

The Transatlantic Trade and Investment Partnership: The Services Dimension

Patrick Messerlin

Paper No. 6 in the CEPS-CTR project “TTIP in the Balance”
and CEPS Special Report No. 106 / May 2015

Abstract

The paper examines the main facets of the debate about TTIP and services. First, it looks at the political and economic context and the various alternatives in terms of political support, stressing that only a partnership that ensures substantial economic gains will attract the support of the top policy-makers. Second, the paper makes the point that large economic gains in services require deep discussions on regulatory issues, and third, such discussions cannot rely on the negotiating techniques normally used for goods. There is thus a need to adopt a new approach, based on the mutual recognition and equivalence of regulations enforced in the services at stake, preceded by a mutual evaluation to grant such equivalence – all measures to be carried out by the regulatory bodies concerned, not by trade negotiators. This new game is a complex one but it has huge side benefits: it induces each TTIP partner to review the quality of their own regulations; it is at ease with the notion of a ‘living’ (evolving) agreement; and it can easily be open to third countries. All these benefits should reassure a general public that is fearful of a hastily baked deal.



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Introduction

The negotiations on the Transatlantic Trade and Investment Partnership (TTIP) are far from being the first attempt to establish a ‘Transatlantic Market Place’. Indeed, the acronym ‘NAFTA’ was forged in the 1960s to designate the North Atlantic Free Trade Agreement among the US, Canada, the UK and the then European Community. This distant ancestor raises two interesting questions about the nature of TTIP.

- First, since their origin, the US-EU trade negotiations have had a geo-political dimension: the desire to shape world rules and governance, sometimes as a means of challenging other super-powers (the 1960s NAFTA initiative targeted the Soviet Union). Is this dimension still present when TTIP negotiators talk about “norms-setting” – a key question in the case of services, which are regulations (norms)-intense.
- Second, TTIP is the last ‘mega-preferential trade agreement’ (mega-PTA) to be launched by the world’s largest economies – after the Trans-Pacific Partnership (TPP), the Economic Cooperation Framework Agreement between China Mainland and Taiwan, the China-Japan-Korea, the Regional Cooperative Economic Partnership (RCEP) in East Asia, the Japan-EU Free Trade Agreement. Why is TTIP the latest of these mega-PTAs, and not the first?

The TTIP ‘negotiations’ got off to a bad start. They were launched amid an explosive cocktail of unspecified ‘grand’ ambitions, excessive secrecy, unclear concepts (harmonisation, mutual recognition, careless mention of equivalence) and totally unrealistic deadlines. All this at a time when governments on both sides of the Atlantic are trying to play down just how hard it is to mobilise the necessary coalitions for such an endeavour – a problem not specific to trade issues, but one that prevails in many domains. Add a generous dose of spying among close friends and geopolitical turbulence in the wider world, and the cocktail was ready to create huge anxiety, fear and fury among EU and US public opinion, troubled by so much bad news since 2008. Both old and new opponents to the domestic reforms that TTIP was supposed to buttress have been very easy to mobilise.

All these mistakes are particularly costly in the area of services which, as argued below, should be run by ‘talks’ (rather than negotiations), well-defined (rather than unspecified) ambitions, trust (rather than secrecy) and realistic (not unrealistic) deadlines spread over time. The problem is that the economic significance of TTIP critically depends on services,

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which represent 73-79% of GDP on both sides of the Atlantic; 35% of EU exports to the US and 43% of US exports to the EU. Last but not least, the US accounts for 34% of the foreign direct investment stocks held by the EU in the rest of the world, and 44% of the foreign direct investment stocks held by the rest of the world in the EU.

The early months of 2015 have seen two serious attempts to correct these initial mistakes. First came the transparency initiative of the Commission (January 2015), which posted papers on its website aiming to better explain the situation to stakeholders (see section 2). The second initiative (March 2015) is a paper on regulatory coherence and cooperation released by the US Chamber of Commerce – tackling head on the most crucial aspects of how to deal with services in the context of modern economies (see section 3).

The thrust of this paper is as follows. The services dimension of TTIP will bring substantial welfare gains only if the two sides are convinced that, first, they need to undertake domestic reforms to improve the performance of their services sectors and, second, that TTIP is an essential instrument to buttress and boost these domestic reforms. In turn, such a use of TTIP requires a fundamental overhaul of the way ‘talks’ – not negotiations, as explained below – in services will be held.¹ Without such innovations, TTIP will only deliver welfare gains ‘at the margins’ of the services sectors, hence undermining its capacity to attract the strong political support it requires to be concluded successfully.

The two last years have shown that it would be unwise to assume that such strong political support already exists. In fact, since mid-2014, TTIP has faced wide-ranging and vociferous opposition, including in EU member states that are traditionally free-trade supporters, such as Germany. In addition, services have considerable potential to be sources of toxic transatlantic disputes – be they old (audiovisual) or new (data protection); each of them capable of fuelling, at any time, emotional charges among public opinion of both sides of the Atlantic.

The paper is organised in five sections. Section 1 looks at the broad political economy background, particularly at the strength of domestic political support as predicted by economic analysis. Section 2 examines market access issues in services, and the desirability of TTIP as an instrument to ‘deepen’ both the EU and US ‘internal markets’ in services. Section 3 turns to what ‘talks’ on services regulations means, arguing that the success of TTIP is highly dependent on its capacity to deal successfully with this set of issues. Section 4 briefly examines the relations between the TTIP countries and the rest of the world in the services area. Finally, a section concludes on the interactions between the TTIP and Trade in Services Agreement (TiSA) discussions.

1. Political economy background

TTIP discussions in services are particularly sensitive to two key political economy issues. The first one has an international dimension: is TTIP a genuinely free-trade agreement or is it the eastern flank of the China-containing strategy that (at least some in) the US would like to see – the Trans-Pacific Partnership (TPP)? This question is particularly important since China

¹ The need for such innovations justifies abandoning the term ‘negotiations’ in services. This paper uses the term ‘talks’ for reasons outlined in section 3. This point was also stressed by P. Lamy in his speech for the Third Jan Tumlir Lecture at ECIPE (9 March 2015).

is now realising the importance of services to a fully developed economy, hence will be increasingly ready to play an active role in the plurilateral discussions on TiSA in Geneva. The second political economy issue is the magnitude of the domestic political forces behind TTIP: what can economic analysis reveal about the strength and weakness of domestic political support for TTIP?

