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Investment accords come under growing scrutiny

More voices are being raised, not only in developing but in developed countries as well, questioning the wisdom of signing trade and investment agreements which would allow foreign investors to sue governments in international tribunals. The increasing calls for a rethink of such treaties are prompted, among others, by concerns over bias and flaws in the so-called investor-state dispute settlement system.

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131 Jalan Macalister
10400 Penang, Malaysia
Tel: (60-4) 2266728/2266159
Fax: (60-4) 2264505
Email: twnet@po.jaring.my
Website: www.twn.my

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Tide turns on investor treaties

The winds of change are blowing against trade and investment treaties that contain the investor-sue-the-state system, which is now described as "toxic" by Western politicians and media.

by Martin Khor

The tide is turning against the controversial system in which foreign companies are allowed to sue governments of their host countries in a foreign court for millions or billions of dollars.

At first it was the developing countries that started to rebel against the system, known as investor-state dispute settlement (ISDS), which is embedded within bilateral investment treaties (BITs) or in free trade agreements (FTAs).

South Africa, Indonesia and Bolivia have withdrawn from the BITs they signed with other countries, following cases taken against them by multinational companies that made claims of up to $3 billion, in the case of Indonesia versus a British oil company.

Other developing countries are reviewing their BITs or weighing whether to sign up to FTAs they are negotiating that contain the ISDS system.

It is a matter of time before many of them decide to pull out or give notice that they are allowing existing BITs to expire without being renewed.

Developed-country opposition

More surprising is that the disquiet against ISDS has spread to prominent developed countries, their institutions and establishment media.

The German government shocked Europe when it announced it would not sign up to a free trade agreement that the European Commission had concluded with Canada on behalf of the 28 European Union states because it contains the ISDS system. It is inconceivable that the FTA can take effect if Europe's biggest economy refuses to be part of it.

Germany has also made clear it does not want the ISDS system to be inside the Transatlantic Trade and Investment Partnership (TTIP) that the European Commission is negotiating with the United States.

This is a remarkable turnaround since Germany has been one of the main advocates of BITs. One reason for this is that two cases have been brought against the country by a Swedish company claiming many billions of euros of lost profits because of new German policies to phase out nuclear power and to tighten emissions regulations in power plants. That the country's environmental policies are being challenged in such an audacious way, and that this is made possible by a skewed ISDS system, outraged the public, the parliament and the government.

Germany was not the first developed country to turn around. A few years ago, Australia decided not to enter any new BITs or FTAs that contain ISDS, after its government was sued for billions of dollars by Philip Morris for its policy requiring minimum display of corporate logos on cigarette packages. The new Australian government has since watered down this ban by considering membership of FTAs with ISDS on a case-by-case basis.

Meanwhile, two of the new top officials of the European Commission, the President and the Trade Commissioner, both made known their scepticism if not opposition to ISDS when they took office a few weeks ago. The Trade Commissioner even called ISDS "toxic". Both officials hinted that they would make it difficult for future EU trade deals to contain ISDS.

The new EC leaders were partly responding to the European Parliament, many of whose members are strongly opposed to having ISDS in the TTIP.

European non-governmental organizations are also up in arms against ISDS, accusing the international tribunals that hear the cases of being heavily biased in favour of investors and against the states, and also of being riddled with conflict-of-interest situations.

The same 10 to 20 law firms act as lawyers in some cases and as arbitrators in others. In one case, the chair of a tribunal that ruled against Argentina was later found to be a board member of the parent company of the firm that sued and won. Yet a review panel ruled that the decision would remain and that there was no need for the case to be heard again by another panel.

Another blow against the ISDS system came when the Secretary-General of the OECD, the club of developed countries, wrote an opinion piece on the "increasing problems" of the investment treaties.

Then the *Financial Times* and *The Economist*, the two most prominent pro-free enterprise newspapers in the Western world, also joined in the onslaught against BITs. The *FT* even published a full-page article on what it headlined as "toxic deals."

The winds of change were also evident when many governments and organizations spoke in favour of urgent reform of the whole ISDS system at the World Investment Forum organized by the UN Conference on Trade and Development in Geneva in October.

The criticisms against ISDS include that the provisions of the treaties are problematic, the arbitration system is biased and flawed, and that national laws, parliaments and government policies are being seriously undermined by allowing foreign investors to bypass them by taking up cases in international tribunals that do not take account of the national laws when making their decisions. ❐

Martin Khor is Executive Director of the South Centre, an intergovernmental policy think-tank of developing countries, and former Director of the Third World Network. This article first appeared in The Star *(Malaysia) (24 November 2014).*

Investment treaties bring more risk than benefit

Developed countries rethinking the merits of investment accords can look to South Africa and Ecuador for examples of the potential harm these pacts pose – and of what can be done about it.

by Kevin P. Gallagher

As they negotiate a mega-trade and investment deal with the United States – the Transatlantic Trade and Investment Partnership (TTIP) – Germany and the rest of Europe have recently started to question the merits of signing treaties that allow private investors to sue their governments over new regulations to promote economic prosperity.

This is old news to emerging-market and developing countries that have experienced an onslaught of corporate suits against their governments as they have attempted to foster policies for human rights and environmental protection that create inclusive growth for their citizens. While Europe debates the costs and benefits of signing a deal with the US that allows such loopholes, pioneering nations such as South Africa and Ecuador offer sober lessons.

Both South Africa and Ecuador have been subject to pasts where ultra-right regimes favoured foreign-driven elites. By the turn of the century both countries had toppled such regimes in favour of new governments focused on correcting past inequities and putting their countries on a path of broad-based equitable prosperity.

Yet, to allay fears, once these new regimes took office, South Africa and Ecuador both signed or inherited whatever they could to send the "right" signals to the world investment community that they were open for business and that the boat wouldn't be rocked.

Then each country discovered that they had signed on to treaties that allowed the very interests they toppled to take them to secret tribunals that could potentially overturn the very foundations of the new societies they sought to justify. That's right, if you signed a trade or investment deal with the US or a European nation over the past few decades, you are under much more scrutiny than if you are simply a member of the World Trade Organization (WTO), where just states file claims against each other. The deals across Western and developing countries, more often than not, allow private firms to directly sue a government.

In South Africa, foreign investors found loopholes to sue the South African government in private for its policies to promote greater equality in its lucrative mining sector. South Africa had required that these companies be partly owned by "historically disadvantaged persons."

In Ecuador, foreign investors attacked the country for new environmental regulations that enjoined foreign firms to clean up their act and engage with local and indigenous communities that had long been exploited.

After foreign firms attacked the black empowerment law, South Africa put in process an all-inclusive multi-stakeholder review of all its bilateral investment treaties. The government concluded that these treaties were inconsistent with its new constitution that aimed to restore the human rights and improve the employment prospects of South Africans. Bilateral investment treaties, the review found, "pose risks and limitations on the ability of the government to pursue its constitutional-based transformation agenda." Since this review, South Africa has further concluded that "bilateral investment treaties were now outdated and posed growing risks to policymaking in the public interest."

On that basis, the government has recently moved to terminate many of its bilateral investment treaties. South Africa is far from thumbing its nose at foreign capital. Alongside the carefully negotiated withdrawal from its treaties, South Africa is willing to renegotiate them.

Similarly, Ecuador – attacked by Occidental Petroleum corporation under secret tribunals – has begun to withdraw from its treaties as well. Occidental and others confront Ecuador's new constitution that aims to rectify past inequities and seek better treatment for indigenous peoples and to protect the country's rich ecological heritage.

Dubious claims

Both countries stand on strong moral and economic grounds. First, both countries have been subject to regimes that have exacerbated severe inequities. Second, trade and investment treaties have not proven to deliver their promised benefits.

