

# Economic Consequences of a Transatlantic Free-Trade Agreement for Asia

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Negotiations between the US and the European Union (EU) on a joint free-trade agreement began in July 2013. The economies involved are hoping for more intense trade activities, stronger economic growth and higher employment rates. A current study of the ifo Institut commissioned by the Bertelsmann Stiftung shows that these expectations would be met. For most other countries in the world, however, this would result in welfare loss. In the following we sketch some of the possible economic consequences of a comprehensive transatlantic free-trade agreement for the Asian region.

## Preliminary remarks on the method

The economic effects presented here are based on simulation calculations that estimate how international trade flows would change in the event of a comprehensive free-trade agreement between the US and the EU, a Transatlantic Trade and Investment Partnership (TTIP). The starting point is the consideration that the abolishment of customs duties and non-tariff barriers to trade between the contracting parties would reduce the costs of bilateral trade for the participating economies. In this way, a TTIP would intensify foreign trade between the US and the 27

EU member states (trade creation). Reduced trade costs between the countries involved in the free-trade agreement would, however, also cause a reduction in trade activities between the contracting economies and the rest of the world (trade diversion).

In the simulation calculations two main scenarios are considered. In the first scenario (tariff scenario) the economic consequences of the total abolition of import duties between the EU and the US are examined. In the second scenario (liberalization scenario), non-tariff barriers to trade are abolished along with customs duties. Both sce-

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narios are compared with a situation where there is no transatlantic free-trade agreement. The effects resulting from the removal of barriers to trade are calculated using a model for the analysis of free-trade agreements developed by the ifo Institut. This model uses existing free-trade agreements to evaluate the resultant effects on export and import flows. These empirically estimated values for trade effects are then integrated into a simulation model that calculates the trade creating and trade diverting effects of a transatlantic free-trade agreement for 126 economies under consideration. Necessary adjustment processes are not explicitly treated. Thus the consequences sketched in the following are long-term effects, i.e. effects that will only unfold their full consequences 10 to 20 years after the agreement comes into force (cf. for a detailed description, Felbermayr et al 2013). The macroeconomic effects sketched below therefore must be interpreted as indicating the amount the respective economic values would have had in 2010 had the US and the EU entered into a comprehensive free-trade agreement 20 years ago and had this agreement unfolded its full effect by 2010 at the latest.

Since import duties between the EU and the US have already reached a very low level, the economic effects would be marginal if import duties alone were abolished. Thus only the economic effects that would result in the event of a comprehensive free-trade agreement between the EU and the US are sketched below (liberalization scenario).

### Global welfare effects of a comprehensive free-trade agreement

Removal of barriers to trade between the EU and the US would increase trade activities between the two regions. Intensification of these trade relationships would, however, be offset by a reduction of trading activities within the EU and a reduction of foreign trade relationships with most third countries.

Increase in foreign trade between the US and the 27 individual EU member states would also increase production and employment. One important indicator for measuring the economic benefits in this context is real gross domestic product per capita. Figure 1 provides an overview of the winners and losers of a comprehensive transatlantic free-trade agreement: While the US and EU member states would profit from this, other countries would suffer the effects of trade diversion. This would hit Canada

**Figure 1: The top 25 winners and losers of a comprehensive free-trade agreement**

Changes to the long-term real gross domestic product per capita

#### Indication in percent

United States	+ 13.4	Lebanon	- 3.4
Great Britain	+ 9.7	Algeria	- 3.5
Sweden	+ 7.3	Switzerland	- 3.8
Ireland	+ 6.9	New Zealand	- 3.8
Spain	+ 6.6	Norway	- 3.9
Finland	+ 6.2	Iceland	- 3.9
Malta	+ 6.2	Niger	- 4.0
Estonia	+ 5.7	Malawi	- 4.0
Latvia	+ 5.4	Botswana	- 4.1
Denmark	+ 5.3	Panama	- 4.2
Greece	+ 5.1	El Salvador	- 4.4
Lithuania	+ 5.1	Guatemala	- 4.4
Cyprus	+ 5.0	Honduras	- 4.4
Portugal	+ 5.0	Barbados	- 4.5
Italy	+ 4.9	Jamaica	- 4.7
Bulgaria	+ 4.8	St. Lucia	- 4.8
Germany	+ 4.7	Costa Rica	- 5.5
Romania	+ 4.6	Israel	- 5.5
Hungary	+ 4.4	Jordan	- 5.5
The Netherlands	+ 4.4	Chile	- 5.6
Slovakia	+ 4.2	Japan	- 5.9
Poland	+ 3.7	Belize	- 6.0
Belgium	+ 3.6	Mexico	- 7.2
Slovenia	+ 3.3	Australia	- 7.4
Luxembourg	+ 3.0	Canada	- 9.5

