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Global Value Chains and the Transatlantic Trade and Investment Partnership

Kommerskollegium
National Board of Trade

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Foreword

The changing nature of trade through a geographical fragmentation of production, often referred to as global value chains, is becoming common knowledge among trade policymakers. With the launch of negotiations on a Transatlantic Trade and Investment Partnership (TTIP) it is natural to put insights related to the emergence of global value chains into practice in a trade negotiation of global significance. A global value chain perspective is the intuitive approach in any modern trade negotiation, but it becomes even more important when the world's two largest and most advanced economies engage in a possible partnership.

In this report, the National Board of Trade analyzes the potential policy implications of global value chains in the context of TTIP. We also use recently published value-added trade data that indicate that the US market is more important for both Sweden and the EU as a whole than previously thought. The value-added statistical analysis moreover reveals that services play a dominant role in Swedish and EU exports to the US.

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Stockholm in May 2013

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Executive Summary

In this report we analyze potential policy implications of global value chains in the context of a Transatlantic Trade and Investment Partnership (TTIP). A global value chain perspective is the natural approach in any modern trade negotiation but it becomes even more important when the world's two largest and most advanced economies engage in a possible partnership.

Transatlantic trade in value added figures

The United States is by far the largest trading partner for the European Union in value-added terms, with an export share of 23 percent of total EU exports and an import share of 20 percent of EU imports. The US is also the largest export market for Sweden with an export share of 12 percent of total exports. On the import side, the US is Sweden's third largest trading partner in value-added terms with an import share of 7 percent of Swedish imports.

When measured in value-added terms, a majority of both EU and Swedish exports are services. Services play an even more dominant role in EU and Swedish trade with the US. In 2008, the share of services in EU value-added exports to the US was 60 percent. The share of services in Swedish exports to the US was 62 percent.

The value chain approach to TTIP negotiations

A value chain approach to the TTIP negotiations would allow greater focus on reducing costs and improving logistics along the production chain. It would also underline the mutual interest in eliminating trade barriers and keep attention on the economically most important issues.

Because of intense supply chain trade between the EU and the US, it is increasingly difficult to identify clear-cut 'offensive' and 'defensive' interests in the negotiations. Therefore, a more pragmatic, problem-based perspective could replace strict reciprocal thinking in the negotiations.

An open agreement

Although regional trade agreements (RTAs) are not fully compatible with the trend toward global value chains, there are many things trade negotiators could do to improve the effectiveness (in terms of trade creation) of RTAs. In line with the idea of 'open regionalism', TTIP negotiators could design an agreement that is as open as possible to third parties. Most importantly, the TTIP could remain open for third parties to join once it has come into effect.

An open agreement might also give priority to provisions that are difficult to apply on a discriminatory basis, for example commitments related to mutual recognition, harmonization, trade facilitation and good governance (transparency, anti-corruption).

Transparency with respect to future TTIP rule making, non-tariff barriers (NTBs) and discussions on regulatory issues could also be provided for in the new institutional structure that is expected to be set up under the TTIP.

As a final option to promote openness, tariff and quota liberalization under TTIP could be extended to least-developed countries.

A level playing field for firms that rely on global value chains

EU and US firms that rely on global value chains should be able to take full advantage of liberalization under the agreement. To achieve this, more liberal rules of origin should be considered. Ultimately, it is important that information and communication technology (ICT) firms benefit from the TTIP even when they have a global sourcing strategy.

Integration of goods and services

The world economy is becoming increasingly dependent on services as lubricants of global production networks. It is therefore important to make services a TTIP priority and to ensure that negotiations on goods and services are mutually supportive. As far as possible, traditional silos should be abandoned. From a global value chain perspective, it is also essential that negotiation take into account the impact of digitalization and servicification.

Movement of personnel

A trade-in-task economy underlines the need for a better flow of personnel with the right skills to perform certain tasks or instruct others how to perform them. From this perspective, an ambitious transatlantic agenda to speed up mobility of personnel in key sectors should be a priority. Such an agenda would require moving beyond the traditional issue of market access and include other aspects of movement of personnel, such as speedy and transparent visa procedures.