Such treaties boast that they will bring more foreign investment and that such investment boosts economic growth. However, the majority of economic analysis shows that such treaties do not bring foreign investment and that foreign investment, when it does come, is not necessarily correlated with growth. Brazil, a nation that has refused to sign such treaties, remains the second-largest recipient of emerging-market and developing-country foreign investment in the world.

Indeed, a recent United Nations Conference on Trade and Development (UNCTAD) report confirms that investment treaties are not strongly correlated with attracting foreign investment. In addition, new research by the Peterson

Institute for International Economics further confirms that when foreign investment does come to a nation, it is not necessarily correlated with economic growth. Indeed, in many cases foreign firms put locals out of business for an impact that is a net negative.

Both South Africa and Ecuador have remained in good standing despite their re-evaluation of these policies, as the Germans and other Europeans inevitably will as well. South Africa continues to receive record amounts of foreign investment. In the case of Ecuador, that country has investments upwards of 23% of GDP, while Latin America as a whole has investments at a mere 20.5%. Moreover, Ecuador's credit rating has been upgraded in recent years and has paved its way back to global capital markets – despite the country's disdain toward obscure trade and investment treaties.

The world of global economic governance, and global capital markets themselves, have begun to realize that elevating the rights of private capital over national governments can create more political and economic risk than benefit. Nations such as South Africa and Ecuador should be praised for their progressive action. Nations such as Germany and their counterparts in Europe should follow their lead and make sure the TTIP allows for the continuity of market capitalism and welfare for citzenries. ❒

Kevin P. Gallagher is the author of Ruling Capital: Emerging Markets and the Reregulation of Cross-border Finance. *He is a professor at the Pardee School of Global Studies, Boston University. This article is reproduced from the Triple Crisis website (triplecrisis.com, 24 November 2014).*

Cosmetic changes to fundamentally flawed World Bank report

Despite some changes in its methodology, the World Bank's latest assessment of countries' business climate remains of little relevance to poverty alleviation and may even end up promoting the wrong policy reforms, contends an analyst from the European Network on Debt and Development (Eurodad).

by Tiago Stichelmans

The 2015 edition of the World Bank's widely distributed *Doing Business* report received a lot of media attention. However, it did not tackle the serious criticisms made by the World Bank's Independent Evaluation Group (IEG), civil society organizations (CSOs) and an Independent Panel appointed by the Bank itself to review the report. In fact, there were only minor changes compared with previous versions of the report.

Created by the World Bank in 2002, *Doing Business* ranks the business climate of 189 countries on the basis of 10 indicators. The following three main changes to *Doing Business 2015* fail to address fundamental flaws.

1. Rankings: "Distance to frontier" to give a clearer picture of reality

The most notable change in the 2015 report is the way rankings are calculated. Rankings were first introduced in 2005 to make the report more influential among policymakers. The Bank's chief economist Kaushik Basu argues, in the foreword of the report, that rankings make "possible meaningful international comparisons of the regulatory performance of economies, contributing, along the way, to increasing the accountability of political actors".

However, after criticism by the Independent Panel on the methodology used for the rankings, the Bank decided to use a "distance to frontier" measure. This introduces a cardinal logic to the rankings by indicating, in addition to the rank, the actual "distance" to the best performance for each indicator and for the aggregated best performance. This change allows clearer comparisons to be made between countries' performances, as well as comparisons for each country's performance over time. However, this is a cosmetic reform since the main feature of the report remains the ranks of each country. This reform does not answer the criticism expressed by the Independent Panel or civil society organizations, which had called for the removal of the aggregate rankings.

The Independent Panel outlined several problems with the rankings system in its report.

First, it explained that the rankings were an "arbitrary method of summarizing vast amounts of complex information as a single number. Changing the weight accorded to a particular indicator can easily change an item's ranking". Currently, the Bank uses a subjective way of weighting the 10 different indicators' scores to produce the aggregate ranking. The ranking itself is merely the countries put in order, according to the Bank's subjective scores. It is these final results that attract media attention, with little consideration for the information's subjectivity.

Second, in line with the IEG's general criticism of the Bank's investment climate work, *Doing Business* indicators do not consider the social or economic benefits of regulation, making the rankings a dubious measure in terms of the Bank's goals of eradicating poverty and promoting shared prosperity. The Bank defines *Doing Business* as an attempt to measure how governments provide a positive business environment. According to the Bank, governments should fight against "excessively burdensome regulations [which] can lead to large informal and less-productive sectors, less entrepreneurship and lower rates of employment growth". However, as many experts have pointed out, not all the indicators are self-evidently linked to higher rates of economic growth. For example, the US Economic Policy Institute showed in a study that low corporate tax rates do not necessarily increase the rate of economic growth. Taking this into consideration, the level of corporate taxation in the "paying taxes" indicator is misleading.

Furthermore, there is no empirical evidence that the rankings are linked to poverty impact or even to economic growth, which is the core attack from emerging markets on the report. For example, many of the world's fastest-growing economies come very low down the list – China is at number 90, India is at 142 – while poor economic performance can happily coincide with excellent *Doing Business* scores. For example, Macedonia (2.1% average economic growth between 2010 and 2013) is at number 30 and South Africa (2.7% average economic growth between 2010 and 2013) is at number 43. In that sense, *Doing Business* rankings push for de-regulatory reforms without clear evidence that these are important for achieving the Bank's goals. This situation led some emerging countries to attack the report, leading to its review. Their critiques are summarized in the Independent Panel report.

Third, rankings tend to push countries to manipulate the indicators to improve their rankings instead of trying to improve the reality that the indicators try to capture. In 2012, Russian President Vladimir Putin ordered the government to improve Russia's *Doing Business* ranking from 120th in 2011 to 50th by 2015 and 20th in 2018. Although the 2015 target was missed, Russia witnessed a notable improvement, as it is currently ranked at 62. Analysis by the Russian daily newspaper *Kommersant*, however, reveals that this improvement is based on cosmetic reforms and not on a real improvement in the business environment in Russia. The ease with which results can be manipulated and the way that this tends to shift the focus of governments away from reforms with real impact on development is a major concern.

Eurodad's main concern is that they push countries to dedicate important efforts to improving their rankings, despite the fact that these reforms may not bring any benefits to their poorest population, and may divert attention and efforts from other, more important reforms. In so far as the rankings promote controversial policies, they can even be harmful to the poor. Given that the rankings are highly subjective and are not statistically sound, Eurodad is among the many voices that are calling for them to be abandoned. Furthermore, as a benchmarking exercise, *Doing Business* gives the idea that business environments should be inspired by "best" practices. This conception of a policy reform agenda denies the fact that every country lives in a specific and complex context, which should be the starting point in determining the kind of reforms that are needed.

2. Inclusion of a second city for the 11 biggest economies

Previously, the *Doing Business* data was collected on the basis of a standardized scenario of the business regulations faced by a fictitious firm that has 60 employees, is based in the country's largest business city, and has exports worth more than 10% of its sales (among other characteristics). This year, the second largest city was included in the data sample of the 11 countries with more than 100 million inhabitants.

The Bank claims that this reform is an answer to the Independent Panel report and its methodological recommendations. The Panel criticized the fact that using only one city "has the potential to create a distorted picture in larger countries and those with a federal system". However, the data sample still ignores rural areas where many small- and medium-sized enterprises (SMEs) are located in the developing world.

The Bank has ignored other important critiques regarding its methodological approach to data collection, in particular, the use of law firms as the main source of data. This approach implies that data may be disconnected from reality on the ground. Concrete application of laws and regulations, as well as corruption, are absent from the report. This can push governments to focus on the reform of their regulatory framework with little regard for its concrete implementation. The *Doing Business* team tried to resolve this by expanding the data collected for several of its indicators (see below) but, as pointed out by the Independent Panel, "there are inherent limits to what their methodology can achieve".

