

# TTIP – Economic Consequences and Possibilities for Third Countries: the Case of Norway<sup>1</sup>

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## Summary

The possible realisation of a Transatlantic Trade and Investment Partnership (TTIP) between the EU and the USA may have significant impacts, also for third countries. This policy brief analyses the economic consequences and possibilities for one third country – Norway – discussing both TTIP and a separate agreement on trade and investments between Norway and the USA.

## 1. Introduction

The EU and the USA are currently involved in ambitious negotiations over a Transatlantic Trade and Investment Partnership (TTIP). The aim is to reach a comprehensive agreement that focuses not only on tariff reductions, but also on reductions in regulatory barriers to trade (Non-Tariff Barriers, or NTBs) through mutual recognition and harmonisation of standards, rules and laws. The agreement is intended to cover trade in goods and services, in addition to investments.

Bilateral trade between the EU and the USA constitutes only 3.8% of world trade. However, if realised, TTIP will be the world's largest preferential trade agreement in terms of the partners' economic significance: the EU and the USA account for about half of global GDP and 44% of world trade in goods.<sup>2</sup> One declared goal is that TTIP should set guidelines for the partners' future negotiations on trade and investments with other countries. Thus, the agreement may result in rules and standards that others will have to follow, and the consequences for third countries may prove significant. In several third countries that are already deeply integrated with the EU, like Norway, Switzerland and Turkey, stakeholders have demanded that their country seek association with the TTIP in some form or another. One possible form of association could be separate agreements with the USA.

## 2. Norway's economic relations with the EU and the USA

### 2.1. Trade and capital flows

After several decades with international investment growing faster than trade, it is important to recall that cross-border

trade flows are but one, limited, aspect of economic links between countries. This applies also to Norwegian–US economic relations: sales from affiliates are larger, in many cases much larger, than cross-border trade. This holds true for goods and services alike, and in both directions – from the USA to Norway, and the converse.

Because of geographical distance and more limited trade integration, the share of the USA in Norway's foreign economic links is much smaller than that of the EU. As shown in Table 1, the US share ranges from 4–5% for trade in goods to 8–11% for Foreign Direct Investment (FDI), with services in-between. Even though the USA is one of Norway's large trade and investment partners, its role is dwarfed by that of the EU, who accounts for shares of Norway's trade and FDI of between 53% and 82%.

Table 1. Shares of the USA and the EU in Norway's foreign economic activity

Type of activity		Year	USA (%)	EU (%)
FDI (Foreign Direct Investment)	Outward	2012	11	61
	Inward	2012	8	70
Trade in goods	Exports	2013	4	82
	Imports	2013	5	65
Trade in services	Exports	2013	8	53
	Imports	2013	7	65

Data source: Statistics Norway

### 2.2. Tariffs and non-tariff barriers (NTBs) facing Norwegian exporters in the EU and the USA

Standard Most Favoured Nations (MFN) tariffs in the EU and the USA are low and on average about 3%. Whereas Norway has no separate trade agreement with the USA and therefore faces MFN tariffs, it is deeply integrated with the EU through the European Economic Area (EEA) Treaty, which ensures tariff exemption on most goods.

NTBs are the result of various trade-related regulations such as quantity restrictions, price control, health and safety regulations, standards, and testing requirements. Several studies have attempted to calculate the trade-restricting effects of NTBs (tariff equivalents). In general these are much greater than tariffs for both the EU and the USA. Kee et al. (2009), for example, find NTB tariff equivalents of about 11.4 and 7.5%, in the two markets respectively. However, for Norwegian exports to the EU, these are probably considerably lower, due to the EEA Treaty, whereby goods are to receive mutual recognition, and many standards, rules and regulations are harmonised.

<sup>1</sup> To a large extent this brief builds on NUIPI and Norstella (2014, in Norwegian).

<sup>2</sup> Figures are nominal values for year 2010 and based on own calculations using data from COMTRADE (trade) and World Development Indicators, CIA World Factbook and national statistical sources (GDP statistics).

Although Norway enjoys free market access to the EU for most goods, EU NTBs and tariffs are important for Norwegian exports, since they grant preferences to Norwegian exporters as compared to non-EEA exporters.

Whereas the TTIP is expected to lead to the near-total elimination of all tariffs, many NTBs cannot be removed, as they may relate to safety measures, national preferences, or politically sensitive areas. Ecorys (2009) estimates that about half of the NTBs between the EU and the USA are ‘actionable’ in the sense that removing them is possible and desirable.