Source: ifo Institut



and Mexico particularly hard, both of which currently maintain a free-trade agreement with the US that would be devaluated by ratification of a transatlantic free-trade agreement. European states that are not part of the EU would also suffer real income loss. Threshold countries would be another big loser. As a whole, however, the world would profit from a comprehensive transatlantic free-trade agreement: Average real per-capita income would increase by nearly 3.3 percent.

### Trade Effects on Asia

If the US imported more goods and services from EU member states and EU-states increased their imports from the US as well, demand for imports from other coun-

ties in the world would decline. Figure 2 shows the strongest export loss in percent among selected Asian economies.<sup>1</sup> The largest reductions in percent would be for exports to the US and Great Britain. In absolute terms, China would suffer the strongest reduction in exports, if there was now a fully functional transatlantic free-trade agreement already in place, Chinese exports to the US would drop from their current level of around US\$ 327.5 to US\$ 218 billion. However, such a reduction of trading activities would also affect Asian imports from the US and the EU. For example, US imports into China, Indonesia, Thailand and South Korea would be cut by one third.

Reduction of the trade relationships between Asia on the one hand and the US or individual EU member states

**Figure 2: The biggest loss of exports in percent among selected Asian economies resulting from a comprehensive transatlantic free-trade agreement**

Exporter	Importer	Export volume 2010 (in M. US-Dollar)	Change of exports (in %)
Japan	United States	117,876,109	-20.1
China	Ireland	2,951,793	-20.2
South Korea	Finland	629,350	-20.7
China	Sweden	6,021,559	-20.9
Thailand	Ireland	320,451	-21.1
South Korea	Spain	2,156,943	-21.7
Thailand	Sweden	587,248	-21.9
South Korea	Ireland	429,296	-23.0
South Korea	Sweden	2,067,784	-23.8
India	Great Britain	8,257,631	-24.7
China	Great Britain	48,619,164	-27.6
Indonesia	Great Britain	2,284,965	-28.4
Thailand	Great Britain	3,678,968	-28.4
South Korea	Great Britain	4,013,072	-30.2
India	United States	29,213,796	-30.8
China	United States	327,554,013	-33.4
Indonesia	United States	17,316,834	-34.2
Thailand	United States	22,627,135	-34.2
South Korea	United States	49,766,160	-35.8

Source: ifo Institut

<sup>1</sup> The study comprises 15 Asian countries: Bangladesh, Brunei, China, India, Indonesia, Japan, South Korea, Malaysia, Nepal, Pakistan, Papua New Guinea, Philippines, Singapore, Sri Lanka and Thailand.



on the other would be partially compensated by more intensive trade activities between the Asian economies. This development is illustrated for selected countries in Figure 3.

