



Transatlantic Trade and Investment Partnership Agreement (T-TIP)

A STUDY ON THE ECONOMIC IMPACT TO PORTUGAL



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Executive summary

In the wake of the recent financial crisis, in 2013 the European Union and the United States launched a joint, ambitious effort to boost their respective economies through a comprehensive trade and investment agreement. Known as the Transatlantic Trade and Investment Partnership Agreement (T-TIP), the negotiations process that has followed, and that indeed is still on going, is supposed to bring about tariff-free trade in goods, reduction of non-tariff barriers (NTBs) for goods and services, and liberalization of public procurement markets for the transatlantic market. This study examines the economic impact of a successful T-TIP agreement on the economy of Portugal.

At this stage, the shape and coverage of a final T-TIP agreement remain uncertain. It needs to take into account particularities of a great number of different partners and thus on substance amounts to a new type of mini-lateral agreement. It also needs to cover areas ranging from broad tariff concessions to sector-specific questions of regulation. While tariff reductions are relatively straightforward since it is basically a political decision without major implementation issues, an important ambition under T-TIP actually relates to greater coherence and convergence of regulatory standards. Such an institutional mechanism might have strong implications for a broader set of countries that are also grappling with regulatory barriers to trade and investment. While the goal of regulatory convergence (and better cross-recognition of standards) is a part of this venture, it requires enhanced cooperation in rule making. As such it is not as straightforward as tariff elimination. Indeed, there is growing recognition that a successful T-TIP agreement would combine immediate liberalization in some areas (such as tariffs) with institutional mechanisms set up to allow progressive, long-run liberalization in others. For this reason it is important to understand relatively immediate effects from tariff elimination, separately from likely longer run effects as trade cost reductions linked to NTBs are realized.

Given the complexities and uncertainties involved, the approach taken in this study is to examine scenarios involving varying levels of liberalization for NTBs. We also examine the potential impact of tariffs (where liberalization may be relatively immediate) separate from those for NTBs (which may be liberalized more gradually). Our assessment is centred on a quantitative model of the world economy.

It is likely that under the final agreement, tariffs will be eliminated first, while NTB reduction will be more gradual. We find that tariff elimination is far more important for Portugal than it is for the EU as a whole. Because of this, Portugal is likely to benefit proportionately more from tariff reductions than the EU as a whole, and Portugal is likely to benefit much earlier, and to a greater extent, from the first stages of T-TIP implementation.

Modeling assumptions

The basic methodological approach followed in this study involves the use of a computational model of the world economy (known as a CGE model). This model has Quantifying the Economic Impact of T-TIP on Portugal⁴ been used to look at alternative T-TIP scenarios. We have supplemented the CGEbased analysis with market focused (partial equilibrium) modelling of more detailed sectors than those identifiable in the CGE model. The model is based on the one used for recent European Commission assessments of T-TIP and the EU-Canada FTA¹.

¹ Ecorys (2009). Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis. Report prepared for European Commission, Directorate-General-for -Trade, Reference: OJ 2007/S 180N219493. CEPR (2013). Assessment of a Reduction of Barriers to Trade and Investment between the EU and the US, Centre For Economic Policy Research, report prepared for the European Commission. European Commission and the Government of Canada (2009). Assessing the Costs and Benefits of a Closer EU-Canada Economic Partnership, joint report, Brussels and Ottawa.

Alternative scenarios in terms of the outcome of T-TIP have been analysed given uncertainty about what exactly the agreement will incorporate and when these features of the agreement will be implemented. It should again be stressed that in contrast to reducing tariffs, the removal of NTBs is not as straightforward. There are many different reasons and sources for NTBs. Some are unintentional barriers while others reflect deliberate public policy. As such, for many NTBs, removing them is not possible because, for example, they require constitutional changes, unrealistic legislative changes, or unrealistic technical changes. Removing NTBs may also be difficult politically, for example because there is a lack of sufficient economic benefit to support the effort; because the set of regulations is too broad; or because consumer preferences or language preclude a change. In recognition of these difficulties, we follow recent studies by focusing on the set of possible NTB reductions (known as “actionable” NTBs)² given that many will remain in place. Of those NTBs that can feasibly be reduced, we focus on different levels of ambition for NTB reduction.