TTIP: a genuinely free-trade agreement?

The geopolitical background is particularly important for talks on services that focus on regulations, and hence require a huge amount of trust among partners. It is reasonable to posit that the necessary level of trust can only be achieved and sustained if both partners share a relatively similar geopolitical approach.

The presence of geopolitics in the EU and US PTAs is not new. But little attention was paid to it as long as the WTO negotiating forum was functioning well. Only a few EU and US PTAs were mostly driven by economic considerations: for instance, Canada and Mexico in NAFTA; the Korea-EU Free Trade Agreement (KOREU); and the Korea-US Free Trade Agreement (KORUS). These PTAs have two specific features. First, their economic impact on the EU and US economies is limited because their partners are (relatively) small economies. Second, the EU and US partners (particularly Mexico and Korea) have been deliberately using PTAs to shore up much-needed but politically painful domestic reforms – the best illustration of which being Korea’s willingness to accept the liberalisation of its cinema market in KORUS (Parc, 2014).²

Neither of these features applies in the TTIP case. First, the impact of TTIP on each TTIP economy will be much greater than the impact of any other PTA because the economic size of the partner is much bigger and its range of produced goods and services much wider. Second, as of today, the largest EU member states (EUMS) and the US have not shown much willingness to undertake the deep structural domestic regulatory reforms that they need for their own good. Last year saw worrisome developments among the EU member states that are the key players in regulatory matters: Germany with a more regulated labour market (minimum wage) and a sudden attraction for some kind of industrial policy in services (internet operators); the UK is engulfed in constitutional debates that prevent it from exercising the great influence it once had on EU services liberalisation, hence to further expand it; a timid start to reform in France that most observers consider to be too limited to address France’s challenges.

The current deadlock in the Doha Round adds its own heavy burden to this situation; these negotiations collapsed during the July 2008 mini-ministerial meeting. The then USTR Susan Schwab had the necessary authority to strike a deal during this meeting. Officially, the July 2008 failure was a conflict between the US and India over the level of safeguard measures in the Doha Agreement in agriculture. In fact, the breakdown reflected a much deeper problem: the collision course between the US and China on global governance in the WTO. The US argued that multilateral rules should be changed to significantly reduce the degree of freedom enjoyed by the emerging economies – above all China – thanks to the developing economy status in the WTO. China disagreed, arguing that its several hundred million poor people and its very recent WTO membership still justified the remnants of its developing

² In sharp contrast to France in the TTIP.

status in the WTO. Having lost all hope of changing the WTO game in July 2008, the US Administration swiftly ‘pivoted’ towards East Asia. In September 2008, it formally notified Congress of its willingness to be part of – de facto to lead – the TPP predecessor (P4 Agreement) (Gillson & Oliver, 2012). Since then, the US has seen the TPP as the blueprint of the ‘WTO version 2.0’ that it could not establish in the WTO forum.

In short, its origin has made the nature of TPP ambiguous: is it a free trade agreement or a China-containing strategy? Signals from Washington are still hard to decipher.³ By the same token, the nature of TTIP is also ambiguous. Is the US looking essentially for economic benefits? Or is it thinking in terms of the ‘West against the Rest (of the world)’ by combining TPP (the Western flank) and TTIP (the Eastern flank), as echoed by the notion of ‘norms setting’? (Rosecrance, 2013; Eizenstatt, 2013) (see section 4).

What domestic support for TTIP?

A successful TTIP requires robust domestic support. If adequately interpreted, the estimates of TTIP benefits and costs as provided by computable general equilibrium models (see Box 1) shed interesting light on the support to be expected from the two main groups of actors in these discussions: the top decision-makers (presidents, prime ministers and equivalents) and the other decision-makers involved in the negotiations (ministers, trade officials, business people, consumers and NGOs) (Messerlin, 2013).

Box 1. Modelling TTIP

Several computable general equilibrium (CGE) studies on TTIP are available: Erixon and Bauer (2010), Francois et al. (hereafter CEPR) (2013), Febermayr et al. (2013), Kinman and Hogberg (2013) among others.⁴

For simplicity’s sake, this paper focuses on the CEPR and CEPII studies, which envisage roughly the same various levels of liberalisation: i) only tariff cuts focusing on goods; ii) a reduction of non-tariff measures covering goods and services; iii) a ‘comprehensive’ liberalisation combining tariff cuts and a reduction of non-tariff measures (NTMs).

Such estimates are subject to many limits, two of which are particularly important in the case of services. First, these estimates do not directly take into account foreign direct investment flows, which are the main channel of international competition for many services (CEPR, 2013, p. 22). Second, they aggregate all the economic activities into a very small number of sectors. This aggregation process leads to an average level of protection by sector. By construction, such a process underestimates the big welfare gains to be expected in the highly protected sectors because trade in relatively open activities is over-represented compared to trade in highly protected activities. This bias happens to be much more important for services (75% of EU/US GDP aggregated into 9 different sectors) than for manufacturing (22% of EU/US GDP aggregated into 8 different sectors) and agriculture (3% of EU/US GDP aggregated into 2 different sectors).

³ For instance, it is said that routine briefings are held on TPP by US negotiators in Beijing. In sharp contrast, no less than the US Defense Secretary has stepped into the debate on Trade Promotion Authority for TPP (International Wall Street Journal, April 8, 2015, p. 14) and a top ranking Democrat senator has declared that “the stated goal of this deal [TPP] is to lure [...] other countries away from China” (International Wall Street Journal, 18-19 April 2015, p. 10).

⁴ For an in-depth review of the CEPR model, see Pelkmans et al. (2014).

Top policy-makers

Top policy-makers (presidents, prime ministers, etc.) do not pay much attention to whether gains from a trade deal flow from agriculture, manufacturing or services. They are more interested in the expected impact of the agreement on the whole economy of their country because they see trade agreements only as an instrument to boost growth (Hamilton & Schwartz, 2012). Top policy-makers care about what happens to individual sectors only in 'crises' – big sectoral shocks, highly visible domestic vested interests; all cases that are more likely to occur in manufacturing and agriculture.