In addition, the Independent Panel points to the "one size fits all" approach of the report's methodology, which focuses on "whether one specific rule does or does not exist in different countries. This effectively disregards other legal solutions that achieve the same goal."

3. Changes within the indicators

Doing Business expanded the data collected for three out of its 11 indicators (the 2016 edition will include an expansion of five other indicators). The objective of this expansion is to improve the assessment of the quality of the regulations. This year, the report introduces more features on the strength of legal rights and depth of credit information and on minority shareholders' rights. It

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Trade deals sow seeds of injustice

A raft of existing and planned free trade agreements are entrenching corporate control of seeds. *GRAIN*, a non-profit group working to promote sustainable food systems, cautions that this seed privatization drive puts traditional farming practices at risk.

Trade agreements have become a tool of choice for governments, working with corporate lobbies, to push new rules to restrict farmers' rights to work with seeds. Until some years ago, the most important of these was the World Trade Organization (WTO)'s Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Adopted in 1994, the TRIPS Agreement is the first international treaty to establish global standards for "intellectual property" rights over seeds. The goal is to ensure that companies like Monsanto or Syngenta, which spend money on plant breeding and genetic engineering, can control what happens to the seeds they produce by preventing farmers from reusing them – in much the same way as Hollywood or Microsoft try to stop people from copying and sharing films or software by putting legal and technological locks on them.

But seeds are not software. The very notion of "patenting life" is hugely contested. For this reason, the WTO agreement was a kind of global compromise between governments. It says that countries may exclude plants and animals (other than microorganisms) from their patent laws, but they must provide some form of intellectual property protection over plant varieties, without specifying how to do that.

Trade agreements negotiated outside the WTO, especially those initiated by powerful economies of the global North, tend to go much further. They often require signatory countries to patent plants or animals, or to follow the rules of the Geneva-based Union for the Protection of New Plant Varieties (UPOV) that provide patent-like rights over crop varieties. Whether in the form of patent laws or UPOV, these rules generally make it illegal for farmers to save, exchange, sell or modify seeds they save from so-called protected varieties. In fact, in 1991 the UPOV convention was modified to give even stronger monopoly powers to agribusiness companies at the expense of small and indigenous farming communities. This 1991 version of UPOV now gets widely promoted through trade deals.

The North American Free Trade Agreement – signed by Mexico, Canada and the US, at about the same time the TRIPS Agreement was being finalized – was one of the first trade deals negotiated outside the multilateral arena to carry with it the tighter seed privatization noose. It obliged Mexico to join the UPOV club of countries giving exclusive rights to seed companies to stop farmers from recycling and reusing corporate seeds. This set a precedent for all US bilateral trade agreements that followed, while the European Union, the European Free Trade Association (EFTA, composed of Iceland, Liechtenstein, Norway and Switzerland) and Japan also jumped on the same idea.

A non-stop process of diplomatic and financial pressure to get countries to privatize seeds "through the back door" (these trade deals are negotiated in secret) has been going on since then. The stakes are high for the seed industry. Globally, just 10 companies control 55% of the commercial seed market.

But for these corporations, that market share is still not enough. Across Asia, Africa and Latin America, some 70-80% of the seeds farmers use are farm-saved seeds, whether from their own farms or from neighbours or nearby communities. In these unconquered territories, the agribusiness giants want to replace seed saving with seed markets and take control of those markets. To facilitate this, they demand legal protections from governments to create and enforce corporate monopoly rights on seeds. This is where free trade agreements (FTAs) come in as a perfect vehicle to force countries to change their laws.

Latest trends

GRAIN has been tracking how trade deals signed outside the multilateral system are coercing countries to adopt the industry's wishlist of intellectual property rights for seeds, and ratchet up global standards in that process, for 15 years. A recent update of our dataset (www.grain.org/attachments/3247/download) shows that this trend is not letting up. In fact, there are worrisome signs on the horizon.

- The most important recent gains for Monsanto, DuPont, Limagrain and Syngenta – the world's top seed companies – have come from new trade deals accepted by Latin American states. In 2006, the US (home to Monsanto and DuPont) closed major deals with Peru and Colombia forcing both countries to adopt UPOV 1991. The EFTA states (home to Syngenta) did the same in 2008 and the EU (home to Limagrain) in 2012. In Central America, a similar pattern occurred. The US secured a very powerful Central America Free Trade Agreement (CAFTA) in 2007, forcing all countries to adhere to UPOV 1991. EFTA did the same last year.
- An important step towards stronger proprietary seed markets was recently taken in Africa. After 10 years of talks, Economic Partnership Agreements (EPAs) were concluded between the EU and sub-Saharan African states in 2014. Most of them "only" liberalize trade in goods for now, but also contain a commitment to negotiate common intellectual property standards with Brussels. The expectation is that those standards will be based on what the Caribbean states already agreed to in their 2008 EPA: an obligation to at least consider joining UPOV. This is significant because until now African states have been under no obligation to adopt UPOV as a standard, and actually tried to come up with their own systems of plant variety protection. And while it's true that African entities like the anglophone African Regional Intellectual Property Organization (ARIPO) and the francophone African Intellectual Property Organization (OAPI) are already joining UPOV, under the EU trade deals, countries themselves would be the ones to join. Further towards the horizon, Africa is harmonizing within itself as its subregional trade blocs merge and unite to form a single continental free trade zone, supposedly by 2017. This is expected to bring with it an internal harmonization of intellectual property laws across the continent, likely tightening the noose even further.
- The Trans-Pacific Partnership (TPP) agreement is possibly the scariest FTA under negotiation right now in terms of what it may do to farmers' rights to control seeds in Asia and the Pacific. This is because the US, which is leading the talks with 11 other Pacific Rim coun-

tries, is playing hardball. Leaked negotiating text from May 2014 shows the US calling not only for UPOV 1991 to be applied in all TPP states but also for the outright patenting of plants and animals. We don't yet know whether these demands will also appear in the Transatlantic Trade and Investment Partnership (TTIP) currently being negotiated between the US and the EU, as the text remains inaccessible to the public.

● While the extent of what has to be privatized expands, so do the penalties for disrespecting these norms. Under numerous FTAs, countries like the US require that farmers who infringe on these new intellectual property rights on seeds face punishment under criminal law instead of civil law. In some cases, like the recently concluded EU-Canada Comprehensive Economic and Trade Agreement (CETA), the mere suspicion of infringement could see a farmer's assets seized or their bank accounts frozen.

Big battles heating up

The good news is that social movements are not taking this sitting down. They are becoming very active, vocal, bold and organized about this. In 2013, Colombians from all walks of life were shaken up when they saw firsthand how US and European FTAs could result in their own government violently destroying tonnes of seeds saved by farmers who did not know what the new rules were. The outrage, breaking out in the midst of a massive national agrarian strike, was so strong that the government actually agreed to suspend the law temporarily and re-examine the issue directly with farmers' representatives.

In 2014, it was Guatemala's turn to be rocked when the general public realized that the government was pushing through the adoption of UPOV 1991 without proper debate because of trade deals like CAFTA. People were furious that indigenous communities were not consulted as is required, especially when the purpose of the law – ultimately – is to replace indigenous seeds with commercial seeds from foreign companies like Monsanto or Syngenta. After months of pressure, the government backed down and repealed the law. But – as in Colombia – this retreat is only temporary while other measures will be looked at. In yet other parts of Latin America, like in Chile and Argentina, new laws to implement UPOV 91, often dubbed "Monsanto Laws", are also being intensely and successfully resisted by social movements.

In Africa too, waves of public protest are rising against the plant variety protection regimes which countries are now going into. In Ghana, a vibrant campaign is under way to stop the country from adopting UPOV 1991 legislation. Elsewhere, civil society networks like the broad-based Alliance for Food Sovereignty in Africa are filing appeals to stop ARIPO from adopting UPOV-based legislation and joining the union.

