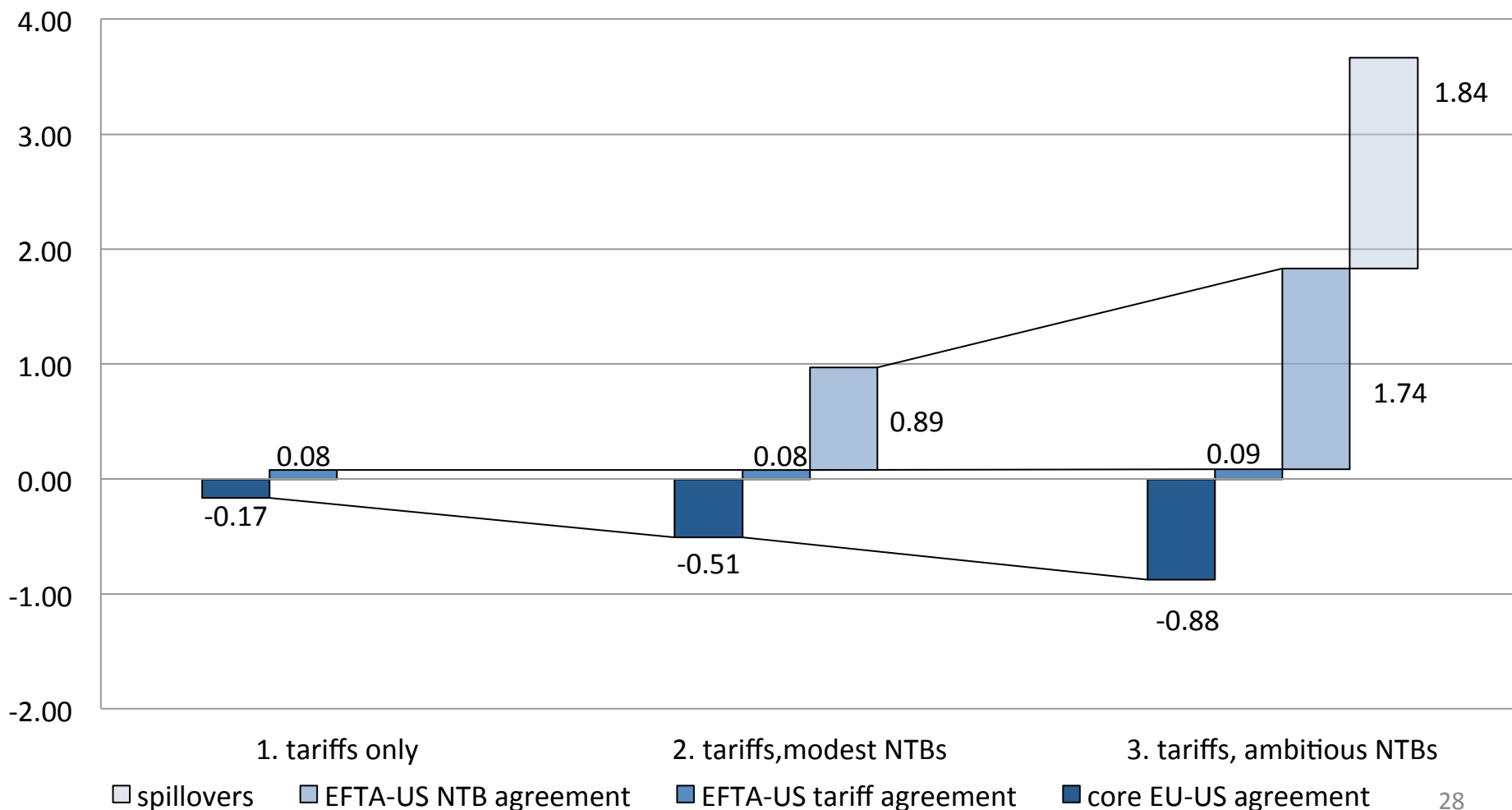
% change in annual GDP level, with and without pure discrimination