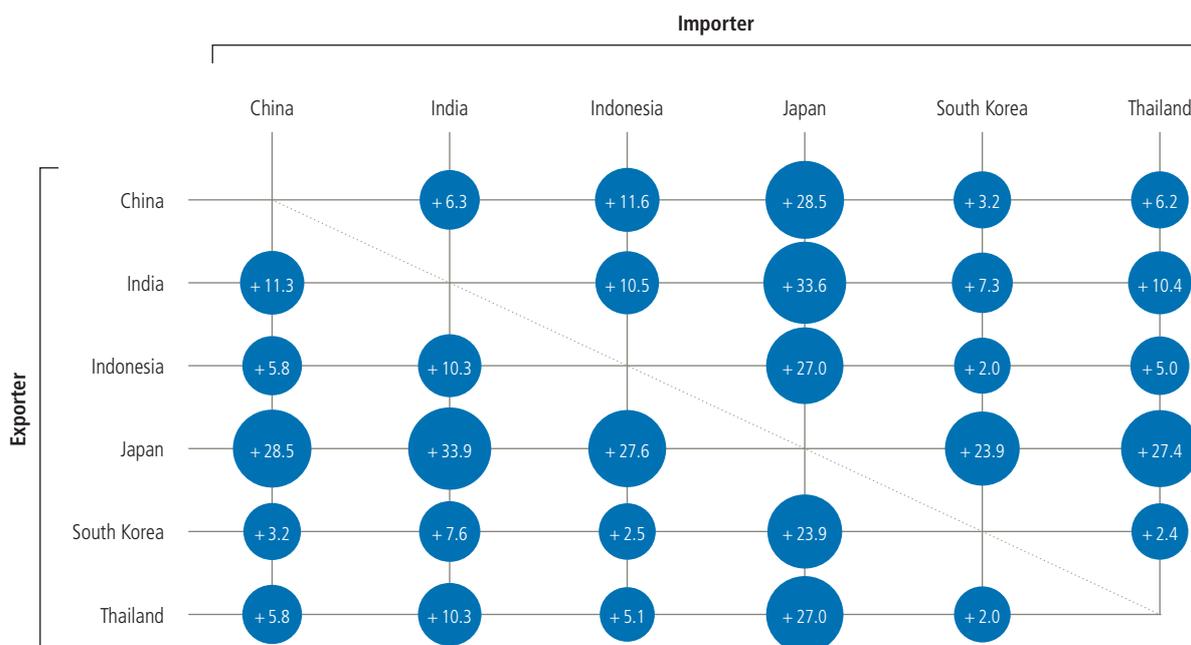
While most Asian economies would reduce their exports to the US and EU-states in the wake of a transatlantic free-trade agreement, Japan would raise its exports to a number of EU-states (see Figure 4). This is mainly because the Japanese economy offers many products (such as cars and electronic goods) that European consumers value and that would still be in demand in spite of a reduc-

tion in the prices of US imports following a transatlantic free-trade agreement.

### Welfare effects on Asia

One common indicator to measure welfare effects is the above cited real gross domestic product per capita. Finalization of a free-trade agreement would act on this indicator via two central channels: on the one hand by changes to international trade flows, and on the other via the price-reducing effect of a free-trade agreement. In terms of trade flows, an increase of domestic exports

Figure 3: Changes in exports following a comprehensive free-trade agreement for selected Asian economies (data as percent)