Business involvement at an operational level

The best way to keep up with the changing nature of trade is to maintain a close dialogue with the business community. To facilitate this, procedures for continuous information to and feedback from the transatlantic business community should be set up at an operational level during the TTIP negotiations.

Small- and medium-sized enterprises

SMEs are affected disproportionately by fixed trade costs along the production chain. In order to give SMEs easier access to international production networks, TTIP could raise de minimis levels that allow goods under a certain threshold value to forgo customs control.

Contents

1. Background

The EU-US High Level Working Group on Jobs and Growth (HLWG) was established during the 2011 EU-US summit. In its final report of 11 February 2013,[1] the HLWG recommended that EU and US leaders 'launch negotiations on a comprehensive trade and investment agreement'.

On 8 February 2013, the European Council reiterated its support for a comprehensive trade agreement with the US and called on the European Commission to follow up on the recommendations of the HLWG 'without delay during the current Presidency'. A few days later, on 12 February, President Obama endorsed, during his State of the Union address, the idea of a comprehensive 'Transatlantic Trade and Investment Partnership'. On 12 March 2013, the European Commission sent a draft negotiating mandate to the Council for EU Member State consideration.

In 2012, the Ministry for Foreign Affairs asked the National Board of Trade to make quantitative and qualitative analyses of a possible EU-US agreement. One part of that work, a GTAP study of the possible effects of an agreement, was published in November 2012 (Kommerskollegium, 2012a). This paper follows up on that work and on previous work by the Board on global value chains, by analyzing the policy implications of global value chains in the context of an agreement on a Transatlantic Trade and Investment Partnership (TTIP).

2. Purpose

The purpose of the report is to analyze a prospective TTIP agreement from a global value chain (GVC) perspective. What potential policy implications does the emergence of global value chains have for TTIP?

3. The Implication of Global Value Chains for Trade Policy

Before analyzing policy implications in the specific context of TTIP, we provide an overview of some of the most important policy issues in relation to GVCs that can be found in the literature.

In *Business Reality and Trade Policy – Closing the Gap* (Kommerskollegium, 2012b), the Board concluded that the GVC literature offers surprisingly few concrete trade policy recommendations. Since then, the OECD has analyzed trade policy implications in two GVC synthesis reports (Mirodout and Rouzet, 2013; Gestrin, 2013), the European Commission has published a report (2013) that discuss, among other things, policy lessons from global value chains. In addition, the World Economic Forum, in collaboration with Bain & Company and the World Bank (2013), has published a report that offers policy conclusions. Finally, independent scholars, such as Richard Baldwin at the Graduate Institute in Geneva, have also contributed to the growing debate (Baldwin, 2012).

Below, we summarize some general policy messages contained in these reports, as well as in our most recent work on global value chains and services (Kommerskollegium 2013). In section 5, we address policy issues in the specific context of a TTIP agreement.

3.1 GVCs strengthen the case for multilateralism…

The first conclusion that we come across in the literature is that the changing nature of world trade, through the emergence of global production networks, strengthens the case for multilateralism. The OECD (Mirodout and Rouzet, 2013) argues,

> More than before, the case for multilateral trade liberalisation remains as an optimal way, analytically, to maximise the gains from trade, as barriers between third countries upward or downward in the value chain matter as much as the barriers put in place by direct trade partners.

Against this background, it is problematic that multilateral trade negotiations have come to a halt in recent years. Instead, bilateral and regional trade agreements have become the preferred trade policy avenue of the early 21st century.

3.2 …but multilateral solutions need not be universal

Baldwin (2012) argues that the emergence of GVCs has changed the motivation for cooperation on trade issues in a fundamental manner. The General Agreement on Tariffs and Trade (GATT) was needed to solve a perceived prisoner's dilemma situation with respect to traditional trade barriers. One key purpose of negotiations under the GATT was to prevent one country from 'cheating' and free riding on its trade partners' liberalization efforts.