The results of the CEPR and CEPII studies are similar, and can be summarised as follows:

- Gains from a comprehensive TTIP deal (tariff cuts, reductions in NTMs in goods and services) remain limited – roughly 0.4 to 0.7% of GDP.
- Most of these gains come from the reduction of NTMs in goods.
- Gains from the reduction of NTMs in services alone are small.

Before looking at their impact on top policy-makers, the last – surprising if one considers the size of the services sectors – result should be explained in more detail. In the CEPR and CEPII studies, gains from trade are a function of two main variables: the initial size of trade flows and the initial level of protection.

- In both studies, services are (much) less traded across borders than goods. But caution is needed here. Cross-border trade is not the main channel of international competition in services. In other words, the CEPR and CEPII studies underestimate the gains from more open US and EU services sectors to the extent that they do not directly capture FDI flows.
- The two studies differ on the level of protection in services because they have adopted two different ways to estimate the level of protection.

Indeed, Table 1 shows that CEPR and CEPII estimates of the level of protection differ much more in services than in goods. However, the higher protection level in the CEPII study does not generate a much larger impact on the estimated gains than the CEPR one because trade flows in services are relatively small.

Table 1. The level of protection in the EU and US (in %)

	CEPR estimates		CEPII estimates		Ratios	
	EU	US	EU	US	EU	US
Agriculture	56.8	73.3	48.2	51.3	0.8	0.7
Industry	19.3	23.4	42.8	32.3	2.2	1.4
Services	8.5	8.9	32.0	47.3	3.8	5.3

Notes: Ratios are defined as the CEPII estimates divided by the CEPR estimates.

Sources: CEPR 2013, Ecorys 2009, CEPII 2013, Fontagné et al. (2011).

Such modest results raise a key question for top policy-makers in the US and in the larger EUMS: why risk their limited political domestic capital to negotiate a deal with limited economic gains? The situation of the US and large EUMS' top policy-makers differs from the one faced by the top policy-makers in Canada or Korea when negotiating with the US and the EU (economic gains were much more sizeable for these relatively smaller economies).

If economic gains are not attractive enough, then the fate of the TTIP at the top political level will depend on geopolitical considerations. That makes TTIP volatile, as illustrated by two

episodes: strong negative reactions in Europe (including in Germany - initially a staunch TTIP supporter) after leaks of US National Security Agency's phone-tapping; strong reactions in the US against the price agreement between the EU and China following the antidumping provisional measures on solar panel cells (*International Herald Tribune*, 29 July 2013).

The other decision-makers

If TTIP is unable to attract the attention of top politicians, its fate will be left to the many other decision-makers - officials (ministers of trade, agriculture, etc., trade negotiators and national regulators), business people, consumers, etc. involved in the day-to-day negotiations.

These actors have a much narrower scope of interest. It seems reasonable to suppose that they focus on the changes in trade balances that TTIP would generate in the sectors they are interested in. Economists do not see trade balances as a meaningful indicator, but business people, officials and journalists do. The next question is whether these decision-makers pay attention to changes in bilateral (US-EU) trade balances or to changes in global (world) trade balances generated by TTIP. What follows assumes that they pay attention to global trade balances because most of the firms involved in TTIP negotiations are multinationals (big and small) with worldwide interests and views.

Figure 1 presents the (CEPR) predicted changes in such global trade balances. For simplicity's sake, it does so only for those sectors that would witness "substantial" trade changes - substantial being arbitrarily defined as changes in trade balances larger than US\$ 1 billion in the comprehensive (tariff cuts and reduction of MTNS in goods and services) scenario. This threshold eliminates several service sectors from the TTIP political economy radar screen: water transport, air transport, communications, construction, personal services (for the EU) and other services (for the US).

For the remaining sectors, Figure 1 assesses their position on the basis of changes in their import-export ratios:

- a sector with an import-export ratio lower than 1 (imports grow more than exports as a result of the TTIP agreement) is assumed to be hostile to the TTIP.
- a sector with an import-export ratio higher than 2 is assumed to be supportive of the TTIP;
- a sector with an import-export ratio of between 1 and 2 is assumed to be 'open' to a deal until the final days of negotiations.

Cells 1, 2 and 4 capture the hostile/hesitant sectors on both sides of the Atlantic, cells 6, 8 and 9 capture the supportive/hesitant sectors, cells 3, 5 and 7 the sectors likely to be open to a deal by the end of the negotiations, either because both sides are hesitant (cell 5) or because one side is supportive and the other side hostile (cells 3 and 7).

Table 2. TTIP political economy: a sectoral view

	US sectors		
	Net ratio < 1 (expected hostile)	Net ratio > 1 and < 2 (expected open)	Net ratio > 2 (expected supportive)
EU sectors	Cell 1 Other primary sectors Electrical machinery Wood & paper products Other services	Cell 2 Metals & metal products	Cell 3 Agriculture, forestry, fish Personal services
	Cell 4 Processed foods	Cell 5 Chemicals Motor vehicles Business services	Cell 6 Other transport equip.
	Cell 7 Finance Insurance	Cell 8 Other manufactures	Cell 9 Other machinery

Note: Sectors in bold are those with the largest weight in trade changes (more than US\$ 10 billion US\$ in the comprehensive scenario).

Figure 1 suggests two main observations from a political economy perspective:

- The global *rapport de forces* based on all the goods and services that emerges from Figure 1 looks very uncertain. Only one sector (cell 9) is strongly supportive in both partners, but it is a very heterogeneous (industrial) sector, hence unlikely to be the basis of a robust coalition. The same situation prevails for cells 6 and 8.
- The relatively homogeneous open sectors (chemicals and cars) are expected to play a key role in the negotiations. The same could be expected from business services, with the caveat that it is a very heterogeneous (huge) sector.
- No homogeneous services sector (finance, insurance) is ready to be strongly supportive of TTIP. Rather, these services reflect opposing views, depending on their side of the Atlantic.