### 3. Effects from TTIP

Trade agreements may have positive and negative effects for third countries. Negative trade diversion effects occur because reduced barriers to trade between the EU and the USA lead them to trade more with each other and less with others. In section 3.1 we provide quantitative estimates of diversion effects for Norwegian goods export resulting from TTIP. Diversion may also occur for investments and trade in services if TTIP results in reduced barriers in these areas, but we have not been able to quantify such effects.

Diversion of trade in goods is often stronger from tariff reductions than from reductions in NTBs, because the latter may also have positive spillover effects: mutual recognition or harmonisation of rules and standards between the EU and the USA can make it easier also for third countries to export to these two.

Third countries may also benefit from increased demand for goods, services and investments in the EU and the USA. There are several reasons for this: TTIP may lead to economic growth in the two, production activities are increasingly fragmented across national borders, and FDI and services trade in several sectors are complementary to trade in goods. Norway, for instance, would probably experience an increase in demand for maritime transport services – its most important exported service to the USA.

#### 3.1. Effects on Norwegian export of goods – a diversion analysis

Here we present estimates of reductions in Norwegian goods export to the EU and the USA resulting from trade diversion due to TTIP. The calculations are crude and based on several assumptions. They should therefore be interpreted with caution and are best suited for qualitatively ranking the products that will be most affected. Two scenarios are considered: (i) elimination of all tariffs, and (ii) elimination of all tariffs and 50% reductions in NTBs.

Table 2 displays the results from scenario (ii), showing the effects for total exports and for the products with the greatest losses (in absolute values). We estimate Norwegian exports to the EU and the USA combined to be reduced by about USD 110 million (2012 value). This is a small effect, constituting only 0.1% of Norwegian export to the two, and 0.08 % of total Norwegian export. In relative terms, the effect is greater as regards the USA than the EU, and some products are more heavily affected. For the USA, these include seafood, chemical products, transport equipment, fats and machines; for the EU, the effect is greatest for seafood.

**Table 2. Reduction in Norwegian export due to trade deviation effects from TTIP (in USD 1000)**

Export to	Export of					
	Animal products*	Chemicals	Transport equipment**	Fats (mainly for fodder)	Machines	Total
EU	49 444 (0.80)	1 423 (0.03)	1 206 ( 0.08)	841 (0.36)	102 (0.00)	53 752 (0.05)
USA	20 475 (7.06)	13 946 (2.34)	13 728 (12.54)	2 830 (6.06)	2 120 (0.32)	56 875 (0.86)
EU+USA	69 919 (1.09)	15 369 (0.32)	14 934 ( 0.91)	3 671 (1.30)	2 222 (0.05)	110 627 (0.10)

Note: Figures in parentheses indicate the percentage reduction in Norwegian export to the market in question. The calculations show the effects from elimination of tariffs and 50 % reductions in NTBs. \*mostly seafood \*\* including ships and oil rigs

Comparison of the two scenarios shows that tariff elimination is the most important source of decline in Norwegian exports to the EU, accounting for as much as 94% of the total effect in scenario (ii). For USA the converse is true: here tariffs account for only 24%. However, for certain important goods like fats and machines, tariffs dominate here as well. For the EU and the USA combined, tariff eliminations account for slightly less than 60% of the total effect. This shows how even low average tariffs may have significant effects on exports. They may conceal high rates on certain goods. Moreover, small tariff reductions may have sizable impacts on exports of certain products if demand is highly price-sensitive.

#### 3.2. Effects on Norwegian GDP – earlier studies

The analysis in the previous section was only partial. More comprehensive studies take into account effects on imports as well as exports, trade in services, spillovers from NTB reductions, and other general equilibrium effects. CEPR (2013) and IFO (2013) are two important studies like that. Although the main focus is on the EU and the USA, they also calculate effects for third countries. Different modelling approaches are used. The IFO study uses a gravity model where effects from tariff reductions are calculated directly. For NTB reductions, it uses the model to estimate the effects of current Free Trade Agreements (FTAs) and assumes that the effects from TTIP will be similar. By contrast, the CEPR study uses a computable general equilibrium (CGE) model together with estimates for NTB tariff equivalents, and calculates the effects from reductions in both tariffs and NTBs directly. This makes it possible to take into account any positive spillover effects for third countries from NTB reductions. The IFO study takes spillovers into account only to the extent that they have come about through other FTAs. However, because TTIP is intended to cover such a large economic area, it may induce a convergence towards global rules and standards, which implies that spillovers will be more prevalent than under other FTAs. Spillovers would probably also be particularly important for Norway, as several rules and standards negotiated in TTIP are likely to be applicable there, due to the EEA Treaty.