In a world of global value chains, where imports matter as much as exports, however, trade policy is no longer a prisoner's dilemma. Instead, it is in everybody's own interest to cooperate. From a GVC perspective, it does not make sense to treat, for example, measures that improve customs procedures as a 'concession'.

Baldwin argues, however, that there is still a need for multilateral, 'supply-chain disciplines'. He lists a range of WTO-plus and WTO-beyond areas that could form what he calls a WTO 2.0 for this purpose.[2] The reason for this is that countries still have an incentive to backslide on policies that support the function of the supply chain once they have been integrated into the chain and secured a slice of its value. In order to create long-term predictability and to avoid backsliding, international disciplines are needed.

To achieve their objective, however, disciplines need not be universal, Baldwin argues,

> This suggests that the main players in supply-chain trade should be members [of a trade agreement], but does not argue for membership beyond that as a matter of first-order importance.

The World Economic Forum (2013) is more specific on this point when they discuss the option of a plurilateral International Supply Chain Agreement (ISCA). According to the proposal, WTO plurilaterals, such as the Information Technology Agreement (ITA) and successful WTO negotiations on financial services and basic telecommunication services, would serve as models.[3]

3.3 GVCs strengthen the case for unilateral liberalization

According to the OECD (Mirodout and Rouzet, 2013), most real trade liberalization over the past two decades 'took place unilaterally and on an MFN [most favored nation] basis'. They go on to argue that this

> is consistent with the idea that removing barriers to trade has benefits on the import side to increase the competitiveness of domestic firms and to encourage further specialization in the value chain. There is no need to wait for other countries to do the same and, on the contrary, there are distinct advantages for the 'first movers'…Global value chains seem to have weakened the case for 'reciprocal trade liberalisation'.

Another OECD synthesis paper (Gestrin, 2013) on global value chains draws a similar conclusion.

> With the emergence of GVCs, the mercantilist approach that views exports as good and imports as bad, and that views market access as a concession that can only be granted in exchange for access to a partner's own market, has clearly become counterproductive.

The World Economic Forum (2013) expresses similar sentiments from a business perspective:

> [P]rogress in improving the policy environment need not and should not wait for international agreements.…There is much that governments can and should do to improve the logistics environment in their own countries to capture the gains from participation in supply chains.

In a world of global value chains, it is difficult to see areas, with the possible exception of tariffs, which are suitable for a strictly reciprocal approach to trade negotiations. Whereas the basic telecommunications negotiations in 1997 did create real liberalization in ICT services, there are few other examples of new market access liberalization (beyond water cuts) in service negotiations. Moreover, in a modern economy such as the EU or the US, it is increasingly difficult to envisage service-related regulation that effectively denies service suppliers from one country market access but allows it for others.[4]

Similarly, it seems far-fetched to imagine behind-the-border regulations (technical barriers to trade (TBT), sanitary and phytosanitary (SPS) measures etc.) that discriminate between domestic and foreign firms. In other words, as we move deeper into a behind-the-border trade agenda, a reciprocal approach to trade policy becomes less suitable. In fact, it runs the risk of becoming counterproductive because domestic reforms are put on hold in anticipation of international agreements that may never come. Instead, the challenge becomes to find practical solutions to regulatory barriers affecting businesses both at home and abroad while preserving legitimate consumer, environmental and labour protection.

The changing nature of world trade thus (1) strengthens the case for unilateral trade liberalization and (2) necessitates a more cooperative approach to trade negotiations than is currently the case.

To some extent, the conclusion that a reciprocal approach to trade negotiations has become outdated, conflicts with the view that GVCs support multilateral trade liberalization (which is of course reciprocal). On the one hand, trade policy has become increasingly interdependent when products are 'made in the world'. Other countries' trade policies and what happens in upstream or downstream markets increasingly affect domestic producers. On the other hand, it is also true that the increasing importance of inputs and improved cross-border logistics, allow countries to strengthen their competitive edge through unilateral reform.

