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Fakten für eine faire Arbeitswelt.

Comments on the claimed benefits of TTIP

TTIP Debat, Copenhagen, 26.9.2014

Sabine Stephan, Macroeconomic Policy Institute

Outline

- Purpose and limitations of modelling exercises
- Model simulation: Long-run vs. short run effects
- Growth and employment effects derived from very different models:
 - CEPR study → EU Commission
 - ifo/BMWi study → German Federal Ministry for Economic Affairs
 - ifo/Bertelsmann study → Bertelsmann Foundation

Why modelling exercises?

- Modelling exercises are meant to estimate the effects of a policy change.
- here: effects of a transatlantic free trade agreement (FTA) on the EU and US economies
- Since the outcome of the negotiations is unknown in advance, **different** assumptions about changes in policy are considered.

Why modelling exercises?

Table 4 Scenario Summaries

Narrow (limited) FTA Scenarios	
Tariffs only	98 per cent of tariffs eliminated
Services only	10 per cent of services NTBs eliminated
Procurement only	25 per cent of procurement NTBs eliminated
Comprehensive Scenarios	
Less ambitious	98 per cent of tariffs eliminated
	10 per cent of NTBs eliminated on both goods and services (20 per cent of actionable)
	25 per cent of procurement NTBs eliminated
	100 per cent of tariffs eliminated
Ambitious	25 per cent of NTBs eliminated on both goods and services (50 per cent of actionable)
	50 per cent of procurement NTBs eliminated

CEPR study, p.28

Why modelling exercises?

Consequently:

- A modelling exercise does **not** yield a single result but many results.
- Since the results crucially depend on the underlying assumptions, it is inappropriate to refer to single figures without mentioning the underlying assumptions.
- Modelling exercise ≠ forecast; not meant to deliver “hard facts” but information for a qualitative analysis