Table 3 shows the percentage change in GDP due to TTIP as predicted in the two studies. Note that while Norway appears as a separate country in IFO (2013), it is lumped together with three other countries in CEPR (2013), so figures reported there are for the group. Predictions diverge considerably. The CEPR study predicts small positive effects for Norway, due mainly to positive spillover effects; whereas the IFO study predicts a fall in Norwegian GDP of almost 4% as well as an increase in unemployment of 0.44 percentage points (not presented here). Furthermore, Table 3 shows that the main effects from TTIP will come from reductions in NTBs, not tariffs. This somewhat contradicts the results from the diversion analysis in the previous section, which showed that the major part of the overall effect was due to tariff reductions.<sup>4</sup>

3 This is consistent with Fontagné et al. (2013), who find small diversion effects for third countries due to TTIP.

4 Note that CEPR (2013) uses different data for NTBs tariff equivalents than we do in our analysis in section 3.1.

**Table 3. Predicted percentage change in GDP due to TTIP**

% change in GDP	Reductions in	EU		USA		Norway	
		IFO	CEPR	IFO	CEPR	IFO	Cepr*
	Tariffs	0.2	0.10–0.11	0.8	0.04	0.0	-0.3
	Tariffs and NTBs	4.95	0.27–0.48	13.4	0.21–0.39	-3.9	0.08–0.19

Note: Figures are based on CEPR (2013) and IFO (2013). IFO analyses effects for trade in goods and assumes a 100% reduction in tariffs together with effects from NTB reductions corresponding to that of existing FTAs. CEPR analyses effects for trade in goods and services and assumes 98–100% reduction in tariffs and 10–25% reductions in NTB tariff equivalents.

\*Norway was not considered as a separate country in this study; reported effects are average effects for Norway, Australia, New Zealand and Switzerland.

Capaldo (2014) has criticised the above-mentioned studies for, among other things, not considering the costs of temporary and permanent increases in unemployment following from sector reallocations under trade liberalisation. Using the United Nations Global Policy Model (GPM), he finds that TTIP would have a negative effect on GDP in several EU countries and a slight positive effect (0.36%) for the USA. For third countries, the effects are positive but very small (0.1%). However, drawing separate conclusions for Norway would be very inaccurate, as the country is lumped together with many others in his study.

Although Capaldo draws attention to important adjustments costs following from FTAs, we doubt that the model applied is suitable for studying productivity gains from trade. Firstly, it operates with only three aggregated sectors. Hence, productivity gains following from sector reallocations (one of the main sources of gains from trade) are not likely to be taken properly into account. Secondly, the GPM is a macro-model, with behavioural rules or relationships between main variables estimated on the basis of earlier developments. In the baseline scenario (without TTIP), the model predicts a stark decline for the EU but gradual recovery for the USA (Cripps et al., 2010). According to the creators of this model, important policy changes should be reflected in changes in the behavioural rules (*ibid.*, p. 15), and one cannot simply insert new data on some variable and run the model as a black box (*ibid.*, p. 6). In parts of his simulations, Capaldo (2014) takes trade predictions from other studies on TTIP and plugs them into the GPM. His main results (*ibid.* sections 4.1 and 4.2) are based on this. We must ask whether these results follow from unchanged behavioural rules.

#### 4. Effects from a separate agreement between Norway and USA

The diversion effects discussed in section 3.1 would be irreversible for Norwegian exports of most goods to the EU. Tariffs as well as many NTBs have already been eliminated, so Norway cannot regain conditions of competition by negotiating further reductions in barriers to trade. Also for services export and investments, there are only limited possibilities for reversion of any diversion effects, since barriers are already low. For seafood, however, the picture is different. The EU is an important market for Norway; and, even though the two have a separate agreement on seafood trade, Norway still faces EU tariffs on important products like salmon, herring and mackerel. If TTIP is realised, it may become even more important for Norway to obtain duty-free export of seafood to the EU.

Since Norway faces MFN tariffs to the USA, any diversion effects there could be reversed if Norway in a separate agreement with the USA were granted the same tariff and NTB reductions as the EU. This could also boost Norwegian export of certain goods and services in addition to investments.

##### 4.1. Reduced tariffs and NTBs for goods and services

Norway faces limited tariffs for its exports to the USA: the trade-weighted average, including petroleum, is only 1%. However, exports beyond oil are dominated by price-sensitive goods like metals, min-

erals and fish, where price competition is tough and even low tariffs may bite. Melchior et al. (2009) simulates the potential for increased Norwegian goods export from tariff elimination for about 150 countries. They find that the USA comes in second, with a potential of USD 139 mill., equivalent to 1.6% of exports (2007 values). Although this is large compared to most other countries, it is not massive, because tariffs are low. However, the potential would be larger if also NTBs were reduced. In CEPR (2013), an 'impact ranking' shows the sectors with the greatest trade potential from tariff and NTB reductions. Replicating this calculation for Norway, we find that metals, chemicals and electrical machinery top Norway's ranking for goods, whereas maritime transport and business services are important for services.