One way of looking at this apparent conflict is to argue that multilateral negotiations that fully recognize the importance of imports for competitiveness are the optimal solution. Unilateral action, however, remains a more direct route to competitiveness, particularly in a world where many countries are stuck in a GATT-era mindset.

Another way to look at it is to argue that it is only the 'exchange of concessions' approach to trade negotiations that has become outdated. The GATT-era prisoner's dilemma is gone. However, the new intertwined, border-crisscrossing nature of world trade still makes it important that everybody, or at least a critical mass of countries, is on board. In this sense, reciprocity still matters.

3.4 A renewed focus on 'open regionalism'

As mentioned above, the recent trend toward regionalism in trade policy is problematic given the fact that global value chains reinforce the case for multilateralism. However, while bilateral or regional trade agreements (RTAs) are not fully compatible with modern trade patterns, there are many things trade negotiators could do to improve the effectiveness (in terms of trade creation) of such agreements. The OECD (Mirodout and Rouzet, 2013) concludes,

> Regional trade agreements can help if they cover a sufficient number of economies, are consistent with regional production networks, do not introduce distortions with third countries and are progressively multilateralised.

With this in mind, deliberate thought should be given to how the effects of regional agreements can be maximized. In particular, the changing nature of world trade makes it critical to apply 'open regionalism' to future RTAs. It is also important that RTAs are designed to prepare the ground for multilateral or plurilateral agreements.

In theory, open regionalism can be applied in many ways (see Bergsten 1997 for an overview),

- openness with respect to membership,
- a credible commitment to pursue multilateral liberalization in parallel to regional negotiations,
- a prioritization of non-tariff reforms that don't lend themselves to preferential treatment,
- a high degree of transparency with respect to future rule making,
- liberalization between the parties on an MFN basis.

We will return to some of these options in the last section of this report.

3.5 A comprehensive approach to trade liberalization

GVCs require a comprehensive approach to trade liberalization because all tasks along the value chain are critical parts of the production process.

Apart from manufactured goods, services also play a key role in the transformation of trade, both by enabling value chains in manufacturing and through the creation of value chains in their own right.

In addition, modern production networks depend on tasks related to cloud computing, data storage, the protection of intellectual property, logistics, insurance, IT goods and services, and cross-border payments and credit. It therefore makes sense to apply a comprehensive approach to trade liberalization that includes goods, services, investment, competition, intellectual property rights and the temporary movement of workers. The last aspect is probably more important than commonly understood because international supply chains require a lot of face-to-face interaction and key competence (either to perform a certain task or to instruct others how to perform it).

For similar reasons, the World Economic Forum (2013) advocates a 'whole of the supply chain' focus in trade agreements. In their presentation, a 'whole of the supply chain' approach (as opposed to a 'silo approach') brings together service sectors that are particularly relevant from a logistics perspective. These include cargo handling, storage, warehousing, ancillary services, along with freight services (air, road, rail, maritime, express/courier).

> Negotiating commitments on these various services – treated as a 'bundle' or 'check-list' - along with parallel negotiations on trade facilitation focusing on border management procedures and disciplines pertaining to product standards and technical regulations, offers the prospect of addressing many of the policies affecting the operation of global supply chains…Additional cross-cutting issues such as e-commerce, investment policy, and some elements of competition policy (to address concerns regarding the behavior of dominant suppliers) should also be taken into consideration.

More generally, the World Economic Forum puts a strong emphasis on improving logistics efficiency along the supply chain in their policy recommendations.

3.6 Maintaining a business perspective

In *Trade policy and Business reality – closing the gap*, the Board observed that the nature of world trade is changing and that trade policy in most OECD economies has not kept pace with that development. Because technology, business models and trade itself are changing rapidly, it is critical that trade negotiators acquire a genuine understanding of modern trade. This, in turn, requires a business perspective and a close business dialogue.