Corporate interest groups have pushed too far trying to privatize what people consider a commons. This is not limited to seeds. The same process has been going on with land, minerals, hydrocarbons, water, knowledge, the Internet, even important microorganisms, like avian flu a few years ago or the Ebola virus today. People are fighting back to stop these things falling under the exclusive control of a few corporations or defence ministries. A good way to take part in this battle is to join the campaigns to stop important new trade deals like TTIP, CETA, TPP and the EPAs – and to get old ones like the US and European deals with Mexico, Central America, Colombia or Chile rescinded. Trade deals are where a lot of these rules do get written and that is where they should be erased. ❒

GRAIN is a small international non-profit organization that works to support small farmers and social movements in their struggles for community-controlled and biodiversity-based food systems. This article is reproduced from "Trade deals criminalise farmers' seeds", which was published as part of the Against the Grain series of opinion pieces on recent trends and developments in the issues that GRAIN works on (www.grain.org/article/categories/13-against-the-grain).

(continued from page 6)

also introduces a measure of the strength of the legal framework for insolvency.

In general, this reform fails to solve most of the problems with the indicators. As pointed out by the Independent Panel, there is no "scientific evidence to support the report's current selection of indicators". The report fails to explain how the selection of indicators is relevant to the Bank's goals of eradicating poverty and promoting shared prosperity. It seems that the main rationale behind the selection of criteria is the idea that regulation is always "red tape" that prevents business development, job creation, economic growth and ultimately poverty eradication.

In addition, some indicators need additional information in order to give a relevant assessment of the area they are covering. From that perspective, the extension of the qualitative aspects of the indicators is a step in the right direction. For example, the inclusion of "reliability of supply" in the "getting electricity" indicator will give a clearer picture of the reality. The same kind of reform should have been designed for the "getting credit" indicator, which does not include any measure of the availability of credit for firms.

This misleading indicator drove the Zambian government to undertake a reform programme that improved its "getting credit" ranking. According to a paper produced by the Jesuit Centre for Theological Reflection and the Catholic aid agency CAFOD, this programme had little impact on local micro and small enterprises. These smaller businesses are largely excluded from the reforms or are lacking the information about how to benefit from them. Such reforms are an example of an intervention designed to improve a country's ranking and to attract foreign direct investments over prioritizing the real needs of local and smaller businesses.

Two other indicators are particularly problematic. Despite data from the "labour market regulation" indicator not affecting a country's overall ranking, this information is still collected and included on the *Doing Business* website. This indicator continues to see labour market regulations in terms of costs rather than benefits. It has been widely criticized by many actors, including the International Trade Union Confederation (ITUC).

Finally, the "paying taxes" indicator continues to reward lower corporate tax rates, although not automatically. This "race to the bottom" has negative effects on development, as outlined by a recent International Monetary Fund (IMF) paper.

Off-target reform

Doing Business 2015 comes at the end of an extensive review process. However, it does little to address the major concerns that were raised during that process. The result is a highly publicized report that tells us very little, has limited relevance to poverty alleviation, and may end up promoting the wrong reforms. If the report continues in its current manifestation, CSOs, including Eurodad, will continue to oppose this misguided exercise. ❒

Tiago Stichelmans is Policy and Networking Analyst at Eurodad, the European Network on Debt and Development, from the website of which (eurodad.org) this article is reproduced.

Water services flowing back into public hands

With privatization failing to deliver, more and more public authorities the world over are reclaiming control of water supply and sanitation services.

by Emanuele Lobina, Satoko Kishimoto and Olivier Petitjean

Cities, regions and countries worldwide are increasingly choosing to close the book on water privatization and to "remunicipalize" services by taking back public control over water and sanitation management. In many cases, this is a response to the false promises of private operators and their failure to put the needs of communities before profit.

A new report, "Here to Stay: Water Remunicipalisation as a Global Trend", published by Public Services International Research Unit (University of Greenwich), Transnational Institute and Multinational Observatory looks at the growing remunicipalization of water supply and sanitation services as an emerging global trend and presents the most complete overview of cases so far. In the last 15 years there have been at least 180 cases of water remunicipalization in 35 countries, in both the global North and South, including high-profile cases in Europe, the Americas, Asia and Africa. Major cities that have remunicipalized include Accra (Ghana), Berlin (Germany), Budapest (Hungary), Buenos Aires (Argentina), Kuala Lumpur (Malaysia), La Paz (Bolivia), Maputo (Mozambique) and Paris (France). By contrast, in this same period there have been very few cases of privatization in the world's large cities: for example Nagpur (India), which has seen great opposition and criticism, and Jeddah (Saudi Arabia).

Despite more than three decades of relentless promotion of privatization and public-private partnerships (PPPs) by international financial institutions and national governments, it now appears that water remunicipalization is a policy option that is here to stay. Direct experience with common problems of private water management – from lack of infrastructure investments to tariff hikes to environmental hazards – has persuaded communities and policymakers that the public sector is better placed to provide quality services to citizens and promote the human right to water.

Remunicipalization refers to the return of previously privatized water supply and sanitation services to local authorities or to public control more broadly speaking. This typically occurs after the termination of private contracts by local governments or their non-renewal, but the process is not always (or only) on a municipal scale. Regional and national authorities have considerable influence over services funding and policy, and in some cases act directly as water operators, so the process unfolds within this broader context.

Whatever its form and scale, remunicipalization is generally a collective reaction against the unsustainability of water privatization and PPPs. Because of the unpopularity of privatization, private water companies have used their marketing propaganda to encourage people to believe that concessions, lease contracts and other PPPs are quite distinct from privatization; they are not. In fact, all these terms refer to the transfer of services management control to the private sector. Policymakers must be aware of the high costs and risks of water privatization, and as such they have a lot to learn from the experiences of public authorities which have chosen remunicipalization and are working to develop democratically accountable and effective public water operations.

The key findings of the "Here to Stay" report are as follows:

1. Water remunicipalization is an emerging global trend

As of October 2014, the global list of known water remunicipalizations that occurred from 2000 to 2014 features 180 cases. As the mapping of this process is still in its early days, we expect many more cases to come to light as work progresses. This strong remunicipalization trend is observable both in the global North and in the global South: 136 cases were found in high-income countries – where local authorities benefit from greater administrative resources and are less subject to the lending conditionality of multilateral banks – whereas 44 cases were from low- and middle-income countries.

In the global North, the list of cities that have remunicipalized their water services includes capitals such as Paris (France) and Berlin (Germany) and major US cities such as Atlanta and Indianapolis. Beyond the symbolically powerful cases of cities like Paris, many smaller municipalities are opting for public control as well: for example, in France alone more than 50 municipalities have terminated their private management contracts or decided not to renew them. In the global South, remunicipalization also involves former flagships of water privatization, including Buenos Aires (Argentina), La Paz (Bolivia), Johannesburg (South Africa), Dar es Salaam (Tanzania) and Kuala Lumpur (Malaysia). In Jakarta (Indonesia), there is also a strong ongoing campaign to remunicipalize the city's water services.

2. Remunicipalization is accelerating dramatically

The number of cases in high-income countries shows a marked acceleration: 81 took place between 2010-14, while only 41 had occurred between 2005-09. Thus the pace of remunicipalization has doubled over the last five years. This trend is even stronger in some countries such as France: eight cases between 2005-09 compared to 33 cases since 2010. The high-profile 2010 remunicipalization in Paris in particular has influenced many other municipalities in and outside France such as Spain.