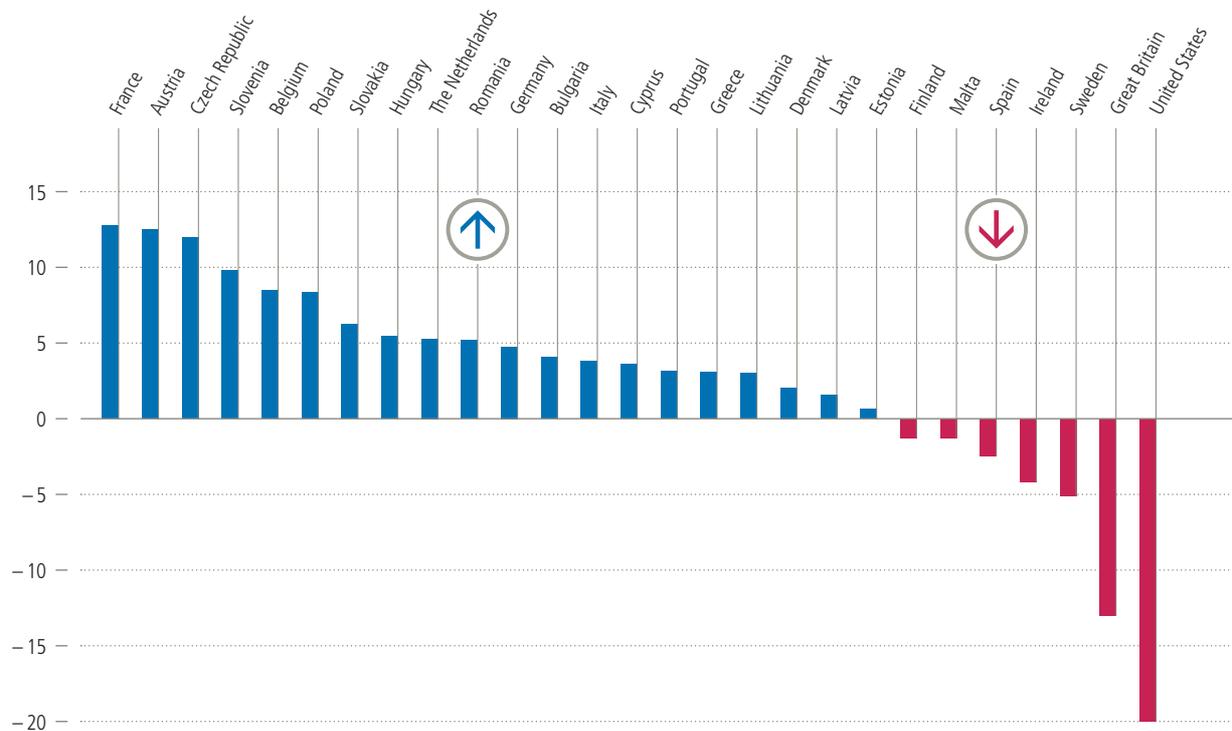
Source: ifo Institut



on its own would increase production and employment in the exporting country which in turn would tend to favor an increase in the real gross domestic product. Yet on the other hand an increase in imports would displace domestic products which would tend to reduce production and the real gross domestic product in the importing country. Finally, the removal of tariff and non-tariff barriers to trade would reduce the prices of internationally traded products. The general reduction of the price level this would entail would increase the real gross domestic product.

At the end of the day which of these effective channels would be more important in the countries under observation cannot be derived from purely theoretical considerations, but can only be ascertained once the simulation computations are performed. Figure 5 shows that a comprehensive transatlantic free-trade agreement would result in the reduction of the real gross domestic product of all the 15 Asian economies under consideration here with the exception of South Korea where the welfare-increasing effect resulting from the import of cheaper products from the US and the EU would be predominant.

**Figure 4: Changes in Japanese exports to selected countries following a comprehensive transatlantic free-trade agreement (data as percent)**