The World Economic Forum (2013) sees the Trans-Pacific Partnership (TPP) as a model in setting up such a dialogue.

> A major element of the TPP's proposed approach is regular communication and interaction among officials, regulators and industry representatives with a view to identifying problems and potential solutions.

The World Economic Forum advocates similar feedback loops between government and firms at the domestic level.

3.7 Trade in goods - the cost of protectionism increases

Given the increasing importance of imports for exports, the cost of national borders has increased. A range of import barriers, from tariffs to non-tariff measures, custom procedures, and anti-dumping duties therefore run the risk of hurting the competitiveness of domestic industries. As goods cross borders several times, the cost of these barriers are magnified along the value chain. As a result, the cost of protectionist trade policy measures has increased.

Here we make the point in relation to trade in goods, but the conclusion (mentioned in most reports on the issue of GVCs and trade policy) that GVCs raise the cost of protectionism applies across the board.

3.8 Trade in goods - rules of origin

In a world where firms depend on global value chains, rules of origin become particularly important. Restrictive rules of origin reduce the ability of firms to increase their productivity through integration into global production networks. The European Commission (2010) makes a similar argument:

> Global commerce is characterized by large and increasing volumes of trade in intermediate products. Producers take advantage of different costs in different locations to source the cheapest inputs possible. Allowing producers access to raw materials or intermediate products from low cost international sources through relaxed rules of origin (RoO) is therefore vital. (p. 54)

In view of this, it is important that that rules of origin are designed in a way that takes GVCs into consideration when regional trade agreements are negotiated.

3.9 Trade in services - modal neutrality

Because most service firms provide services through different modes of supply, they function best in a regulatory environment of modal neutrality that allows them to switch between modes and to combine them when necessary for cost purposes. Modal neutrality means that all modes of services supply (cross-border supply, consumption abroad, commercial presence, and movement of natural persons) should be equally open. For example, the skills gap in ICT services in the EU requires firms either to offshore ICT tasks or to rely on movement of highly skilled personnel to Europe. If both channels were open, it would improve flexibility and thus competitiveness for EU firms and create conditions for more ICT investment in Europe.

3.10 Regulatory coherence, transparency, and predictability

When goods and services are intertwined in global production networks, barriers to goods affect services, and vice versa. GVCs therefore reinforce the importance of cross border regulatory coherence as well as regulatory simplicity and efficiency.

A firm whose business model is based on cross-border production networks also depends on the ability to predict the cost of moving goods, services, people, and capital across borders. A transparent and predictable policy environment thus becomes very important from a GVC perspective. Sudden changes in regulation or an arbitrary application of rules can have large negative effects on competitiveness.

3.11 Small and medium-sized enterprises

Fixed trade costs along the production chain disproportionately affect small- and medium-sized enterprises. In relation to their turnover, SMEs face larger barriers to trade and higher costs. Often they are related to logistics or other types of transaction costs (The World Economic Forum, 2013).

The World Economic Forum therefore proposes that SME interests are represented in the policy prioritization process and that solutions designed to address constraints that affect SMEs disproportionately are explored.

4. Transatlantic Trade in Numbers

As a background to the discussion that follows in section 5 on potential policy implications for TTIP, we provide a statistical overview of transatlantic trade relations.

4.1 Data

The data in this section are taken from Eurostat and the OECD database Trade in Value Added (TiVA)[5]. The TiVA database covers the years 2005, 2008, and 2009. The figures in this report are taken from the first version of the database published in January 2013. It is still under development, however, and the figures will be updated later this year. Because of the impact of the financial crisis on the 2009 data, the figures used here are for the year 2008.

4.2 How to measure trade?

For a long time international trade was conceived as a process where goods were produced in one country and exported to another for final consumption. Today, however, production of goods and services is increasingly fragmented into tasks that are carried out in different parts of the world. As mentioned above, this report uses the term 'global value chains' to describe this phenomenon.