3. Reasons to remunicipalize are universal

As illustrated by the cases discussed in the report, the factors leading to water remunicipalization are similar worldwide. The false promises of water privatization that have led to remunicipalization include: poor performance of private companies (e.g., in Dar es Salaam, Accra, Maputo), under-investment (e.g., Berlin, Buenos Aires), disputes over operational costs and price increases (e.g., Almaty, Maputo, Indianapolis), soaring water bills (e.g., Berlin, Kuala Lumpur), difficulties in monitoring private operators (e.g., Atlanta), lack of financial transparency (e.g., Grenoble, Paris, Berlin), workforce cuts and poor service quality (e.g., Atlanta, Indianapolis).

4. Remunicipalization is more of-

ten initiated through termination of private contracts

Most cases of remunicipalization around the world have occurred following the termination of private contracts before they were due to expire, with the exception of France where most local governments have waited until the renewal date to end water privatization. At the global level, 92 cases of remunicipalization followed contractual termination, while 69 cases were non-renewals of private contracts after expiry. This means that in the great majority of cases, private contracts proved so unsustainable that local governments opted to remunicipalize even though they knew that they may have to pay compensation. While the best way to avoid the costs of remunicipalization is not to privatize in the first place, this also suggests that terminating a private contract is feasible and often less costly than continuing with privatization in the long run.

5. Leading the remunicipalization trend are countries with long experience of private water management

It is no accident that France, the country with the longest history of water privatization and home to the leading water multinationals, presents so many cases of remunicipalization. French local authorities and citizens have experienced firsthand the "private management model" that Veolia and Suez have exported around the world. In the past few years, many French cities have decided to follow in the footsteps of Grenoble and Paris and take back control of their water services. An even larger number of contracts are coming up for renewal in the next few years and it is expected that many more French cities will remunicipalize.

6. Remunicipalization tends to improve access and quality of water services

By eliminating the profit maximization imperative of the private sector, water remunicipalization often leads to enhanced access and quality of services. The equal or greater efficiency of public water services and lower prices can be observed in cases as diverse as Paris (France), Arenys de Munt (Spain) and Almaty (Kazakhstan). In some cases the new public operators also dramatically increased investments in the water systems, such as in Grenoble (France), Buenos Aires (Argentina) and Arenys de Munt (Spain). The social benefits of water remunicipalization have been visible in Arenys de Munt (Spain), where the local government and the new public operator restructured the tariff system to guarantee access to water for low-income households. In Buenos Aires (Argentina), achieving universal access to water has become a top priority for the new public operator AySA. Since remunicipalization, AySA has extended training programmes for employees who work with poor neighbourhood residents to expand service access.

7. Remunicipalization offers opportunities to build democratic governance

Remunicipalization allows for strengthening accountability and transparency. In Paris and Grenoble (France), the new public water operators have introduced advanced forms of public participation. First, civil society representatives sit on the board of directors together with local government representatives, and have equal voting rights. This allows civil society to partake in decisions on the management of this most essential public service, and to make operations responsive to the interests of local communities. Second, citizen observatories have been established to open spaces for citizens to engage in strategic decisions on investment, technology options and tariff setting. Both cities consider that full information disclosure is a fundamental condition for accountability, transparency and participation.

8. Remunicipalization carries external risks including possible litigation

Successful remunicipalization requires careful planning and assessment of external risks, even more so for countries of the South which are under the grip of pro-private multilateral agencies. Decision-makers need to be aware that transaction costs of remunicipalization may include paying compensation to private operators for their foregone profits. When a private contract is terminated before its expiry date, private companies can sue local governments to receive payment of the full profits granted under the contract.

A private concessionaire in Arenys de Munt (Spain) fiercely obstructed the remunicipalization process by filing complaints against the city council. The US city of Indianapolis was forced to pay a $29 million fee to French multinational Veolia to terminate the 20-year contract over a decade early. Berlin residents have had to accept very high costs to buy back the shares held by two private operators. Private concessionaires sued Tucuman and Buenos Aires (Argentina) before an international arbitration tribunal to obtain compensation. The risk of having to pay hefty compensation can distort the decision-making process of local governments which are considering termination and remunicipalization (e.g., Jakarta, Indonesia; Szeged, Hungary; Arezzo, Italy). But in other cases the potential benefits are so clear that local authorities are ready to face such risks.

9. Public-public partnerships can support remunicipalization efforts

Public water operators and national or regional associations are increasingly helping each other through the remunicipalization process. In Spain, the regional public company Aguas del Huesna (Andalusia) facilitated remunicipalization for 22 municipalities. The remunicipalized water operators from Paris and Grenoble played a key role in helping other local authorities in France and elsewhere to remunicipalize and improve their water services. French local authorities and public water operators have benefited from the exchange of experience and knowledge on remunicipalization that has been facilitated by associations of local governments and public enterprises. The regional institution CONGIAC in Catalonia also played a key role in Arenys de Munt's remunicipalization process from decision making to implementation. There are other such examples across boundaries: After failed PPP experiments, the Mozambican government entered into a not-for-profit partnership with a Dutch public water company focusing on local capacity building. Cooperation between public water companies as part of public-public partnerships is a viable alternative to costly PPPs and the most effective way to assist public water authorities in improving services. ❐

The above is extracted from the report "Here to Stay: Water Remunicipalisation as a Global Trend" (November 2014) published by Public Services International Research Unit (PSIRU), University of Greenwich; Transnational Institute (TNI); and Multinational Observatory. The full report is available on the PSIRU website www.psiru.org.

TTIP may lead to EU dis-integration, unemployment, instability

The Transatlantic Trade and Investment Partnership (TTIP), a major trade pact now under negotiation by the US and the EU, is being touted on the basis of studies which predict net economic gains for all countries involved. However, these projections are derived from questionable assumptions and flawed models; a more realistic assessment finds that TTIP would lead to loss of income and employment in the EU, with few viable policy options available to counter the decline.

by Jeronim Capaldo

The European Union and the United States are currently negotiating the Transatlantic Trade and Investment Partnership (TTIP), a major trade agreement intended to further integrate their economies.

In today's low-tariff reality, TTIP focuses on removing non-tariff trade barriers between countries, such as differing standards set in the EU and in the US for given consumer goods and services. The underlying logic is the same as in traditional liberalizations: reducing the costs of trade – whether eliminating tariffs or other impediments – is supposed to lead to a higher trade volume and overall economic benefits.

Unfortunately, experience has shown that this appealing reasoning is often misleading.

As is common for trade agreements, TTIP negotiations have been accompanied by a series of econometric studies projecting net economic gains for all countries involved. In the EU, advocates have pointed to four main studies mostly projecting small and deferred net benefits alongside a gradual substitution of intra-EU trade with trans-Atlantic trade.

This leads the European Commission, TTIP's main advocate in Europe, into a paradox: its proposed policy reform would favour economic dis-integration in the EU. TTIP might also lead to other serious consequences for the EU and its members. Recent literature has shown that the main studies of TTIP do not provide a reliable basis for policy decisions as they rely heavily on an unsuitable economic model.

Assessing TTIP with the United Nations Global Policy Model, a model based on more plausible assumptions on economic adjustment and policy trends, we found very different results. Evaluated with the UN model, TTIP would lead to net losses in terms of GDP, personal incomes and employment in the EU.

In particular, we project that labour incomes will decrease between 165 and 5,000 euros per worker depending on the country. We also project a loss of approximately 600,000 jobs, a continuing downward trend of the labour share in total income, and potentially destabilizing dynamics in asset prices.

Our projections point to bleak prospects for EU policymakers. Faced with higher vulnerability to any crises coming from the US and unable to coordinate a fiscal expansion, they would be left with few options to stimulate the economy: favouring an increase of private lending (with the risk of fuelling financial imbalances), seeking competitive devaluations or a combination of the two.