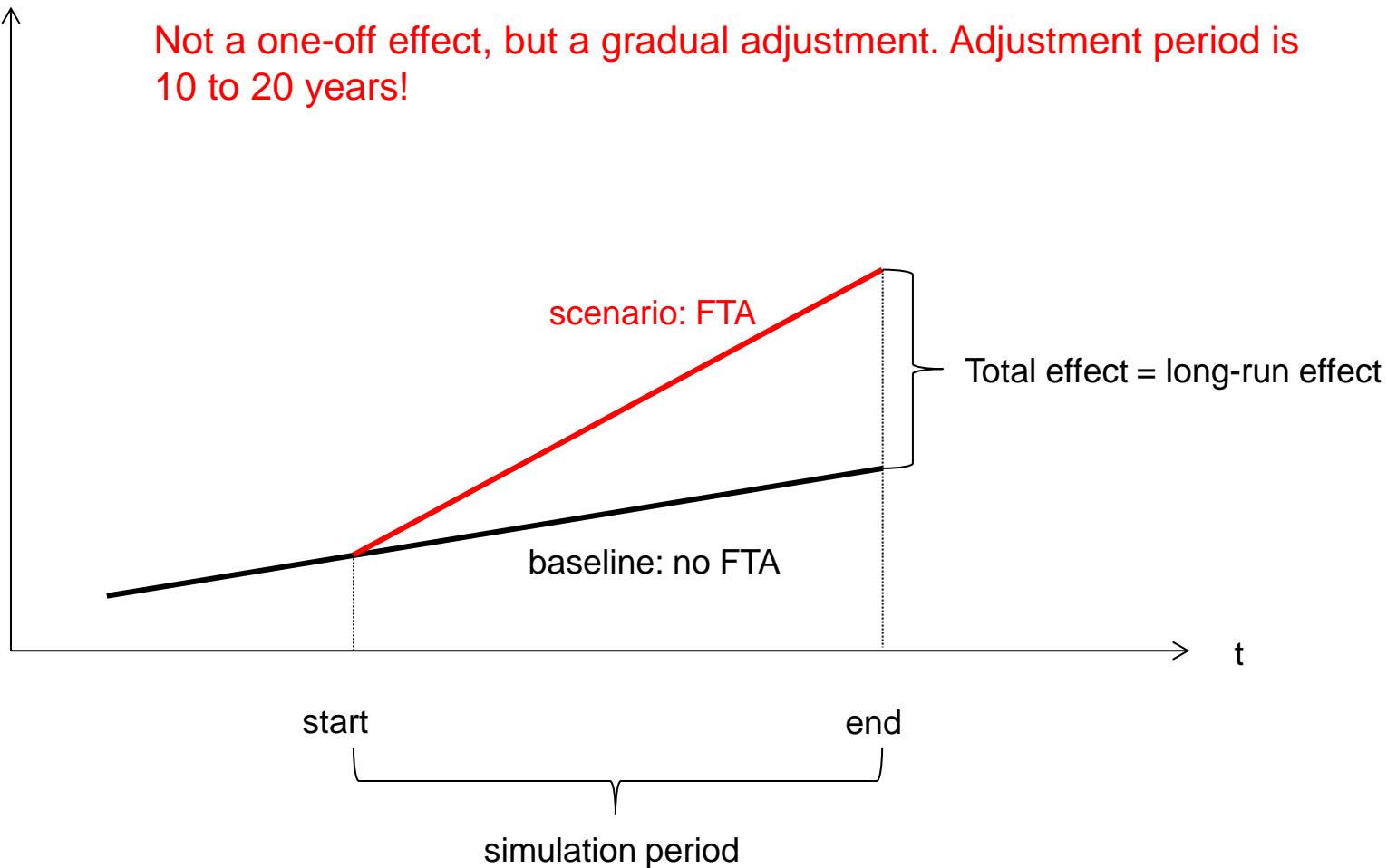
Model simulation

- Comparison of 2 situations:
 - Baseline: no policy change = no FTA
 - Scenario: policy change = FTA
- The **total** effect (= **long-run** effect) of the policy change can then be benchmarked by the difference between baseline and scenario at the end of the adjustment period.

Model simulation

Output

Not a one-off effect, but a gradual adjustment. Adjustment period is 10 to 20 years!



Scenario under consideration

Growth and employment effects of a **comprehensive FTA**.

Comprehensive FTA:

- Complete elimination of all tariffs
- Significant reduction of non-tariff barriers/measures
→ far-reaching liberalization of trade
- most ambitious and most optimistic scenario

EU Commission's perspective

EU Commission forcefully promotes TTIP, claiming significant economic benefits:

„(...) a comprehensive agreement covering all sectors would be overwhelmingly positive, opening up trade and bringing a welcome boost to economic growth and job creation on both sides of the Atlantic.

(...) The TTIP would be the cheapest stimulus package imaginable.”