Our scenarios range from a relatively shallow agreement on tariffs, combined with modest NTB liberalization at one extreme, and a deep agreement covering tariffs and ambitious NTB reductions. These scenarios do not mean that we believe one of these is particularly likely or even preferred. Rather they serve to frame the questions covered in the report.

1. Modest scenario (Tariffs and modest NTB liberalization): Under this scenario, we assume that 20 % of trade costs from actionable NTBs (those that can be reduced) actually are eliminated. We also assume that with modest NTB cost reductions, these are discriminatory. Hence US liberalization would only benefit EU firms, and vice-versa.
2. Ambitious scenario (Tariffs and ambitious NTB liberalization): Under this scenario, we assume that 50 % of costs from actionable NTBs (those that can be reduced) are eliminated. We also assume that not all of these NTB cost reductions are discriminatory. This reflects what are called “regulatory spillovers.” Basically, with a deep agreement on NTBs, we assume that third countries will also benefit, but to a more limited extent, in terms of some improvement in market access. The logic is that, with deep regulatory reform, at least some of the changes are likely to affect all players, and not just the EU and US firms. For example, where the US recognizes EU standards, firms in other countries might then find it easier to then meet US standards themselves if they already meet EU standards.

Summary of the scenarios

² Actionability is the degree to which an NTB or regulatory divergence can realistically be reduced (via various means and techniques) if the political will to do so exists. To define actionability, the Ecorys (2009) study used expert opinions and crosschecks with regulators, legislators and businesses, supported by the business survey. The figures on actionability should be interpreted with some caution given the difficulty of providing exact measure of the extent of actionability.

<p>Full Implementation (long-run effects):</p> <ul style="list-style-type: none"> • Focuses on year 2030, with full effects of implementation • Includes longer run investment changes and reallocation of capital across sectors. • Labour markets in Portugal have further recovered from the impact of recession. 	Long-run effects of an agreement that has been fully implemented.
Modest Scenario	98 % of tariffs eliminated, 10 % of NTBs (20 % of actionable NTBs) are eliminated
Ambitious Scenario	100 % of tariffs and 25 % of NTBs (50 % of actionable NTBs) are eliminated
<p>Initial Stages of Implementation (short-run effects):</p> <ul style="list-style-type: none"> • Excludes longer run investment changes and reallocation of capital across sectors. • Labour markets in Portugal reflect current conditions with high unemployment (soft labour markets) 	Assuming that the modest scenario represents the first stages of an ambitious agreement – 98 % of tariffs eliminated, 10 % of NTBs (20 % of actionable NTBs) are eliminated

Note: Following CEPR (2013) we assume 20% and 50% reductions in actionable NTBs. This translates into roughly 10% and 25% of all NTBs, with some variation across sectors. See CEPR (2013)³ for further discussion