Figure 1 deserves a final caveat. As stated, most services in Figure 1 are highly aggregated, heterogeneous sectors. As a result, some activities in a heterogeneous sector could strongly support TTIP while the other activities could strongly oppose it. That said, the long history of many PTAs negotiations shows that even tiny vested interests can poison negotiations, to the point of derailing them for years. Indeed, a small services sector – the French/EU audiovisuals – has rapidly shown its trouble-making capacity in the TTIP context.

2. Market access issues

In services, the High Level Working Group (HLWG) report states three objectives: “i) to bind the highest level of liberalisation that each side has achieved in trade agreements to date, ii) while seeking to achieve new market access by addressing remaining longstanding market access barriers, iii) recognising the sensitive nature of certain sectors”.

This wording was not prudent enough. Binding is associated with the already reached ‘highest’ level of liberalisation, ignoring the massive differences among the existing level of

liberalisation within the EU (see Tables 3 and 4, below) and probably within the US. Calls for new market access target the remaining longstanding market access barriers, that is, those successfully kept by the presumably strongest vested interests. The caveat for sensitive sectors was minimal (“recognition”) – offering to the most aggressive vested interests a golden opportunity for fighting to set aside their services, such as French-EU audiovisuals and US maritime transport, despite the fact that these sectors are now much more divided about market opening than they used to be (for audiovisuals, see Messerlin, 2014).

The baseline: how are EU and US services protected?

As illustrated by the wide differences between the CEPR and CEPII estimates (Table 1), it is notoriously difficult to assess the current level of protection in services. That said, it is useful to have a sense of which are the most and the least protected services sectors – a sense of the ranking in terms of protection level that is provided by estimated *ad valorem* ‘tariff equivalents’ for the various services (CEPR, 2013). Table 3 suggests several observations in this respect:

- There are marked differences among sectoral tariff equivalents in the EU and US.
- The ranking of services sectors is not dissimilar on both sides of the Atlantic.
- There is a positive correlation between the level of tariff equivalents and the degree of ‘actionability’ (defined as the degree (according to the sectoral experts) to which non-tariff barriers can ‘realistically’ be reduced by 2018 if the political will to do so exists).
- The level of ‘actionability’ as assessed by the experts is relatively high. In other words, there is room to improve domestic regulatory quality, and by the same token market access.

Table 3. “Tariff equivalents” and actionability in services

	Tariff equivalents (%)		'Actionability'	
	US [a]	EU [b]	US [a]	EU [b]
	1	2	3	4
A. Sectors relatively more protected				
Financial services	31.7	11.3	55	49
Insurance services	19.1	10.8	48	52
Communication services	1.7	11.7	66	70
B. Sectors relatively less protected				
Other business services	3.9	14.9	49	51
Construction services	2.5	4.6	57	38
Personal, cultural & recreational services	2.5	4.4	47	37
C. Sectors with no estimated tariff equivalents				
Travel services	n.a.	n.a.	61	60
Air & water transport services	n.a.	n.a.	59	56

Notes: [a] US barriers to EU exports; [b] EU barriers to US exports.

Source: Ecorys (2009).

What does 'binding' mean in services?

The goal of 'binding', as stated by the HLWG is rather more difficult to interpret than it might seem at first glance (as is the case for goods). Table 4 illustrates this point on the EU side (for a detailed review of barriers in EU services, see Mustilli and Pelkmans (2013)). It provides the highest and lowest OECD-calculated "product market regulations" indicators for 18 EUMS, with the name of the corresponding EUMS for 2007, and for 2003, 2007 and 2013.⁵ Naming the EUMS allows more light to be shed on the 'large' EUMS, which are likely to have more weight in the negotiations. It also gives a better sense of the two possible layers of the TTIP discussions: the one that is ongoing between the US and the EU, and the one that could be conducted among the EUMS and the various states of the US.

Table 4. Barriers to market access in selected services and EUMS, 2003-2013

	Highest PMR		A: Highest		B: Highest PMR in		C: Lowest	
	2003	2008	PMR	EUMS	PMR	EUMS	PMR	EUMS
Electricity	68	67	54	Estonia	53	France	15	Spain
Gas	89	69	63	Greece	42	France	0	Britain
Post	78	72	56	Slovenia	56	Italy	11	Netherlands
Telecoms	52	38	33	Slovenia	19	Germany	5	Britain
Airlines	82	83	59	Slovenia	8	France	0	5 EUMS [b]
Rail	100	88	81	Ireland	67	Spain	4	Britain
Road	100	71	71	Italy	--	--	25	8 EUMS [c]
Retail	78	76	68	Belgium	53	Italy	10	Sweden
Prof. services [a]	59	50	48	Hungary	44	Germany	9	Sweden

Notes: [a] Accounting, Architect, Engineer, Legal. The 'large' EUMS are the UK, France, Germany, Italy and Spain. [b] Austria, Germany, Greece, Hungary, Slovakia. [c] Austria, Denmark, Finland, Germany, Ireland, Slovakia, Sweden and the UK.

Source: OECD (2014).

Table 4 helps to convey the elusiveness of the notion of "binding" as stressed by the HLWG report, and the huge differences in its various interpretations, such as:

- Would it consist of binding the autonomous liberalisation carried out between 2003 and 2013 by the most protected EUMS (the one having the highest PMR in 2013)? In this case, Table 3 shows that such binding would consist of limited additional market access.
- Or would it consist of binding the PMRs at the level of the second-highest PMR among the large EUMS in 2013? In this case, binding would generate rather better market access to most services sectors in the most protected EUMS.
- Or would it consist of binding the PMRs at the level of the most open large EUMS? This would create substantial (huge in some sectors, such as electricity, gas or airlines) new market access in the most protected EUMS.

⁵ The original range of the PMR indicators is 0 to 6, from the least to the most restrictive countries. A larger range (0 to 100) is used because it seems easier to read. But these PMR indicators should not be interpreted as tariff-equivalents since they only rank the existing level of protection associated with current services regulations in the services sectors covered. The services listed in Table 4 represent roughly two-thirds of the entire US and EU service sectors.