European Commission: About TTIP – Questions and answers

<http://ec.europa.eu/trade/policy/in-focus/ttip/questions-and-answers/>

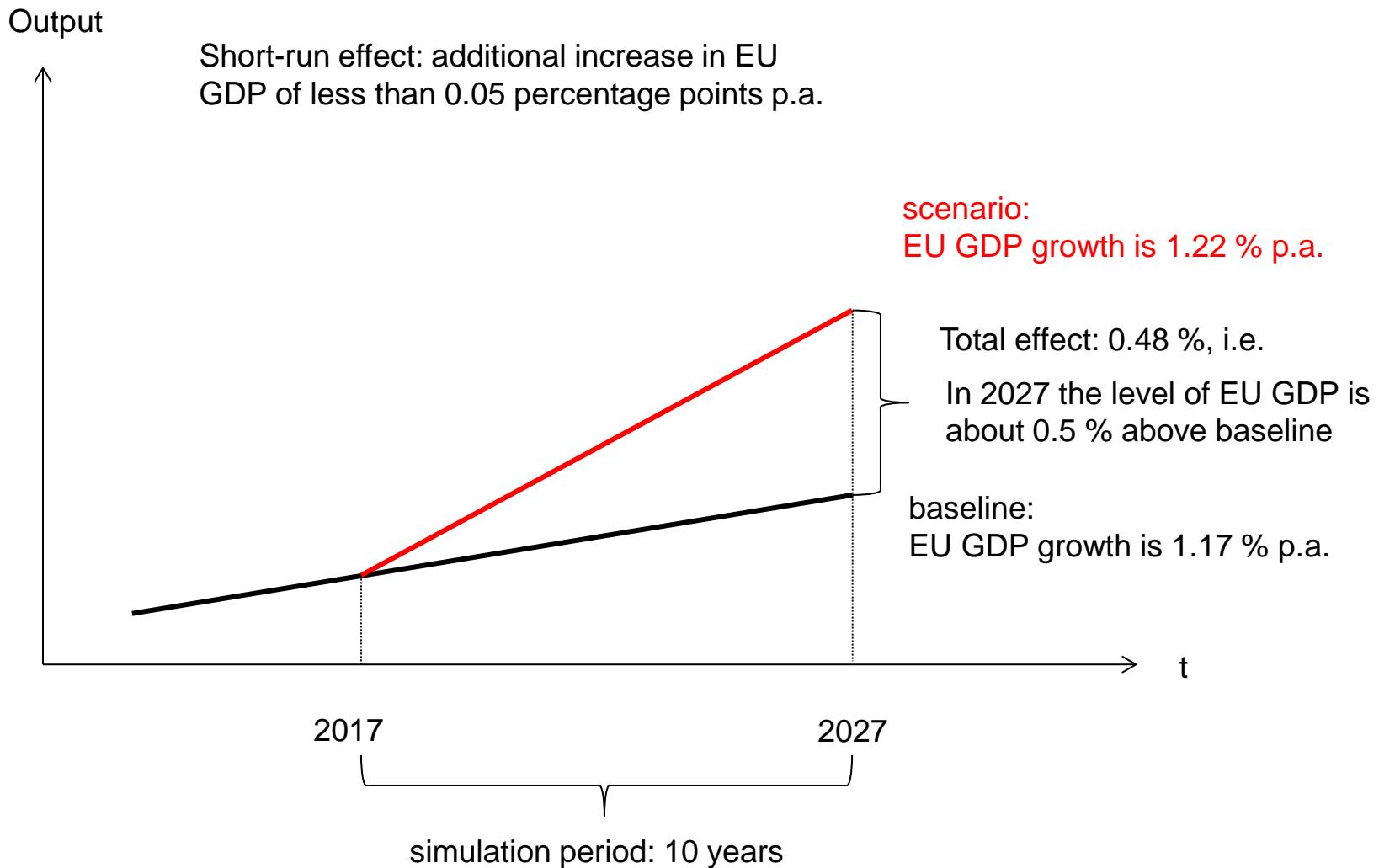
EU Commission's perspective

- EU Commission refers explicitly to the CEPR study, pretending that her claims are supported by this study.
- What are the results of the CEPR study with regard to GDP growth and employment?

CEPR study: growth effects

- Long-run effect (in 2027)
 - EU GDP: + 0.48 % above baseline
 - US GDP: + 0.39 % above baseline
- Short-run effect: additional increase in GDP per year
 - Less than 0.05 percentage points p.a.
 - Tiny little effect! Statistically not different from zero

CEPR study: growth effects



CEPR study: growth effects



Thus,

- TTIP is obviously not a stimulus package!
- TTIP will definitely not boost economic growth!

CEPR study: employment effects



Claim of EU Commission:

„An independent report suggests that an ambitious agreement could result in millions of euros of savings to companies and create hundreds of thousands of jobs.”

European Commission: About TTIP – How Europe can benefit from TTIP

<http://ec.europa.eu/trade/policy/in-focus/ttip/about-ttip/>

CEPR study: employment effects



CEPR study says **nothing** about the impact of TTIP on job creation/losses overall!

Why?

CEPR model assumes fixed labour supply (= no involuntary unemployment), i.e.

- Short-run: search unemployment is possible, because employment shifts from shrinking to expanding branches
- Long-run: level of employment is constant!

CEPR study: employment effects

In other words:

Due to the specific model framework (fixed labour supply) the FTA has **no** influence on the level of employment in the long-run.

CEPR study: Conclusions

Main arguments of the EU Commission, TTIP

- brings a boost to economic growth and job creation,
- is the cheapest stimulus package imaginable,
- creates hundreds of thousands of jobs,

are **not** backed by the results of the CEPR study!

- ifo institute published two studies:
 - Federal Ministry for Economic Affairs (BMWi)
 - Bertelsmann Foundation
- Completely different methodological approach in order to remedy problems/shortcomings of other studies (Ecorys (2009), CEPR (2013), CEPII (2013)).

How to quantify ... ?

- Key assumption: Reduction in non-tariff measures (NTMs) will reduce trade costs.
- By how much? → Quantifying the cost saving effect is a serious problem!
- Ecorys (2009) provides estimates of actionable non-tariff measures, based on literature reviews, econometric analysis, business surveys, interviews with experts, ...

How to quantify ... ?

- Points of criticism:
 - Estimates of NTMs reflect subjective statements of experts and their perception of NTMs rather than policy measures actually in place,
 - Indices constructed exceed estimates of authoritative studies (i.e. Anderson and van Wincoop 2003, 2004) by a multiple.