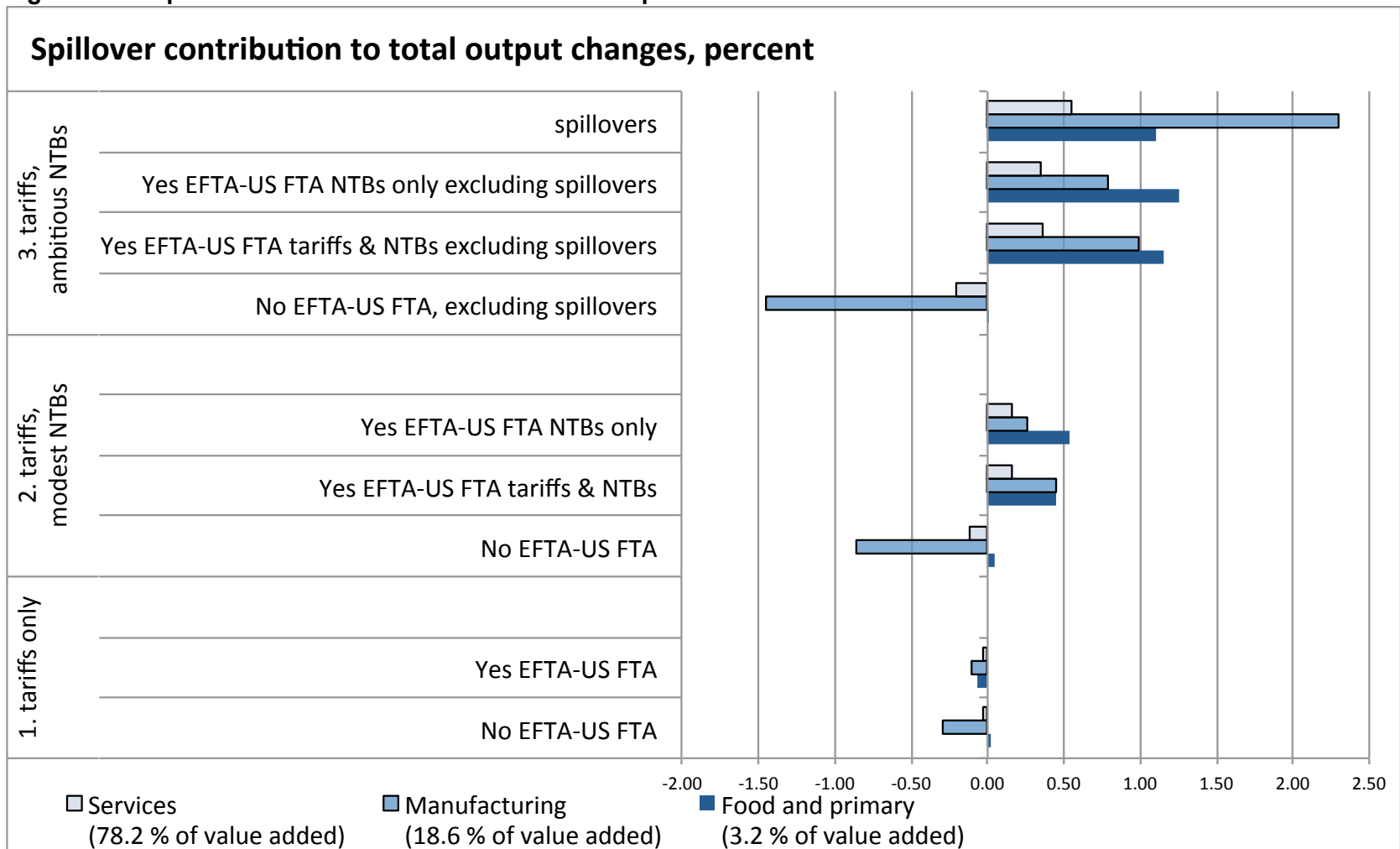
	United States	European Union	Germany	France	United Kingdom	Italy	Spain	EFTA	Turkey	Other Europe	Mediterranean	Japan	China	Other TPP countries	Other Asia	Other Middle Income	Low Income
with spillovers	1.13	2.97	2.32	1.88	2.22	2.23	1.37	0.56	1.80	0.15	0.08	0.09	0.26	0.05	-0.47	-0.06	0.02
with diversion	0.97	2.27	1.43	1.33	1.82	1.46	0.75	-2.58	-0.75	-0.16	-0.23	-0.19	-0.27	-1.23	0.38	-0.11	0.15

SWITZERLAND- THIRD COUNTRY CHALLENGES: Approach to regulatory convergence will be important (will it be discriminatory?)

Decomposition of Change in Swiss GDP, percent



SWITZERLAND - THIRD COUNTRY CHALLENGES: Approach to regulatory convergence will be important -- (will it be discriminatory?)



Systemic Challenges

- Potential for third country harm is not trivial
- We may expect to see WTO challenges (Brazil tires case)
- Will these deals have a “docking clause”?
- Will these deals lead to expanded structure for the WTO
- Is there scope to integrate the DSB in some way?