Crucially, a complete assessment of the notion of ‘binding’ in TTIP would require equivalent information for the American states. There is some evidence that the American states also have regulatory differences in a significant number of service sectors. Unfortunately, there is no systematic evidence of such differences and providing such an assessment appears to be one of the most pressing tasks in the TTIP context. It would either dispel² wrong expectations from the EU side if differences among American states happen to be small. Or it would make these states more conscious of the internal reforms they need to implement for their own good if differences happen to be large – illustrating the role of trade agreements as a boost for better domestic governance.

The state of play

Nothing in the TTIP will limit the ability of both sides to provide state support to public services, to designate public monopolies or to place limits on market access and national treatment regarding publicly funded education, health care or water services (Heydon, 2015). There is a long tradition in trade agreements of not dealing with such sectors. This situation is reinforced in the TTIP case by less polarised views on both sides of the Atlantic on these matters – the US and the EU are becoming more accommodating on these issues because their education, health and water services face problems that are different but severe in both economies. There now seems to be a willingness to learn lessons from others rather than impose any specific regime.

In January 2015, the EU Commission improved its website on the TTIP in order to give a better idea about what was going on. However, services are not as well covered by this effort as industrial goods. In its two-page ‘Fact sheet’ cover for services, the Commission lists five broad goals in a few words each:⁶

- tackle barriers in maritime services and in “other” (unspecified) services;
- improve mobility of qualified providers of professional services (such as architects or lawyers);
- make it faster and simpler to obtain licenses or formal approval in services like banking and insurance, accountancy, management consultancy and legal advice;
- agree on new rules in telecommunications, e-commerce, financial services, postal and courier services, and maritime transport;
- ensure protection for sensitive sectors such as audiovisual, public health and education, social services and water distribution.

The two other Commission papers that deal with services are devoted to “TTIP and culture” and “Protecting public services”. But these papers simply restate the usual EU position on these topics – ranging from reluctance to outright opposition.

The US equivalent website is both more laconic and more vague. It states briefly that the US seeks:

- to obtain improved market access in the EU on a comprehensive basis;
- to address the operation of any designated monopolies and state-owned enterprises, as appropriate;

⁶ European Commission website (<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1230>).

- to reinforce transparency, impartiality, and due process with regard to authorisations to supply services; and
- to obtain additional disciplines in certain services sectors, while improving regulatory cooperation where appropriate.

A better idea of the current situation may be provided by using non-official sources. In Europe, a recent communication from the European Services Forum (the most active coalition of EU service providers) lists six services where the EU believes to have strong export interests: professional services, maritime transport, aviation transport, financial services, mobility of services suppliers and public procurement in services (Kerneis, 2015). It also stresses the US reluctance to tackle the key issue of US-driven regulations and/or enforcement (particularly in professional services) and American unwillingness to discuss financial services, mobility of services suppliers and the Jones Act (maritime transport) in particular.⁷ In the US, a forthcoming book adds three other recommendations for a TTIP compromise to the usual general desire for TTIP commitments to go beyond TiSA commitments: to target infrastructure, information communications technology and construction; to delay the application of TTIP obligations with regard to financial services regulatory policies until three years after the entry in force of TTIP; that is, once regulatory restructuring in each market is solidified. Finally, there is a desire to coordinate US and EU efforts to produce a successful TiSA in Geneva (Schott et al., forthcoming).

The last point to be examined is the fundamental choice among the two modalities available to the negotiators: would negotiators work on 'negative' or 'positive' lists of services to improve market access? The EU has traditionally relied on the positive list (only the sectors listed are liberalised, as in the KOREU agreement) while the US has traditionally relied on negative lists (every service is deemed to be liberalised except those listed, as in the KORUS agreement) – at least as long as US barriers are not imposed by American states (in some sectors, such as professional services, a US federal offer is of very limited interest since many American states have very specific regulations). Evidently, negative lists offer a much clearer view of what is effectively liberalised. By contrast, positive lists often require from the service providers a thorough knowledge of what has not been liberalised, which is crucial to take advantage of the agreed liberalisation provisions – a constraint that imposes high costs on foreign newcomers, and considerably weakens the pro-competitive impact of the liberalisation measures.

The EU seems ready to shift to a negative list approach. But, the full consequences of this shift on the whole TTIP architecture remain to be seen. First, the EU has to make its new negative list approach consistent with its previous positive list approach in its other PTAs, which means re-phrasing the many exceptions granted to EUMS. Second, such an exercise would logically require that the US starts to list its commitments at the American state level; an exercise it has rarely carried out before (the best illustration being public procurement) and may not be ready to do so.⁸

⁷ The Jones Act requires that all goods transported by water between US ports be carried on [US flagships](#), constructed in the US, owned by US citizens, and crewed by US citizens and US permanent residents.

⁸ For a detailed discussion of public procurement issues, see Woolcock and Grier (2015).

A 'static' vs. 'dynamic' negotiating structure

The current situation is thus problematic. It would greatly benefit from a table of 'enlarged' negotiations (in a form to be defined) to the EUMS and American states themselves. Why is the case? Table 4 suggests that the EU internal market is still very fragmented since PMRs vary considerably among EUMS (see also Miroudot and Shepherd (2011)). If it were possible for US or EU firms to export their services from a relatively open EUMS to a more protected EUMS, then efficient US and EU service providers would have established their activities in the most open EUMS and operate from there towards the rest of the EU. But if this were the case, then keeping high barriers at the EUMS level would make little sense for the most protected EUMS. In other words, the existence of high PMRs across EUMS is a robust indicator that the EU internal market remains fundamentally incomplete.

This lesson is essential because it suggests the adoption of a TTIP negotiating structure that is more conducive to a 'deep' liberalisation in services than the current one. As of today, the structure of discussions is exclusively bilateral – that is, the US vs. the EU. By contrast, a more open structure of discussions that would involve (in ways to be found) individual EUMS and the US could develop interesting dynamics that would enlarge the frontiers of the available concessions in the direction of 'deeper' liberalisation. For instance, service providers from the most open EUMS and the most open American states in a given service would have an intrinsic interest in building an explicit transatlantic coalition in their sector in order to open the markets of the most protected EUMS and the US for the service in question. This approach is perfectly consistent with the need to involve regulators in talks on services, which is highlighted below (section 3).