**Table 4: Top export sectors in 'impact ranking' of the effect of trade liberalization with the USA**

Rank	EU	Norway
Exports of goods to the USA		
1	Motor vehicles	Other primary goods
2	Chemical products	Metals and metal products
3	Processed food	Chemical products
Exports of services to the USA		
1	Financial services	Business services
2	Insurance	Other services
3	Other business services	Maritime transports

Source: Authors' calculations based on tariffs, NTB tariff equivalents, and price elasticities (from CEPR, 2013) and Norwegian trade in goods (from WITS/COMTRADE) and services (from Statistics Norway and the US Bureau of Economic Analysis) for year 2012.

In a world of multinationals, an important point may be that Norway is only a small, peripheral part of Europe. US multinationals are likely to focus on exports to Europe more than to Norway specifically, and a substantial share of imports may be shipped indirectly, passing through trading intermediaries on the way. Comparing the value of goods shipped from USA to Norway with the value of goods imported from USA to Norway (using US/Norwegian statistics, respectively), Medin and Melchior (2014) find that the value of goods increases by about 40% on the way. This gap is considerable and probably larger than prevailing tariffs, NTBs and shipping costs. If some of this margin is a cost that may be eliminated by trade integration, that may add to the potential gains from integration.

For exports from USA to Norway, trade barriers are low for most goods. However, Norwegian agriculture is heavily protected by tariffs; and for some products of considerable interest to the USA, food standards (e.g. on GMO and hormones) are crucial and differ between Europe and the USA. If a trade agreement is to be negotiated between the USA and Norway, it is certain that the USA will demand considerable liberalisation, and this will be highly controversial in Norway.

##### 4.2. Reduced barriers to FDI

Investments between Norway and the USA are large, and mutual sales of goods and services take place more through foreign affiliates than thorough trade. Matters that affect investments are therefore important, and a separate investments agreement between the two could reverse any diversion effects. In Table 5 we present estimated increases in three variables related to FDI from such an agreement. These estimates are highly uncertain and should be interpreted with caution. We assume that the level of barriers between Norway and the USA corresponds to that between the EU and the USA, which is fairly reasonable, as Norway, through the EEA Treaty, is part of the EU Single Market, with free movement of capital. We analyse the effect of reducing the barriers between Norway and the USA to the level of internal EU barriers. This may lead to an

increase in Norwegian revenues from FDI in the USA of 15.7%, or USD 184 million. We would also expect a corresponding percentage increase in the number of US-owned firms in Norway and the number of employees in these.

**Table 5. Predicted effects from an investments agreement between Norway and USA**

		FDI variables for Norway		
FDI		Net income (in USD mill.)	Number of firms	Number of employees
From the USA in Norway	Level in year 2011	3 431	528	40 560
	Predicted increase (level)	858	87	6 043
	Predicted increase (%)	25.0	16.5	14.9
From Norway in the USA	Level in year 2011	209	182	18 068
	Predicted increase (level)	184	19	1 698
	Predicted increase (%)	33	10.5	9.4

Note: The table shows estimated effects from a reduction in barriers for inward FDI (25% for the USA, 36% for Norway).

Sources: predicted percentage changes: authors' own calculations based on information on elasticities and NTB indices for FDI in CEPR (2013) pp. 92 and 93; level numbers: Statistics Norway (SSB), the figures cover only a sample of all firms.

## 5. Conclusions

If realised, TTIP may have consequences for third countries like Norway. Here we have shown that the direct effects are moderate: reductions in Norwegian exports due to trade diversion are small at the aggregate level, albeit large for certain sectors like seafood. We have further shown that a separate agreement with the USA might serve to reverse any deviation effects there, and boost exports of goods and services in addition to investments. TTIP might also have indirect consequences for third countries, by setting guidelines for future international trade negotiations. Furthermore, in Norway new rules and laws negotiated in TTIP may be applicable through the EEA Treaty.

It is important for third countries like Norway to follow the TTTIP negotiations closely, undertake their own impact assessments, and consider how to respond to a potential agreement. However, it must not be forgotten that several other trade agreements are currently under negotiation, some of these covering much larger trade volumes than a TTIP would. One example is the RCEP (Regional Comprehensive Economic Partnership) in the Asia-Pacific, which may cover goods trade more than three times larger than what would be covered under a TTIP. In addition, the importance of strong multilateral institutions for small countries like Norway should also be borne in mind.

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