Traditionally, trade statistics refer to gross trade flows. Gross measures treat all exports from one country as being fully produced domestically and exported for final consumption to the immediate country of destination. As the world economy has become increasingly integrated and production more fragmented across borders, this measure has become insufficient to illustrate bilateral trade relations. In this section, we therefore use both gross figures and figures based on value-added statistics.

Whereas gross exports refer to the full value of any cross-border trade transaction, value-added exports refer to the value of gross exports minus the imported intermediates used in producing the product. A value-added export measure thus isolates the domestic production component of international trade flows.

Calculated this way, Swedish value-added exports to the US refer to Swedish domestic value-added embodied in US final domestic demand. This means that the recorded export figure takes into account both the domestic value-added in direct exports from Sweden to the US and indirect exports made through trade in intermediate goods that appear in final US demand. Hence, goods and services can be exported directly to the US or indirectly via, for instance, Swedish exports to Germany, which in turn are exported from Germany to the US. In gross terms, the value of exports would take into account only the direct exports to Germany whereas the figures from the TiVA-database take into account both the direct exports that go straight to the country and the indirect exports that go through other countries and end up at the final destination. Thus, a direct relationship need not exist between producers and consumers in the two countries.

4.3 Gross EU and Swedish exports to the US

Traditionally gross trade statistics are used to illustrate bilateral trade relations and the importance of markets. In Figures 1 and 2, data from Eurostat are used to describe central aspects of EU and Swedish exports, both generally and in relation to the US.[6] EU export figures refer to the share of external trade, that is, exports outside the EU. For Sweden, the figures include exports to other EU member states.

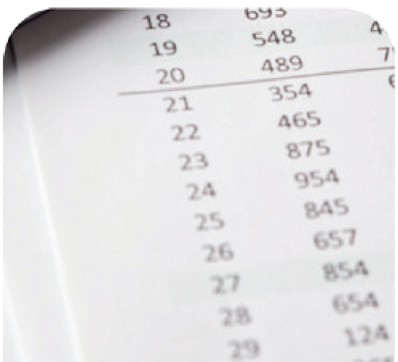
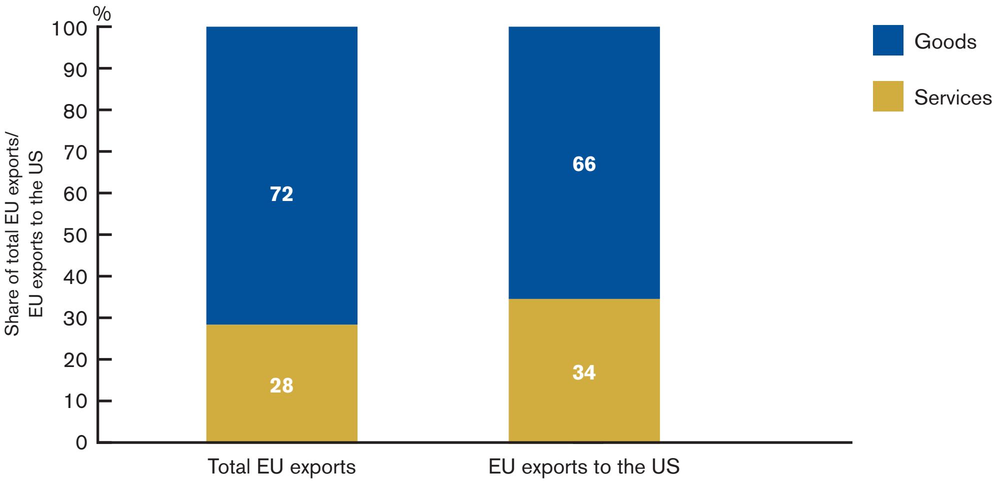