3. Regulatory issues

The first question when discussing services in a trade deal is whether these discussions should be limited to pure market access issues (allowing foreign firms to enter new markets without taking into account the impact of the existing regulations) or whether they should include 'talks' on regulations (examining whether some regulations constitute unjustified barriers to market access). The frequency and magnitude of NTMs in services explains why discussions in services very often boil down to 'talks' on regulations, as in the case of TTIP (Chase & Pelkmans, 2015).

This raises two challenges for a deal in services. The first is well known and occurs during the negotiation phase: it is hard to assess the level of 'unjustified' restrictions imposed on business in a given service by existing regulations. The second challenge is rarely mentioned although it is probably more important. It occurs after the conclusion of a deal: it is very difficult to monitor the faithful implementation of the liberalisation commitments of a trading partner. This is different from tariffs on goods where each country can easily monitor whether its trading partner is cutting its tariff as agreed. The post-agreement monitoring of commitments in services is particularly difficult when a partner modifies its regulations in order to improve the functioning of the service market at stake. By doing so, a partner may well make a foreign services provider's life more difficult, giving the impression of having reneged on its commitments.

All these challenges make it clear that 'talks' on services regulations should rely on innovative techniques or they will end up with pleasant but empty words.

How to 'talk' on services regulations? Innovation urgently required

The first step to defining innovative techniques is to be clear about words. The HLWG report is remarkably vague in this respect. It refers almost indiscriminately to “harmonization”, “mutual recognition”, “mutual equivalence”, “regulatory convergence”, “regulatory cooperation” and “regulatory coherence”. This vagueness has fuelled suspicion and fear among public opinion that TTIP would boil down to a ‘single transatlantic market’ imposing changes in regulations on both partners that would inevitably lead to a general race to the bottom.

After months of confusion, a recent paper by the US Chamber (2015) is the first attempt in circles close to the TTIP discussions to clarify two of these terms: “regulatory cooperation” and “regulatory coherence”:⁹

- regulatory coherence is “*about good regulatory practices, transparency and stakeholder engagement in the domestic regulatory process*”. Clearly, regulatory sovereignty cannot be limited by regulatory coherence, which is an entirely domestic matter. The only influence that TTIP could have on regulatory coherence is very indirect. It would consist of stimulating emulation among partners: the partner having the better practices in a given service is likely to emulate its partner in this service (and vice-versa for other services).
- regulatory cooperation “*is the process of interaction between US and EU regulators, founded on the benefits regulators can achieve through their partnership and greater regulatory interoperability*”. Here again, regulatory sovereignty is not limited by a regulatory cooperation process which puts the appropriate regulators (not the trade negotiators) explicitly in the driving seat of the TTIP talks, which are those in charge of the services at stake.

That said, adopting innovative techniques in the talks on services regulations requires clarification of the four remaining terms: harmonisation, mutual recognition, mutual equivalence, regulatory convergence (Messerlin, 2007, 2011, 2014).

Harmonisation (and regulatory convergence)

In their daily speeches, most TTIP trade negotiators and EU decision-makers refer to harmonisation (see Fabry et al. (2014)). This is rather paradoxical because the history of the EU internal market is a long history of failure to harmonise, especially in services. There is a good reason for such a poor outcome. As modern economies are characterised by a huge variety of differentiated services, a regulation can work well in one country, and badly in another. The OECD database on regulations in services shows that, in most services, only a few regulations have a systematically detrimental impact in all member states on the efficient provision of the service at stake. Moreover, the simultaneous but uncoordinated negotiations of several mega-PTA add another reason to doubt the usefulness of the harmonisation instrument in such a context: how could it be possible to harmonise at the same time and in a consistent way within TTIP, within TPP and within EU-Japan?

Regulatory convergence is a weak variant of harmonisation. It consists of a belief that, although harmonisation is not possible now, it will occur over time. Such a belief relies on an

⁹ The Commission’s website still illustrates this confusion with the title “Regulatory Cooperation” as its first paper under the “Regulatory Coherence” chapter.

unfounded assumption: the existence of an ideal regulation in a given service that would be better than all the other alternatives for all the partners – an assumption very unlikely to be met for reasons mentioned above on the dominant role of differentiation in modern economies. Indeed, such a belief is not supported by evidence in the EU case. It would suggest that over time the EUMS regulatory performance would have become increasingly similar – an observation that is not supported by the available indicators such as those of Doing Business or the World Economic Forum. These indicators do not suggest that the EUMS converge to the same level of regulatory quality. Rather, they suggest complex trajectories over time, with some EU-founding EUMS having slipped behind some recently acceded EUMS in terms of regulatory quality.

Mutual recognition

Mutual recognition (MR) means that each party accepts the regulations of its partner for the services at stake. But this recognition is conditional upon the adoption of a ‘core’ of common provisions (“essential requirements” in EU legal jargon). MR is thus a hybrid instrument: there is a harmonised “core” of provisions, and only the remaining provisions are subject to mutual recognition. As the core is harmonised, the whole MR approach suffers from the same limits as harmonisation – pressures from firms and their backing EUMS for limiting the pro-competition impact of MR by imposing core provisions making costly entry to market. Over time, as core provisions have often been more numerous and costly, MR has increasingly drifted towards harmonisation – hence today a very imperfect “internal market” in many services.

Mutual equivalence

Mutual equivalence (ME) means that each party considers the partner’s regulatory package – the regulations *per se*, the certification or licensing procedures, or both – in a given service as “different but equivalent” to its own.¹⁰ To be politically acceptable, ME requires a systematic crucial step: a joint process of “mutual evaluation” of existing regulations (and their certification or licensing procedures) by the regulating bodies of the partners. The aim of this joint evaluation process is for each partner to decide whether the regulations at stake could be accepted as equivalent or not. (Such an involvement of the national regulatory bodies fits the definition of regulatory cooperation in the US Chamber’s paper perfectly.)

At first glance, ME seems a bold move into the unknown. The EU’s perspective is somewhat different, however. In sharp contrast to the case of goods, the EU has drawn its conclusions about the poor performance of harmonisation and MR in services by adopting the ME approach when designing its 2006 Services Directive (Article 15 of this Directive provides a fine description of what should constitute ‘talks’ in services).