How to quantify ... ?

- Thus, studies based on Ecorys estimates (Ecorys (2009), CEPR (2013), CEPII (2013)) are vulnerable.
- That's why the ifo authors don't use these estimates but adopt a completely different approach.

Approach used by ifo:

- US and EU member countries have signed plenty of free trade agreements in the past.
- By how much have trade flows between participating countries increased due to these agreements?
- Structural equation (gravity model) is used to estimate trade creation effect.

- If trade creation effect is determined, it is plugged into the model, i.e. trade costs are reduced until the model simulates exactly the previously estimated increase in trade flows.

Thus, the cost saving effect of a reduction in NTMs is implicitly determined.

- At a first glance, this is a smart approach, because it circumvents the necessity to quantify the cost saving effects of a reduction in NTMs.

- At a second glance, it is rather strange, because the determination of the increase in trade flows should be the outcome of the studies and not their starting point.

■ Further points of criticism:

- Data set includes very different FTAs (goods; services; goods & services; only tariffs; comprehensive agreements; FTA with developing countries or industrial countries; very different time periods, ...)
- Is it reasonable to extrapolate from heterogeneous past agreements to today's situation between EU and US?

- Unclear, where empirically measured trade creation effects come from (reduction of tariffs and NTBs or other trade stimulating effects [i.e. EU integration, common currency, ...]).

- Trade creation effect is about 80 % (!) on average!
- Although the trade creation effect is very large, the corresponding increase in GDP per capita is very small, i.e. large trade diversion effects, but small increases in output.

ifo studies: growth effects

- Long-run effect (after 10 to 20 years)
 - EU GDP: + 1.6 % above baseline
 - US GDP: + 2.2 % above baseline
- Short-run effect: additional increase in GDP per year
 - 0.1 to 0.2 percentage points p.a.
 - Again, very small effect!

- Both ifo studies report the same growth effects, but the size of the employment effects differs by a factor of 10 to 15. Why?
- Different approaches to model the labour market.

- ifo/BMWi study uses a Melitz model:
 - Heterogeneous firms differ with regard to productivity.
 - More productive firms face lower marginal costs and are therefore able to set lower prices.
 - Since demand is price elastic, more productive firms have higher sales, employment and profits than less productive firms.

- Three different type of firms:
 - only most productive firms are exporters,
 - some firms are just on the cusp, i.e. currently they supply the domestic market, but if trade costs are reduced, they start exporting straightaway,
 - less productive firms only supply the domestic market.

ifo studies: employment effects

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- FTA reduces trade costs → price reductions → higher demand → increase in production and employment
- Since firms differ with regard to productivity, there are winners and losers.

■ Winners and losers:

- Productive firms become even more productive and expand further → employment 
- Firms on the cusp enter the market  employment 
- Less productive firms face increased competition due to new market entries and possibly exit the market → employment 

- The employment effect is mainly driven by **reallocation** from low to high productivity firms.
- Since there is a decline in employment in low productive firms and an increase in employment in high productive firms, the aggregate employment effect is the balance of both effects.

- ifo authors stress the importance of the reallocation effect very much:

„Other studies falsely neglect the reallocation effect and interpret additional employment in the export sector as gains in employment of the economy as a whole.”

ifo, p.86 own translation

- ifo/Bertelsmann: no reallocation! Thus, gains in employment in prosperous branches (export sector) are counted as gains in aggregate employment.

ifo studies: employment effects



ifo/BMWI study

	long-run effect after transition period of 15 years	additional jobs (per annum)
	additional jobs (total)	
EU26*	98 910	6 594
USA	68 790	4 586
DE	25 220	1 681

* DE not included

Source: Table III.13, p. 100

ifo/Bertelsmann study

	long-run effect after transition period of 15 years	additional jobs (per annum)
	additional jobs (total)	
EU17*	1 166 000	77 733
USA	1 085 501	72 367
DE	181 092	12 073
DK	14 623	975
OECD	2 043 178	136 212

* own calculation based on figures for 17 EU member countries;
DE not included since figures for DE are displayed separately.