We draw two general conclusions. First, as suggested in recent literature, existing assessments of TTIP do not offer a suitable basis for important trade reforms. Indeed, when a well-reputed but different model is used, results change dramatically.

Second, seeking a higher trade volume is not a sustainable growth strategy for the EU. In the current context of austerity, high unemployment and low growth, requiring that economies become more competitive would further harm economic activity. Our results suggest that any viable strategy to rekindle economic growth in Europe would have to build on a strong policy effort in support of labour incomes.

Existing assessments of TTIP

Most assessments of TTIP predict gains in terms of trade and GDP for both the EU and the US. Some also predict gains for non-TTIP countries, suggesting that the agreement would create no losers in the global economy. If this were the case, TTIP would be the key to a more efficient allocation of global resources, with some countries achieving higher welfare and all others enjoying at least the same welfare as before.

Unfortunately, as Raza and colleagues (2014) have shown, these desirable results rely on multiple unrealistic assumptions and on methods that have proven inadequate to assess the effects of trade reform.

Furthermore, once the calculations are reviewed, it appears that several of these studies share the same questionable economic model and database. The convergence of their results is, therefore, not surprising and should not be taken as providing independent confirmation of their predictions.

Methodological problems

Quantitative arguments in favour of TTIP come mostly from four widely cited econometric studies: Ecorys (2009), CEPR (2013), CEPII (2013) and Bertelsmann Stiftung (2013).

CEPR has been very influential: the European Commission has relied on it as the main analysis of the economic effects of TTIP, going as far as presenting some of its findings as facts. However, the EC's reference to CEPR as an "independent report" seems misleading since the study's cover page indicates the EC as the client for whom the study has been produced. Ecorys was also commissioned by the EC as part of a wider project encompassing economic, environmental and social assessments.

Methodologically, the similarities among the four studies are striking. While all use World Bank-style Computable General Equilibrium (CGE) models, the first two studies also use exactly the same CGE. The specific CGE they use is called the Global Trade Analysis Project (GTAP), developed by researchers at Purdue University. All but Bertelsmann use a version of the same database (again from GTAP).

The limitations of CGE models as tools for assessment of trade reforms emerged during the liberalizations of the 1980s and 1990s. The main problem with these models is their assumption on the process leading to a new macroeconomic equilibrium after trade is liberalized.

Typically, as tariffs or trade costs are cut and all sectors become exposed to stronger international competition, these models assume that the more competitive sectors of the economy will absorb all the resources, including labour, released by the shrinking sectors (those that lose business to international competitors).

However, for this to happen, the competitive sectors must expand enough to actually need all those resources. Moreover, these resources are assumed to lack sector-specific features, so they can be re-employed in a different sector.

Under these assumptions, an assembly-line employee of an automobile factory can instantly take up a new job at a software company as long as her salary is low enough. Supposedly, this process is driven by speedy price changes that allow an appropriate decrease of labour costs and, consequently, the necessary expansion of the competitive sectors.

In practice, however, this "full employment" mechanism has rarely operated. In many cases, less competitive sectors have contracted quickly while more competitive ones have expanded slowly or insufficiently, leaving large numbers of workers unemployed. One need only look at the experience of Europe in the last decade to see that full employment does not re-establish itself even if job seekers are willing to work informally and at relatively low pay.

A critical point is that the distribution of gains and losses is rarely uniform within economies. If workers in competitive sectors may benefit from higher salaries, while those in shrinking sectors lose, the economy as a whole may be worse off. This is because in some countries domestic demand is mostly supported by the incomes earned in traditional occupations. In practice, aside from their high social costs, these transitions have led to a drop in domestic demand that CGE-based calculations have often overlooked.

Moreover, most CGEs rely on misleading assumptions on the pattern of international trade, imposing a fixed structure on the market share that each country has in its export markets, and on a static analysis that does not explain how economies reach a new equilibrium.

For example, when Country A expands trade with Country B, the rest of the world's economies do not simply stand still. Countries C, D and E will find that they are more or less competitive in these markets as a result of the A-and-B trade changes. This effect is known as "trade diversion", and has been a significant by-product of recent trade integration initiatives.

Finally, the strategy chosen to simulate a "TTIP future" has a strong impact on the results. Ecorys assumes that so-called "non-trade barriers" impose a given cost on trade and that TTIP can remove up to one half of them. CEPR and CEPII borrow this approach but assume a lower share. These barriers can include what other stakeholders refer to as consumer and environmental regulations. Phasing them out may be difficult and could impose important adjustment costs not captured by the models.

Trade

All assessments project large increases in bilateral US and EU exports. In CEPR and CEPII, US bilateral exports increase by 36.6% and 52% respectively in the long term, compared to 28% and 48% for the EU. According to CEPR, the net increase in total exports will be 8% in the US and 5.9% in the EU.

However, in all cases, these increases in trans-Atlantic trade are achieved at the expense of intra-EU trade. Implicitly, this means that imports from the US and imports from non-TTIP countries through the US will replace a large portion of current trade among EU countries.

If these projections were true, higher trans-Atlantic interdependence would heighten the EU's exposure to fluctuations in US import demand. This is an under-examined consequence of certain patterns of trade liberalization. Even if higher exports were to bring higher demand and economic activity (a link that doesn't always work in practice, as discussed), more reliance on the US as an export market would also make the EU vulnerable to macroeconomic conditions in North America.

If Europe could effectively implement countercyclical policies, this greater interdependence would not necessarily be a problem. However, the EU's current institutional structure lacks a central fiscal authority while in practice preventing national governments, through the Maastricht treaty, from implementing any fiscal expansion. This constellation of factors indicates that TTIP might usher in a period of higher instability in Europe.

The remaining two studies raise similar concerns. In Bertelsmann, aggregate figures for bilateral export increase and net increase are not readily available but results exhibit the same pattern as in other studies.

While bilateral exports are predicted to increase by more than 60% for the EU and more than 80% for the US, intra-EU exports are expected to decrease between 25% and 41%. This implication raises the same concerns about vulnerability to US economic shocks as the other studies.

Finally, as noted above, the rest of the world does not stand still when two economies integrate. Applying Bertelsmann's percentages to recorded trade data with EU exports to the world as a whole, Raza et al. (2014) calculate that the overall impact of TTIP on EU global exports, including those to non-TTIP countries, would be negative.

Furthermore, Felbermayr and Larch (2013) find that TTIP will have a negative effect on non-TTIP countries' exports, in a pattern observed after other trade agreements. In other words, both exports and imports of non-TTIP countries are projected to decrease, with uncertain or negative net effects.

CEPR and CEPII do not find negative effects on non-TTIP countries, assuming ad hoc effects (spillovers) that allow exports in the rest of the world to grow.

GDP and personal incomes

Given the small net effects on exports, most assessments predict small increases in TTIP countries' GDP.

In Ecorys, CEPR and CEPII, GDP increases less than 0.5% in both the EU and the US. This means that, at the end of the simulation period in 2027, GDP would be 0.5% higher in a

TTIP scenario than in the baseline, non-TTIP scenario, implying negligible effects on annual GDP growth rates.

This is a defining aspect of the results: Ecorys, CEPR and CEPII point to a one-time increase in the level of GDP, not to an increase in the growth rate of GDP. Furthermore, this one-time increase is small and projected to occur only over the course of 13 years.

Bertelsmann reports higher figures (5.3% for the EU and 13.9% for the US) but provides little detail on the study's methodology. It is, therefore, unclear how the results compare to those of other studies.

Furthermore, given the assumptions on spillover effects, CEPR estimates that all regions of the world would benefit from long-term GDP increases. However, Felbermayr and Larch (2013) indicate that this expectation contradicts previous experiences of trade agreements such as CUSFTA, NAFTA and MERCOSUR since these agreements typically affect the relative trade prices between members and non-members.