The joint process of mutual evaluation of their respective regulations by the two TTIP partners has two interesting features. First, it reinforces the good regulatory practices required by domestic good regulatory coherence. As it requires the involvement of the partner’s regulating bodies in the negotiating process, it suggests some kind of division of labour between TTIP trade negotiators and national services regulators. Trade negotiators

¹⁰ Of course, there is the option of “unilateral equivalence”: one partner considers the partner’s laws and/or processes as equivalent to its own regulations, while the other partner does not do the same.

could suggest broad areas of services they consider as promising candidates for the ME approach in the TTIP. Then, national regulators in charge of these services should confirm these opportunities and undertake the mutual evaluation process consisting of:

- Examining the partner's regulations;
- Asking for clarifications and possibly changes in the partner's regulations as pre-requisites for granting the ME status;
- Defining exceptions (if any) for some sub-sectors of the services examined and,
- Requesting reviews to be performed after a few years.

The joint evaluation process offers a unique opportunity to build, restore and/or improve trust within each signatory and among them. First, within each signatory. Among the most interesting documents on the Commission's website on TTIP are those on the joint evaluation of seatbelts and lighting and visibility for cars.¹¹ These documents offer a very careful technical review of each element of these two essential components of car safety. The EU public has thus the best available assessment of EU regulations by the US and EU regulators, and vice-versa. Second, trust is built among the signatories. It would be unwise to assume that the US and the EU have little need to build trust. Paradoxically, the long history of the transatlantic trade tends to highlight cases where mistrust has flourished. In this respect, mutual evaluation offers an appropriate solution to such situations.

A realistic bundle of techniques

Of course, it would be unwise to assume that TTIP negotiators could shift entirely to the ME approach. First, it cannot be excluded that harmonisation could remain the best solution in rare cases. Second, the ME approach requires a serious change of mind from regulators, trade negotiators, the public and, last but not least, by politicians since, at least in some TTIP countries, regulators are closely monitored by parliaments. As a result, the TTIP negotiators may have to stick to the traditional MR approach in a substantial number of cases for some time in the future.

Such a situation is not a serious problem as long as TTIP is conceived as a living agreement – meaning that the EU and the US agree to return to the table of negotiations within a few years after the conclusion of this first episode of TTIP negotiations in order to further deepen and/or expand their market opening. Indeed, the joint process of mutual evaluation itself requires time to be appropriately conducted, and also a living agreement in order to review the previous evaluations, if needed.

4. TTIP and the world

Almost any PTA is doomed to generate discrimination against non-PTA members. This discrimination is costly for efficient non-PTA producers that are excluded from the PTA markets, and by the same token for the PTA consumers who buy goods produced in the PTA which happen to be less expensive than those produced in the rest of the world only because efficient foreign producers have still to face trade barriers on their products. These general remarks raise four specific issues in the TTIP case: the likelihood and magnitude of its discriminatory impact, the case for compensating spill-over effects, preference erosion of

¹¹ European Commission website (<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1230>).

previous EU and US PTAs, and the beneficial impact of mutual equivalence in this worldwide context.

TTIP discriminatory impact

The TTIP is the PTA between the current two largest world economies. It may thus be a source of discriminations on an unprecedented scale (for a more detailed examination of the risks of discrimination, see Akman et al., 2015). In a nutshell, the risks and costs of discrimination depend on three key elements:

- the higher the initial (pre-TTIP) MFN protection of the TTIP countries,
- the deeper the intra-TTIP liberalisation, and
- the stronger the intra-TTIP emulation long-term dynamics (the capacity to ‘deepen’ further the transatlantic market access as time flows) are,

the higher the risks and magnitude of discriminatory impacts on non-TTIP economies. For instance, a ‘deep’ TTIP agreement in agricultural products would open wide the highly protected EU markets to US products to the detriment of similar goods produced in the rest of the world at a much lower cost, since the EU MFN barriers are high in agricultural products. Similarly, the high *ad valorem* equivalents shown in Table 3 clearly set out the risks of strong discriminatory impact in the most protected services.

That said, it is often stated that the risks of discrimination are much lower in services than in goods because it is difficult to open markets in services in a discriminatory way. However, there is no systematic evidence of such an intrinsically ‘non-discriminatory’ nature of services regulations. Rather, Table 4 supports the opposite view: the remaining range and magnitude of intra-EUMS barriers in services suggests strong possibilities of substantial discriminatory protection.

Spill-over effects

The potential discriminatory impact of TTIP on non-TTIP economies could be mitigated by the fact that dismantling barriers between US and EU markets would generate positive ‘spill-over’ effects for the rest of the world. There are two kinds of spill-over effects. Direct spill-over effects would occur if post-TTIP regulations in the US and the EU would decrease trade costs, not only among the US and the EU services providers, but also those of the third countries exporting to the US and to the EU. Indirect spill-over effects would occur if third countries adopted ‘better’ regulations that TTIP partners would adopt in the emulation context examined in section 3.

Spill-over effects are mere possibilities. Their likelihood and magnitude are unknown. From a policy perspective, it is important to stress the fact that the nature of these two spill-over effects is very different.

- Direct spill-over effects do not require action by third countries. They are provided somewhat ‘automatically’ by post-TTIP regulations, which are assumed to be cost-improving for non-TTIP and TTIP service providers. It is crucial to stress that such situations depend, at least partly, on the instruments used in the ‘talks’ on services regulations. Under harmonisation and mutual recognition, post-TTIP regulations are entirely (harmonisation) or partly (mutual recognition) negotiated. As experience shows, it is far from certain that negotiated regulations are necessarily better than the pre-existing ones: this is because they are the outcomes of political compromises that may

ignore important economic and technological aspects. By contrast, because it introduces emulation among regulators, mutual equivalence (ME) is more amenable to the possibility of post-TTIP regulations being truly better than the pre-TTIP ones.

- Indirect spill-over effects require appropriate action by third-countries which choose to align their national regulations to the post-TTIP regulations. Hence, such spill-over effects should rather be interpreted as autonomous (unilateral) liberalisations undertaken by third countries. It seems quite inappropriate to interpret them as a TTIP result. Once again, such unilateral liberalisations are likely to occur more often in a context of ME-engineered regulatory emulation among TTIP regulators eager to deliver better regulations.