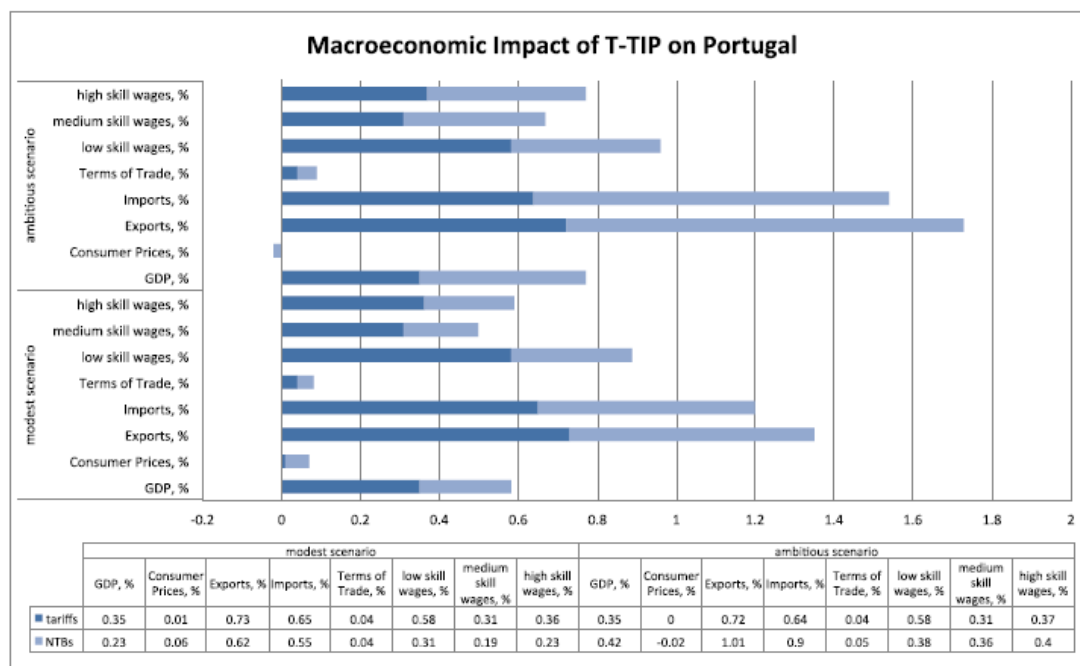
Findings from Economic Modelling

- In contrast to the EU as a whole, where NTBs are the most important element of a T-TIP, for Portugal tariffs are just as important as NTB cost reductions.
- Because Portugal benefits proportionately more from tariff reductions than the EU as a whole, Portugal is likely to benefit earlier, and to a greater extent, from the initial stages of T-TIP implementation.
- Over the short-run, in case of the initial stages of the implementation assuming a modest scenario, the estimated impact for Portugal is 0.66% of GDP.
- Long-run impacts for Portugal under core scenarios in the study range from 0.57% of GDP under a shallow agreement to and 0.76% of GDP under a deep agreement.

Macroeconomic estimates of the baseline long-run scenario (year 2030, including some impact on employment) are summarized in the figure and table below. Portugal would benefit under both the ambitious and modest scenario over the long-run. An important part of the gains stems from tariff liberalisation. This contrasts with the EU as a whole (see CEPR 2013) where tariffs are less important. The reason is that, in the case of Portugal, exports are more concentrated in sectors that would benefit from elimination of high US import tariffs. For example, textiles and clothing are 15.5 % of Portuguese goods exported to the US and face an 8.8 % tariff, but this sector only accounts for 2.4 % of goods exports for the EU as a whole. In addition, 25% of Portuguese value added being exported, with most of this being exported through the manufacturing sector, resulting in an important impact on the Portuguese economy coming through liberalisation affecting the manufacturing sectors. Tariffs are likely to be reduced first (i.e. they will be front loaded) while NTB reductions will take longer. Because Portugal benefits proportionately more from tariff reductions than the EU as a whole, Portugal is likely to benefit earlier, and to a greater extent, from the initial stages of T-TIP implementation.

³ CEPR (2013) "Assessment of a Reduction of Barriers to Trade and Investment between the EU and the US", (TRADE10/A2/A16)

Under an ambitious agreement, national income is higher by €1.6 billion annually in the year 2030 under our baseline scenario. Of this, roughly half comes from tariffs and half from NTBs. Aggregate exports and imports are estimated to increase by around 1.5-1.7% under the ambitious scenario. Wages are also expected to increase, with low skill wages increasing slightly more under both ambitious and modest scenarios.



Source: CGE model estimates in this study, 2030 baseline.