Despite the small projected increases in GDP, some studies suggest that TTIP might lead to large increases in personal incomes in the long term. In often-cited examples, Ecorys estimates that the average EU household would gain 12,300 euros over the work life of household members, while CEPR estimates that the same household would earn 545 euros more every year.

However, as noted above, these estimates are misleading since the studies provide no indication of the distribution of income gains: they are simply averages. With EU wages falling as a share of GDP since the mid-1990s, it is far from certain that any aggregate gains will translate into income increases for households living on income from wages (as opposed to capital).

Employment

Finally, most studies are not informative on the potential consequences of TTIP on employment. While CEPII does not discuss employment effects, CEPR and Ecorys assume a fixed supply of labour. This amounts to excluding by assumption any consequences of TTIP on employment – wages are assumed to fall or rise enough to ensure that all workers remain employed regardless of the level of economic activity.

On the other hand, Bertelsmann predicts that TTIP will lead to the creation, in the long term, of approximately one million jobs in the US and 1.3 million jobs in the EU. However, these positive figures are strongly dependent on the period chosen in the estimation.

Using data up to 2010, the authors estimate that economies where labour and labour income are more protected (for example, by higher unemployment benefits) suffer from higher unemployment, concluding that any cost reductions introduced by TTIP would lead to positive employment effects in those countries.

When more recent data is taken into account, this conclusion ceases to hold since all countries – not just those with stronger labour protection – appear to have experienced higher and persistent unemployment.

An alternative assessment with the United Nations Global Policy Model

To obtain a more realistic TTIP scenario, we need to move beyond CGE models. A convenient alternative is provided by the United Nations Global Policy Model (GPM), which informs influential publications such as the UN Conference on Trade and Development (UNCTAD)'s *Trade and Development Report.*

The GPM is a demand-driven, global econometric model that relies on a dataset of consistent macroeconomic data for every country. Two features make the GPM particularly useful in the analysis of a large trade agreement.

Firstly, the model assumes a more realistic mechanism leading to macroeconomic equilibrium. All models that make these types of projections necessarily make assumptions on the way economies will stabilize after a policy change, which in this case is the introduction of TTIP.

The most important difference between the GPM and the CGE models described is that, in the GPM, the full-employment assumption is replaced by the Keynesian principle of "effective demand". This means that the level of economic activity is driven by aggregate demand rather than productive efficiency. Consequently, a cost-cutting trade reform may have adverse effects on the economy if the "costs" that it "cuts" are the labour incomes that support aggregate demand.

Unlike in CGE models, changes in income distribution contribute to determining the level of economic activity. The absence of this mechanism in many commonly used models has often led to major errors in assessing the impact of trade reforms.

Secondly, the GPM provides an explicit analysis of the macroeconomic workings of every world region. This, in turn, has two important benefits. It means that the model can provide well-founded information on the economic interactions among all regions, rather than just assuming that a given proportion of a country's income will be spent on imports from other countries.

It also means that the GPM allows us to assess whether a given policy strategy is globally sustainable. For example, the GPM shows that, when sought by every country, a strategy of export-driven growth may lead to adverse consequences such as a net loss of trade.

A third valuable feature of the GPM is its estimation of employment. Using International Labour Organization (ILO) data, the GPM specifies how a given change in GDP growth affects employment growth, and vice versa.

A critical advantage of the specification used is that these growth-and-employment relationships (which economists call "Okun's relationships") are not constant over time. In this way, the GPM recognizes that different factors might affect the relationship between output and employment at different moments in history. Thus, the model is able to account for recent puzzles such as "jobless growth."

Given the large amount of data that must be processed to estimate and simulate the GPM, we keep the analysis tractable by aggregating some countries into blocs. With this, we lose specific analysis for these countries.

Despite its limitations, the GPM offers a useful perspective on the consequences of agreements such as TTIP. Indeed, it offers a "big picture" and insights into several important adjustment mechanisms that are often overlooked by other models.

Simulation strategy: Global implications of existing trade projections

Our country aggregation leaves the world's largest economies as independent units. In the TTIP area, the United States, the United Kingdom, Germany, France and Italy appear as standalone economies.

The remaining countries are aggregated into two blocs: "Other Northern and Western Europe" (including Finland, the Netherlands and Belgium) and "Other Southern and Eastern Europe" (including Greece, Spain, Portugal and Eastern European economies).

But European nations and the US are not the only countries in the world. One benefit to macroeconomic models is that we can estimate the effect of a policy change like TTIP on countries outside of the potential trade bloc.

Accordingly, we are able to estimate how TTIP will affect individual countries like Argentina, Brazil, Canada, China, the Commonwealth of Independent States (CIS), India, Indonesia, Japan, South Africa and Turkey (which we count as independent units, much as we did with the US). All other countries are grouped into two blocs per continent.

As in other simulation exercises, we first project a baseline path for the economy of every country or country bloc from 2015 to 2025 in order to match previous studies. We then determine counterfactual values that are implied by the adoption of TTIP.

To determine the baseline, we use all information available on countries' past and present policies and spending patterns. We use the same baseline assumptions as UNCTAD (2014).

For example, we assume that governments in TTIP countries and in some non-TTIP countries will not reverse their commitments to fiscal austerity. Therefore, even in the baseline scenario, we do not expect fiscal spending to expand aggregate demand even though historically this has been an important channel.

This confirms a major advantage to GPM-type models that we noted above: they allow for greater realism about the likely path of policy in the foreseeable future. [For more information about how these assumptions on the path of different countries' policies were constructed, see UNCTAD (2014).]

In order to implement the TTIP scenario, we assume that the volume of trade among TTIP countries will initially expand at the pace indicated by the existing studies. However, we do not rely on these studies for changes in net exports, which ultimately determine any changes in GDP.

Instead, we calculate net export changes taking into account the global feedbacks built into the GPM. Therefore, our simulation clarifies the implications of the "consensus" pattern of trade in terms of GDP, income distribution and non-TTIP trade.

In the GPM, the impact of a given increase in trade is different from other models. As indicated above, such change affects the distribution of income ultimately feeding back into total demand and income.

Finally, we consider two specific mechanisms through which the European economy could adjust to these TTIP-induced changes in net exports.

First, we assume that increased international competition will exert pressure on the real exchange rate. This might occur as firms in every country try to preserve their international competitiveness and increase efforts to reduce labour costs. It might also be the result of unemployment pressures and legislation that would reduce total labour compensation.

As a result, the labour share of GDP would further decrease in Europe in a downward trend toward the lower US share, weakening aggregate demand. Finally, this adjustment mechanism might also play out through a nominal devaluation. This might indeed help an economy gain higher market shares abroad, but it may also generate a race to the bottom at the end of which no country will have gained higher exports.

The second mechanism recognizes a policy strategy that has become central in recent decades, assuming that, in order to stimulate flagging domestic demand, policy authorities may increase lending. As a result, asset prices (including some financial assets) might increase, setting off the unstable dynamics that have become apparent after the 2009 financial crisis.

Net exports and GDP

Our simulations show that the assumed trade expansion among TTIP countries will cause a net export loss for all EU economies. Losses would be a drag on aggregate demand for all EU economies. Northern European economies would suffer the largest decreases (2.07% of GDP by 2025) followed by France (1.9%), Germany (1.14%) and the UK (0.95%).

On the other hand, US net exports would be higher by slightly more than 1%.

A likely explanation for how EU-US trade could expand while EU net exports to the world could decline is that, in the EU's stagnating economy, domestic demand for lower-value-added manufactures – in which the EU is relatively uncompetitive – will crowd out higher-value-added ones.

Indeed, our figures show an increase of net exports in almost every other region of the world except Europe, suggesting that higher demand for low-value-added products will lead to higher net imports from Asian and African economies and from the US.