Preferences erosion

The non-TTIP economies are not 'equal' with respect to the TTIP discriminatory potential.¹² Non-TTIP countries with a PTA with the US and/or the EU already in place have a kind of 'insurance' scheme against TTIP discriminatory impact. (The case of non-TTIP economies without a PTA with the EU and the US is examined in the concluding section.) EU and US PTAs with a substantial services dimension are rare: Canada, Chile, Korea and Singapore with both the EU and the US, Australia and Mexico with the US. The deeper the existing PTAs with the EU and/or the US, the better the 'insurance' scheme of the non-TTIP country.

That said, the preferences that the non-TTIP countries listed above could have enjoyed under their PTAs with the EU or the US will be eroded or eliminated by TTIP to an extent that depends on the TTIP's own 'depth'. From these non-TTIP countries, such a turn of events may be painful for their service providers that will face increased competition from additional TTIP services providers. But, viewed from a world welfare perspective, this evolution should be seen as positive: preference 'erosion' is a systemic, inevitable and indeed desirable down-side effect of PTAs in a world subject to the permanent forces of further liberalisation.

Mutual equivalence and world welfare: from 'norm setting' to 'norm attracting'

Finally, the impact of TTIP on the rest of the world's economies depends on the 'basic philosophy' of TTIP negotiations. TTIP negotiators have often made reference to TTIP as a 'norm-setting' endeavour for the rest of the world, particularly in the context of regulations. This notion conveys a sense of TTIP as a duopoly of (shrinking in relative terms) economies trying to impose their regulations on the rest of the world while there is still time. This is not a very convincing approach, for two reasons. From an international relations perspective, it is hard to believe that the large non-TTIP economies will accept such a set of '*diktat*'. From an economic perspective, such an approach increases the risks and magnitude of TTIP

¹² Of course, there are the options of 'opening' TTIP to other countries on an *ex post* basis and the option to design it as an open agreement. Such options will substantially reduce the TTIP's discriminatory impact and the risks of preference erosion. Despite their intellectual attraction, it is fair to say that such options have rarely been used in the past and, more decisively, that they do not fit today's mood in trade matters. That said, the mutual equivalent approach can easily be adapted to such options on a case by case basis.

discriminatory impact because the EU and the US, being very similar economies and societies, inevitably have intrinsic difficulties to take into account the wide range of regulatory capacities and objectives in the rest of the world.

That said, once again the choice of the techniques used for talks in services plays a key role. Harmonisation and mutual recognition have an intrinsic bias in favour of 'norm setting'. By contrast, mutual equivalence offers the alternative of a dynamic 'norm-attracting' approach because it generates *de facto* emulation among the regulatory bodies of TTIP members, hence giving incentives to each regulator to provide the best regulations to its domestic firms.

- The more innovative a TTIP regulator member is, the more attractive the regulations it designs may be for its own domestic firms and possibly for the TTIP partner's firms.
- The more innovative a TTIP regulator is, the more attractive it may also be for third-countries' service providers. As a result, third-country service providers may be induced to enter TTIP markets via the most innovative TTIP member (a case of direct spill-over effects) and/or to adopt regulations similar to those of the most innovative TTIP member (a case of indirect spill-over effects). Of course, all these dynamic effects are conditional on the fact that TTIP has no restrictive rules of origin on foreign services or services providers.

Last but not least, mutual equivalence is the best protection against regulatory reforms that would diminish the country's welfare – the much feared 'race to the bottom'. Not only is such an attempt the last thing to expect from a regulator (it would be suicidal), but promoting welfare-diminishing reform would also immediately trigger the partners' regulators withdrawing their agreement for mutual equivalence for the regulation at stake.

In short, by inducing TTIP to shift from a 'norm-setting' to a 'norm-attracting' perspective, mutual equivalence largely blurs the frontiers between multilateral and bilateral negotiations by creating permanent incentives among the TTIP members to take into account the rest of the world – the multilateral dimension – when reforming their domestic regulations.

Concluding remarks: TTIP, the WTO and TISA

In order to eliminate the risks of discrimination generated by TTIP, non-TTIP countries with shallow or no PTAs in services with the EU or the US could apply some collective pressure to re-launch the WTO negotiations in services or to focus on the Trade in Services Agreement (TiSA) discussions.

Re-launching (it would probably be more accurate to say launching) the services negotiations in the WTO forum is highly unlikely. The paper has provided ample explanation that talks on services regulations require a level of trust among negotiating countries to a point never before needed in the case of negotiations in goods. Trust is necessary to assess regulations that are hard to compare. It is needed to monitor the implementation of the agreed commitments in an economically sound way. And it is needed to use the mutual equivalence instrument – both at the preliminary stage of the joint mutual evaluation and during the regulatory emulation process that mutual equivalence nurtures. The WTO cannot provide the sufficient level of trust needed: each member cannot trust all its (current) 159 partners.

The trust factor can be (much) better handled by plurilateral negotiations, such as TiSA, because of their limited number of like-minded participants. Indeed, today TiSA negotiators

are testing the level of trust that could exist in TiSA, including if China or other large emerging economies enter into these negotiations.

In this context, the fates of TTIP and TiSA appear largely interdependent – more precisely the mirror image of each other. If the TTIP negotiations do not see the necessary innovations in services ‘talks’, they are unlikely to deliver more than improved market access at the margin. Political support is then doomed to be low and the whole fate of TTIP becomes volatile and highly subject to political turbulence and/or on small but aggressive vested interests.

In such a case, TiSA becomes an attractive alternative to TTIP. The reason is not that TiSA will deliver significantly deeper results than those of TTIP. In fact, TiSA is unlikely to be friendly to a mutual equivalence process – the only one that is promising in terms of substantial economic benefits. But it will deliver (very) limited additional market access on a wider range of countries – hence possibly on a wider range of services. As a result, it is quite possible that the global outcome to TiSA would be (notably) higher than the TTIP outcome if TTIP negotiators are unable or unwilling to use innovative ways to hold ‘talks’ on services regulations.

If correct, this analysis suggests that a good yardstick to measure true progress in TTIP talks in services is not TTIP negotiators’ declarations or the number of TTIP negotiating rounds, but the intensity of TiSA negotiations.

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