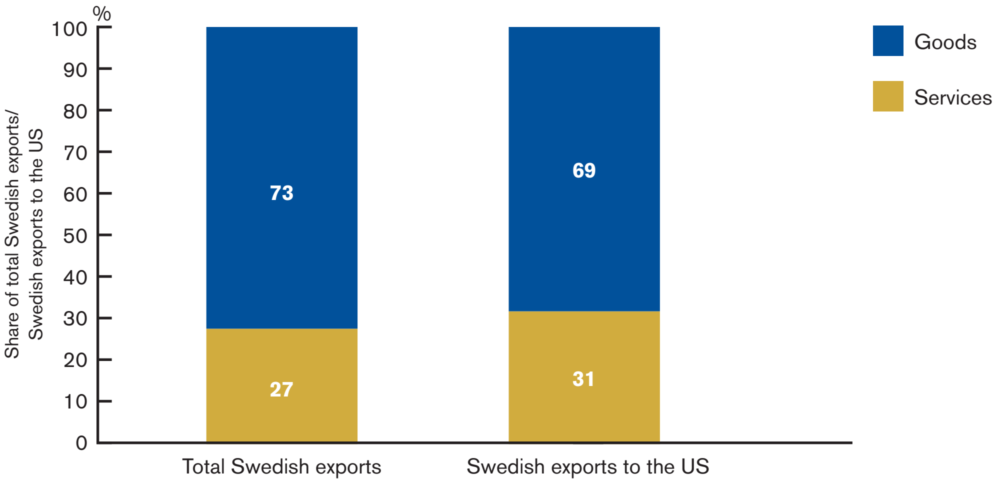
Figure 1. Gross EU exports in 2008



As seen in Figure 1, the share of goods was 72 percent and the share of services was 28 percent of total EU gross exports in 2008. For exports to the US, the share of goods was 66 percent and the share of services was 34 percent. Services are thus relatively more important in EU exports to the US compared with total EU gross exports.

Gross trade statistics from Eurostat also serve to illustrate the relative geographical importance of the US market for EU exports. In 2008, the US was the largest export market for the EU with a share of 21 percent of total EU gross exports of goods and services (not illustrated in a diagram).

Figure 2. Gross Swedish exports 2008



As shown in Figure 2, the share of goods was 73 percent and the share of services was 27 percent of total Swedish gross exports in 2008. For exports to the US, the share of goods was 69 percent and the share of services was 31 percent. As for the EU, services are thus relatively more important in Swedish gross exports to the US compared with total Swedish gross exports.

In 2008, the US geographical share of total Swedish gross exports of goods and services was 7 percent. The lower share of exports to the US (compared with the corresponding figure for the EU) is explained by the fact that Swedish gross exports include exports to other EU member states.

When using gross trade statistics as a measure, the US market stands out as the most important export market for the EU. Moreover, for both Sweden and the EU as a whole trade in services is particularly important in relation to the US. As we shall see below, these conclusions are reinforced further when a value-added measure is introduced.

4.4 Transatlantic trade in value-added terms

As explained above, the TiVA database allows us to study trade with the US in value-added terms.

Value-added exports to the US

As shown in Figure 3, EU value-added exports to the US as a share of total EU value-added exports are 23 percent (a share that is larger than the gross measure mentioned in section 4.3). This makes the US by far the largest destination of EU value-added exports. The share of EU value-added exports to the US is as large as exports to China, Russia, Japan, Switzerland, and India together.

Figure 4 shows the top ten export destinations for Swedish value-added. The largest receiver of Swedish value-added exports is the US followed by Germany, UK, and Norway. Exports of Swedish value-added to the US were 12 percent of total Swedish value-added exports in 2008 (again, a larger figure than the gross figure of 7 percent referred to in 4.3).

