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# TTIP in the Visegrad Countries

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The proposed Transatlantic Trade and Investment Partnership (TTIP) agreement is hotly debated. Proponents hope that it boosts real income in the economies involved in it. However, as we well know from Jacob Viner (1950) and much subsequent analysis, it is not clear *ex ante* whether all partners of a preferential trade agreement actually do benefit. The reason is that the trade agreement affects relative prices, and these could easily move against some of the insiders. Moreover, in the context of Europe, TTIP is likely to create additional transatlantic trade, but it may divert intra-EU trade. Thus, it is an open question as to whether all EU members benefit from such an agreement. Here I look at a potentially vulnerable group of countries who have only recently joined the EU and who still have not fully caught up to, say German or French standards of productive efficiency and quality such as the Visegrad countries (Poland, Czech Republic, Slovakia and Hungary).

## THE STARTING POINT

All four countries (henceforth denoted V4) are very open economies. According to estimates by Costinot and Rodriguez-Clare (2015), V4 countries depend dramatically more than the overall average on international trade linkages. Up to 96 percent of national income would be lost if Slovakia were to be artificially granted a status of complete autarky; for Hungary the share would be 91 percent, for the Czech Republic 87 percent and for Poland 57 percent. Naturally, the smaller the domestic market, the larger the dependence on international trade. Thus one might conjecture that the V4 countries should also benefit more than the average from TTIP. This is what many simple trade models such as Krugman (1980) would suggest.

However, domestic market size alone is certainly not a sufficient predictor for the potential welfare gains from TTIP, particularly if a country already faces very low trade costs with its partners. Moreover, the structure of comparative advantage should matter too. Standard trade theory would suggest that countries with a very different economic structure than that of their trade partners should benefit more than countries with similar production structures. From this point of view, one might also conjecture that the V4 countries should like the idea of a transatlantic agreement.

Indeed, the results from the Eurobarometer Survey of May 2016 show that 56 percent of Poles and Czechs, 55 percent of Hungarians, and 47 percent of Slovaks support the agreement. In the Baltic States, Romania and Bulgaria support is substantially stronger. In the EU core countries Germany, Austria, and Luxembourg, by cont-

rast, the majority of citizens is opposed to the agreement. EU wide, there is a 51 percent razor-thin lead of TTIP proponents.

## SOME REMARKS ON METHODOLOGY

Reality is more complex than the cited simple models suggest. Firstly, V4 countries are strongly integrated into European production networks. This blurs the notion of comparative advantage. Secondly, the larger the potential gains from trade, the larger the costly and disruptive adjustment costs will be. The reason is that the efficiency gains from TTIP depend on the reallocation of resources such as labour from less productive sectors and firms to more productive ones. The more the productive structure of an economy is altered by the agreement, the higher the costs and the benefits. There is, however, an important asymmetry between the two: adjustment costs are short-lived, but the gains of higher efficiency endure.

Measuring the potential benefits of TTIP is fraught with problems. Firstly, the agreement is still not concluded, so one can only guess how ambitious it will be (if it comes). Secondly, even if we had a text already (which we have for the sister agreement with Canada, CETA), it is not straight-forward to quantify the trade-cost reducing effects of the innovative provisions in the agreement, namely those governing regulatory cooperation, rules, or investment protection. Thirdly, even if one has good estimates on trade cost effects, it matters what type of trade model one uses.

The approach of the Ifo Institute has been to analyse existing deep trade agreements, mostly concluded by the EU and the United States with countries like Chile, Korea, Mexico and so on, and estimate the trade cost effects that these agreements have delivered. In a second stop, these estimates are taken as a feasible scenario for TTIP. The idea is that what has been possible in other geographies should work across the Atlantic as well. Of course, the necessary condition is that there is a political will to unlock those gains. Thus, the Ifo top-down approach delivers insights into potential, or possibilities, but it is not to be understood as a forecast.

Other estimates, such as the one presented by Jan Hagemejer in this publication, have gone bottom-up. This means that analysts use industry surveys to figure out the agreement specific trade cost effects of a successful TTIP and use these in simulations. This approach is useful, because it shows very clearly which specific obstacles matter how much, but it is also problematic, because it is likely to be incomplete: the implicit, indirect, ancillary effects that have been empirically observed in other agreements are ignored. Consequently, estimates based on bottom-up effects are smaller.