Alternatively or additionally, TTIP could facilitate EU imports of manufactures assembled in the US with parts made in China and other regions.

Net exports are a key component of GDP. As such, the net loss of trade will directly lower EU countries' national income. Our simulations indicate small but widespread GDP losses for the EU, in a clear contrast with existing assessments.

Consistent with our figures for net exports, Northern European economies would suffer the largest GDP reduction (0.50%) followed by France (0.48%) and Germany (0.29%). GDP would increase slightly in the US (0.36%) while GDP increases in non-TTIP countries would be positive but negligible (approximately 0.1%).

Employment and incomes

Following the reduction of net exports and overall economic activity, we project clear losses in EU employment and labour incomes. Recall that our model allows us to make employment projections, because it estimates the relationship between GDP growth and employment growth over several decades based on ILO data.

This is compatible with a tendency toward specialization in higher-value-added, lower-employment-intensity products, which would lead to export and output gains in a few sectors while adversely affecting many others.

As a result, we calculate that the EU as a whole would lose approximately 600,000 jobs by 2025, most of which are in Northern Europe, France and Germany. By comparison, this is more jobs than the EU lost in the crisis years of 2010 and 2011 – clearly Europe must avoid another job loss of this magnitude even if gradual and spread over many years.

The loss of employment would further accelerate the reduction of incomes that has contributed to the EU's current stagnation. Indeed, labour income will continue its steady decrease as a share of total income, weakening consumption and residential investment while likely exacerbating social tensions.

The flipside of this decrease is an increase in the share of profits and rents in total income, indicating that proportionally there would be a transfer of income from labour to capital. The largest reductions will take place in the UK (with 7% of GDP transferred from labour to profit income), France (8%), Germany and Northern Europe (4%), reinforcing a negative trend that has continued at least since the early 2000s.

To emphasize the difference between our results and existing estimates of employment impact, we calculated the projected reduction of per capita employment income implied by the fall of employment and the labour share.

As mentioned above, CEPR estimates that the annual income of the average household would increase in the long term by 545 euros, while Ecorys projects an increase in working life income, again for the average household, of 12,300 euros.

Given the ongoing deterioration of income distribution, we chose to focus on working households, calculating the change in per capita employment income. Our results are clearly incompatible with both CEPR and Ecorys. Indeed, we project losses of working incomes per capita ranging from 165 euros to more than 5,000 euros. France would be the worst hit with a loss of 5,500 euros per worker, followed by Northern European countries (4,800 euros), the United Kingdom (4,200 euros) and Germany (3,400 euros). For a household with two working persons, the loss ranges from 330 euros to more than 10,000 euros. By contrast, in the US there would be an increase of employment income.

The loss of economic activity and the weakening of consumption in the EU means that tax revenue will be less than it would have been in the absence of TTIP. We estimate that the surplus of indirect taxes (such as sales taxes or value-added taxes) over subsidies will decrease in all EU countries, with France suffering the largest loss (0.64% of GDP or slightly more than 1% of the total government budget).

Government deficits would also increase as a percentage of GDP in every EU country, pushing public finances closer or beyond the Maastricht limits.

The loss of employment and labour income will increase pressure on social security systems. Using GPM employment projections and UN population data, we can calculate the economic dependency ratio, that is, the ratio of total population to employed population. This indicates how many people are supported by each job, either through family relationships or social security contributions.

According to our calculations, the ratio would increase throughout the EU, announcing more troubled times for European social security systems. By contrast, in the US, indirect taxes would not be affected while the economic dependency ratio would slightly improve.

Asset price inflation and real devaluation

Policymakers will have a few options to adjust to the shortfall in national incomes projected by our study. With wage shares and government revenues decreasing, other incomes must sustain demand if the economy is to adjust. These adjustments have to be profits or rents but, with flagging consumption growth, profits cannot be expected to come from growing sales.

A more realistic assumption is that profits and investment (mostly in financial assets) will be sustained by growing asset prices. The potential for macroeconomic instability of this growth strategy is well known.

In this adjustment scenario, there would be a strong increase in asset prices where financial markets are more developed, especially in the United Kingdom, Germany, other Western and Northern European countries and France. Aggregate demand in these economies would be sustained by a recovery of the financial sector, stimulated by domestic lending and growing profits.

However, it is critical to note that such growth would last only as long as asset prices keep growing, requiring ever-rising levels of lending. In the current context of weak commercial lending, this might require intentional policy interventions, such as further deregulation. This road to growth has been taken before and its risks have proven extremely high.

During the most recent economic crisis, individuals and businesses quickly ran up unsustainable debts until generalized insolvency suddenly stopped economic activity. Moreover, the extent to which deregulation is successful in increasing lending, rather than just reducing accountability in the financial sector, is not clear.

Of course, a run-up in asset prices is not the only policy and economic response to the drop in aggregate demand. But it appears to be slightly more viable than alternative adjustment mechanisms. For example, it is often suggested that an opportunity might come from real devaluation. Countries might be tempted to seek this alternative by way of a nominal depreciation, a reduction of real labour costs or both.

In light of the discussion above, the latter channel does not appear viable. This is because it would prove counter-productive when applied by many countries. In other words, if the incomes of workers in every country are reduced, the demand hole is dug even deeper. Moreover, the magnitude of the cuts required could be socially unsustainable after decades of falling labour shares.

On the other hand, a substantial nominal depreciation of the euro would probably trigger defensive depreciation in other currencies before any improvement in competitiveness is achieved.

According to our projections, a real devaluation would have some effect in Germany and France but nothing that might strongly stimulate aggregate demand. Furthermore, attempts at strong devaluations are often followed by a race to the bottom in which the trading partners of the country that devalues try to regain the lost ground by devaluing as well. But even when a race to the bottom does not happen, lasting periods of real devaluation might lead to the accumulation of external debts, as Europe's deficit countries have experienced after 1999.

To reiterate, our model requires some form of adjustment to compensate for the drop in aggregate demand. The precise path that future policymakers will choose (if any) is of course unknowable at present. But our model sheds light on the likely macroeconomic consequences of a TTIP-induced change in trade volumes, and also on the policy responses that are more or less likely to fill the demand gap.

Discussion and conclusion

Existing studies on TTIP have focused on the impact the agreement would have on aggregate economic activity in member countries. They have done so based on detailed sectoral analyses of TTIP economies, but have neglected the impact of income distribution and other important dimensions of macroeconomic adjustment.

Our assessment of TTIP is based on the United Nations Global Policy Model, which has proven a convenient tool to estimate the impact of policy changes involving large areas of the world economy. Our simulation does not question the impact of TTIP on total trade flows estimated by existing studies. Rather we analyze their implications in terms of net exports, GDP, government finance and income distribution.

Our analysis points to several major results. First, TTIP would have a negative net effect on the EU. We find that a large expansion of the volume of trade in TTIP countries is compatible with a net reduction of trade-related revenues for the EU. This would lead to net losses in terms of GDP and employment. We estimate that almost 600,000 jobs would be lost as a result of TTIP.

Secondly, TTIP would reinforce the downward trend of the labour share of GDP, leading to a transfer of income from wages to profits with adverse social and economic consequences. Policymakers would face a few options to deal with this demand gap. Our model suggests that asset price inflation or devaluation could result, leading to higher economic instability.

We have focused above on trade and its consequences, leaving the investment component of TTIP on the sidelines. Going forward, valuable insights could be drawn by further extending the analysis of TTIP's financial effects. *(SUNS7918/7919)* ❐

Jeronim Capaldo is a Research Fellow at the Global Development and Environment Institute (GDAE) of Tufts University in the US. The above is based on his GDAE Working Paper 14-03 (October 2014). The full paper with tables, graphs, footnotes and references can be accessed at www.ase.tufts.edu/gdae/policy_research/TTIP_simulations.html.