Source: Table 11, p. 41

Employment (2012):

EU26: 180.9 Mio

DE: 41.6 Mio

DK: 2.8 Mio

USA: 142.4 Mio

OECD: 553.9 Mio

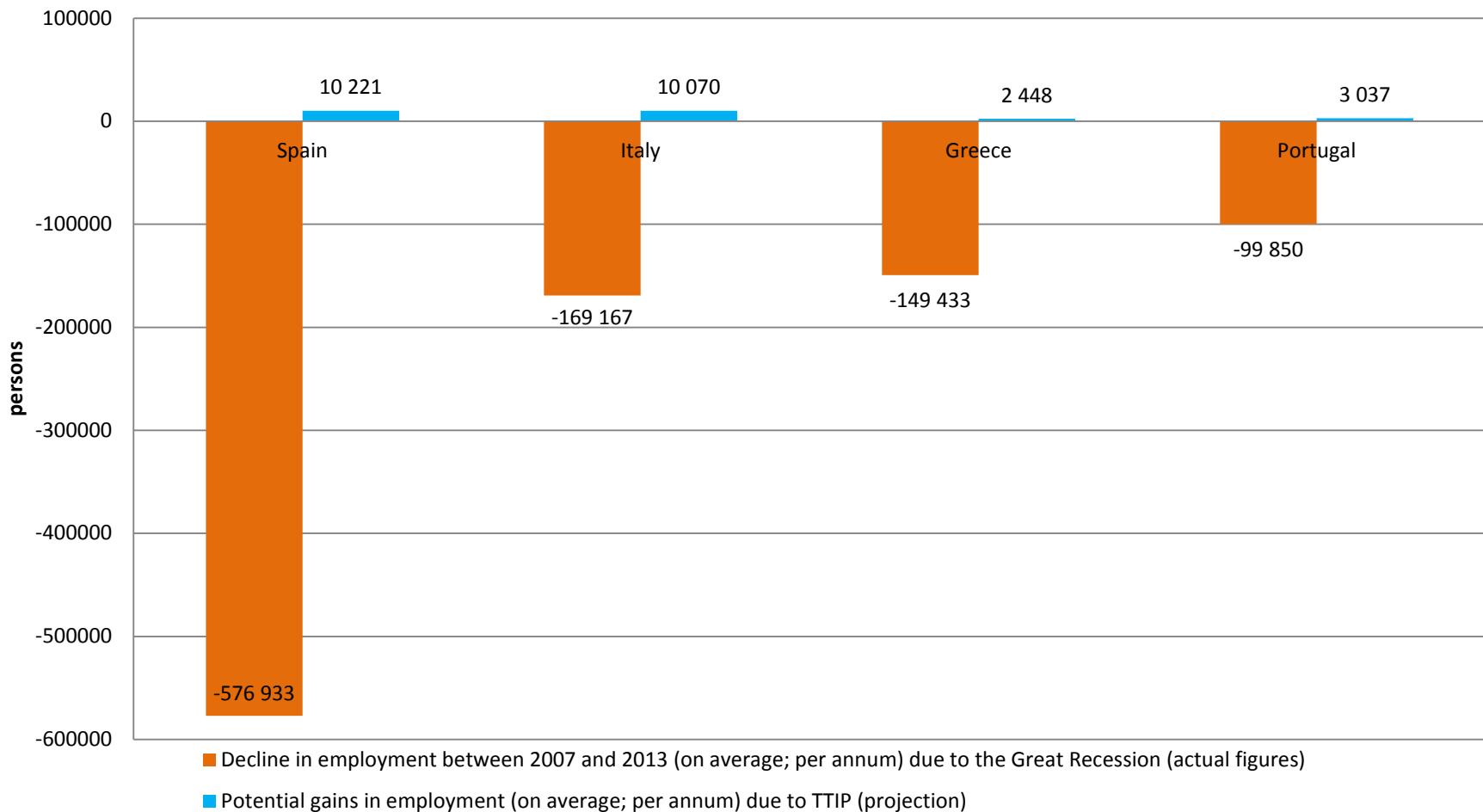
Employment effects are
very small!

ifo/Bertelsmann study

	long-run effect after transition period of 15 years	additional increase per annum (on average)
	increase in employment in %	
EU	N.A.	N.A.
USA	0.78	0.05
DE	0.47	0.03
DK	0.54	0.04
OECD	0.50	0.03

Source: Table 10, p.39

Changes in employment (number of persons; per annum; on average)



Conclusions

- Although the underlying assumptions are highly favourable, growth and employment effects are negligible.
- Serious flaw of all studies:
Costs of FTA are either neglected or downplayed.
 - Macroeconomic adjustment costs are considered as transitory and are therefore neglected.
 - Social costs of regulatory changes are not considered! They might be substantial!

Thank you!