## RESULTS

Table 1 shows the predicted effects on real per capita income from three studies that provide country-level details. The numbers refer to the long-run level effect: about 10 years after implementing the agreement, the

**Table 1**

**Potential long-run effects of TTIP on the level of real per capita income, %**

| Author | ifo[a] | ifo[b] | WTI[c] |
|---|---|---|---|
| Model structure | single-sector | multiple-sector | multiple-sector |
| Trade cost estimates | top-down | top-down | bottom-up |
| Poland | 3.5 | 1.7 | 0.4 |
| Czech Republic | 3.0 | 1.3 | 0.1 |
| Slovak Republic | 3.4 | 2.2 | 0.5 |
| Hungary | 3.5 | 1.3 | 0.1 |
| EU average | 3.9 | 2.1 | 0.5 |

[a] Felbermayr *et al.* (2015). – [b] Aichele *et al.* (2014). – [b] World Trade Institute (2016).

Source: Author's compilation.

average person in the country would have a flow of income that is x percent higher than without the agreement. Other frequently cited simulation exercises such as that commissioned by the EU Commission (CEPR 2013) do not provide any detail on V4 countries.

The first column refers to a study prepared for the journal Economic Policy. It applies a top-down approach to trade costs as explained above, and employs a single-sector setup that builds on Krugman (1980). The V4 countries turn out to benefit quite substantially. Over 10 years, annual per capita income would ramp up to a level between 3.0 percent and 3.5 percent higher than without the agreement and stay higher after the implementation period. It turns out that the EU average is slightly higher (at 3.9 percent). The reason for this is that the V4 countries are more strongly affected trade diversion effects triggered by TTIP. For example, with TTIP German car manufacturers might turn to US suppliers instead of Slovak ones, as the former enjoy better market access in Europe.[1]

The second column also uses the top-down approach, but moves to a multiple-sector setup and to a trade model powered by comparative advantage, rather than product differentiation. It turns out that the simulation yields somewhat lower, but still sizeable benefits, which turn out to be a bit lower for the V4 countries than for the EU average. The gains are lower because the econometric estimates underlying the scenario imply a smaller amount of trade creation, and because imposing a rigid structure of comparative advantage rules out certain benefits due to additional adjustment of the productive system.

The third column turns to a simulation exercise that provides country-level detail to the CEPR (2013) study. Now, the quantification of trade costs follows a bottom-up logic, and the model combines a comparative advantage and a product differentiation logic of trade. Its set-up resembles that of Hagemejer in this publication. The results point towards much more modest gains from TTIP, averaging at about 0.5 percent for the EU as a whole. Again, the V4 countries are found to benefit somewhat less.

Taking the second column as the one covering the middle ground, the results for Poland suggest an annual income gain worth around 200 euros. Similar magnitudes prevail for the other V4 countries, which tend to benefit somewhat less (except Slovak Republic), but have higher initial levels of per capita income.

[1] This study is an updated version of Felbermayr *et al.* (2013) (more countries, more recent data).

These gains in GDP per capita are supported by substantial increases in overall trade openness. Aichele *et al.* (2014) report increases in the share of value added in total domestic absorption. The change in this metric is intimately related to the welfare gains. The change is largest for Slovakia, where openness increases from 28.1 percent to 29.3 percent, it is also sizeable for Hungary (where it goes up from 31.1 percent to 31.9 percent), but somewhat smaller for Poland (19.5 percent to 19.9 percent) and the Czech Republic (26.2 percent to 26.5 percent). This increase in aggregate openness is driven by more transatlantic trade, but it comes at the expense of reduced European trade. Aichele et al. (2016) show that the share of exports destined for EU markets of the V4 countries may fall by about 1.5 percentage points.

## CONCLUSIONS

The following robust conclusions emerge: firstly, all V4 countries stand to benefit from TTIP – the exact magnitude of these gains depends heavily on assumptions about the depth of the prospective agreement. Secondly, countries in the core of the EU may profit more from TTIP than the V4 countries; this may lead to some very minor additional divergence in GDP per capita. Thirdly, the expansion of transatlantic trade is likely to come at the expense of a reduced relative importance of intra-EU trade.

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