Source: ifo Institut

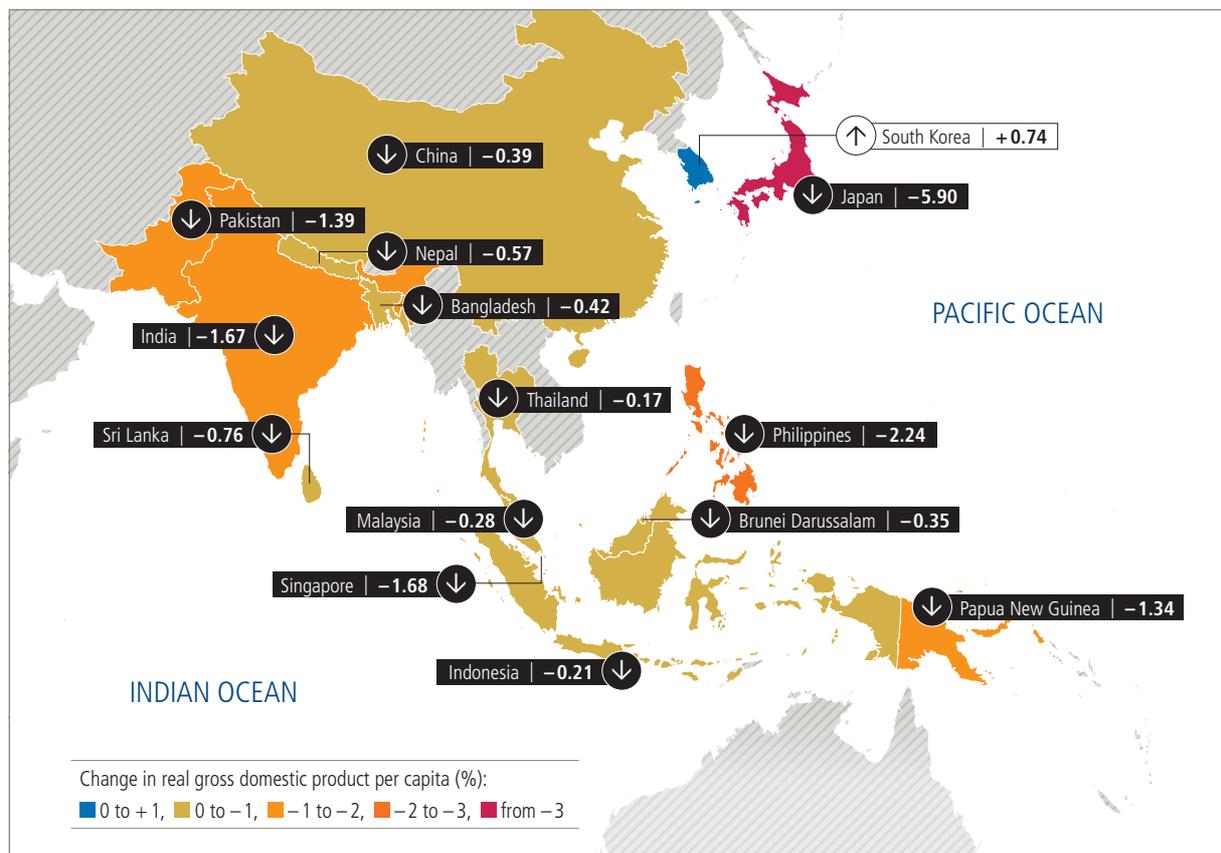


### Results and consequences on economic policy

Intensified trade between the US and the EU would have positive income and employment effects on the economies involved. This applies in particular in the case of a comprehensive agreement that eliminates non-tariff barriers to trade along with customs duties. Welfare gains in the US and the EU would, however, be partially countered by considerable loss of real income in third countries, in-

cluding most of the Asian economies. A TTIP should strive to avoid such negative effects or at least keep them to a bare minimum. In particular, traditional trading partners of the two major economies should be included in the negotiations or be given an early opportunity to enter into similar agreements with them if this has not yet already been done. At the same time, the real welfare gains of Western industrial states should be incentive enough for them to give the losers of the agreement adequate com-

Figure 5: Changes of the real gross domestic product per capita following a comprehensive transatlantic free-trade agreement



Source: ifo Institut



pensation and to show a willingness to compromise in multilateral negotiations.

Moreover, the economies of Asia – and South America and Africa as well – could also try to generate further growth impulses by entering into even stronger economic cooperation with regional partner countries. At the summit meeting of the 21 countries of the Asia-Pacific Economic Cooperation (APEC) held in Bali in early October, the Chinese President Xi Jinping declared that his country wanted to “found a transpacific structure of cooperation” that would benefit all.<sup>2</sup> The ASEAN states (Association of Southeast Asian Nations) and China have already ratified a free-trade agreement that entered into effect on 1 January 2010. In November 2012, the ASEAN states also agreed to negotiate a common free-trade agreement with six partner countries with which they already have bilateral free-trade agreements (Australia, China, India, Japan, New Zealand and South Korea). This agreement would span the Asian-Pacific region and constitute the world’s largest free-trade area covering some 3.4 billion people and with an almost 30 percent share of total global trade (cf. Hoepfner 2013). Latin America already has a multilateral free-trade agreement called Mercosur (short for “Mercado Común del Sur”, or Common Market of the South).

Generally speaking, one of the possible effects of a transatlantic free-trade agreement is that it could lead other economies to seek stronger regional economic integration. Furthermore, a TTIP could also serve to boost and not brake the faltering Doha Development Round of multilateral negotiations.

## Further reading:

Bertelsmann Stiftung (ed.). Transatlantic Trade and Investment Partnership (TTIP) – Who benefits from a free trade deal? Bertelsmann Stiftung (ed.). Transatlantic Trade and Investment Partnership (TTIP) – Who benefits from a free trade deal? Part 1: Macroeconomic Effects, Gütersloh 2013.

Felbermayr, Gabriel et al. Dimensionen und Auswirkungen eines Freihandelsabkommens zwischen der EU und den USA, Studie im Auftrag des Bundesministeriums für Wirtschaft und Technologie, Endbericht, München 2013.

Hoepfner, Maren. ASEAN+6: Größte Freihandelszone der Welt in Planung, GIGA Focus Asien, Nr. 4, Hamburg 2013.

[www.ged-project.de/shorts/short/who-benefits-from-a-transatlantic-free-trade-deal/](http://www.ged-project.de/shorts/short/who-benefits-from-a-transatlantic-free-trade-deal/).

<sup>2</sup> Christoph Hein, China will Führung im Pazifikraum übernehmen, F.A.Z. 07.10.2013, [www.faz.net/aktuell/wirtschaft/wirtschaftspolitik/weltwirtschaft-china-will-fuehrung-im-pazifikraum-uebernehmen-12607892.html](http://www.faz.net/aktuell/wirtschaft/wirtschaftspolitik/weltwirtschaft-china-will-fuehrung-im-pazifikraum-uebernehmen-12607892.html).



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