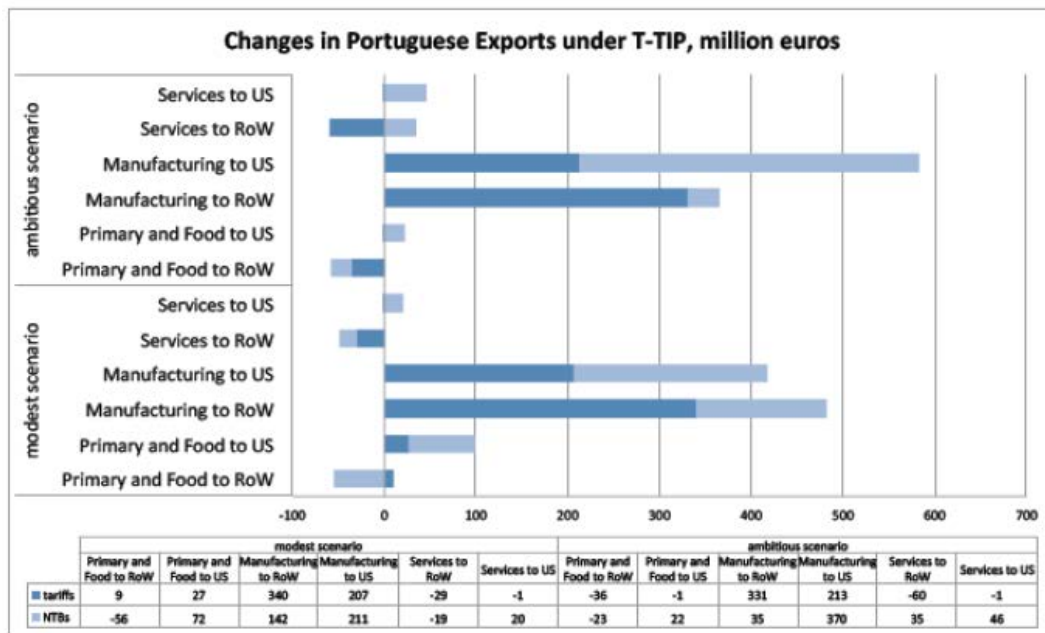
Sector effects⁴ will vary across different sectors, with electric machinery and textiles and apparel standing out. Output in textiles and apparel would increase by around 18% over the long-run, with electric machinery contracting by around 10-12% at the same time. In part, changes in electric machinery production reflect recent estimates for the European industry as a whole (See for example CEPR 2013 and ECORYS 2009). At a European level, the electric machinery sector is part of a European industry that from earlier studies we expect to be on the downside of adjustment across continental Europe. In the Portuguese case, we find that expansion in other manufacturing sectors is especially important in pulling resources out of the electrical machinery sector. Indeed parallel to these output changes, exports in textiles and apparel would increase by around 30% and would decline by about 13- 15% in electric machinery. The increase in aggregate exports in textiles and apparel is mostly driven by a large increase in bilateral exports to the US. Exports in this sector to the US increase due to the underlying trade structure and the initially relatively high barriers on US imports, including tariffs.

Export effects are expected to be concentrated on manufacturing. The forces driving this change are complex. They include not only directly improved access to the US, but the fact that Portugal's customers in the EU (who may source parts and components in Portugal) may also demand more goods from Portugal. In addition, within the EU, shifts in industrial structure in other Member States will also lead to a rebalancing of EU demand for Portuguese exports. The net effects, as summarized below, are substantial growth in exports to the US (estimated as an increase in exports to the US by up to €650 million by 2030) but also to third countries (with total annual exports expanding by roughly €930 million by 2030).

Employment: The study also considers possible impacts on employment in Portugal. Assuming that an agreement will yield immediate tariff cuts and modest NTB reductions up front, and deeper reductions in NTBs only over a longer

⁴ These estimated changes are due to implementation of T-TIP while there could be other external shocks, such as policy changes, which could lead to shifts in Portugal's trade and production structures changing the results presented here.

time horizon, it is estimated that T-TIP could yield 40.5 thousand jobs in the first stages of implementation (given currently soft labour markets) and 23.0 thousand in the longer term with full implementation (modelled in the year 2030).



Source: CGE model estimates in this study, 2030 baseline. RoW=rest of World

The report also looks at the effects of an immediate implementation of the T-TIP with the labour markets reflecting current conditions with high unemployment and assuming the modest liberalisation scenario given that realistically a more ambitious scenario would require a longer time-frame to implement. The estimated impact under this scenario is a total of 0.66% increase in GDP. The potential impact comes both from NTB reductions on goods and tariff reductions. The resulting increase in national income would be €1.16 billion. In addition, aggregate exports and imports are estimated to increase by around 1-1.3 % over the short-run.

For the Azores, gross value added in million euros would increase from about €3279 million to €3289 million under the ambitious with a 0.35% increase in Azores' GDP. Parallel to these changes, there would be a substantial increase in bilateral trade in manufacturing with the US, mainly attributable to increased trade in processed food and primary products.

As T-TIP is fully implemented, it has been estimated that port traffic would also increase in a range from 1.0 to 1.8 %.

Findings from Partial Equilibrium Modelling: The partial equilibrium analysis looked at the potential impact of removal of barriers to trade in certain wine, footwear, pharmaceutical, textiles and clothing, and machinery products. The results indicate that the most pronounced change in terms of both output (1-2.5 % increase) and exports to the US (222-540 % increase) would take place in certain footwear products. This is mainly due to the initial very high tariffs the US puts on these product categories.