Figure 3. Top ten export destinations of EU value-added 2008

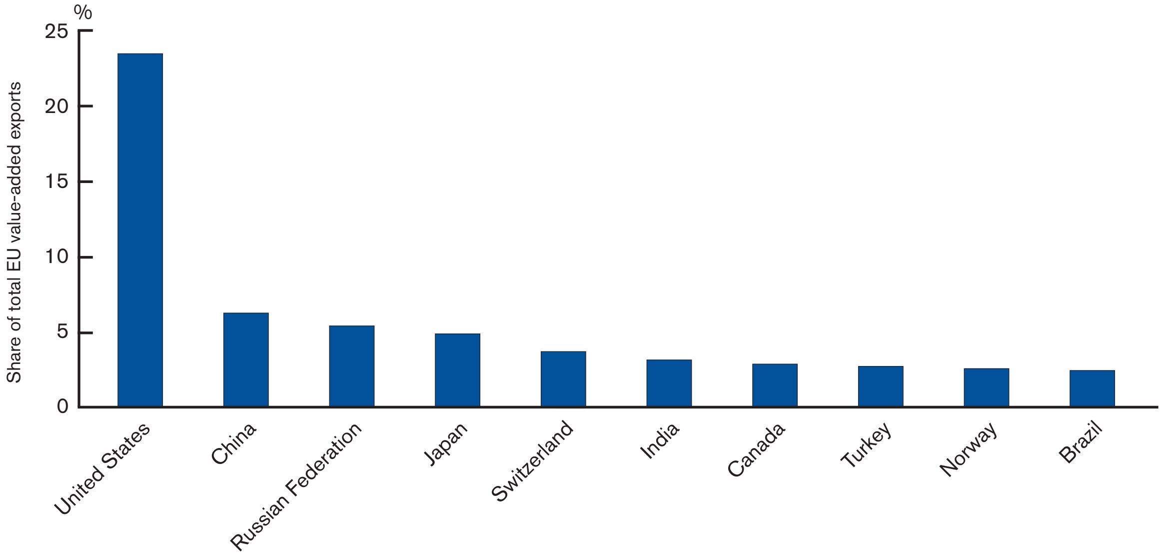
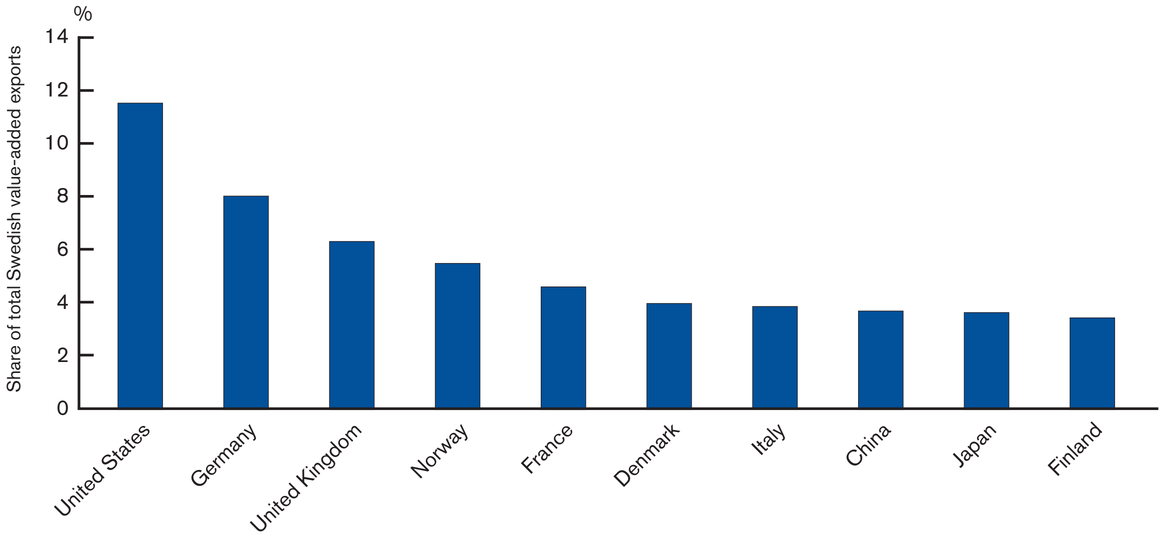


Figure 4. Top ten export destinations of Swedish value-added 2008



Value-added imports from the US

Foreign value-added embodied in final domestic demand can be interpreted as value-added imports. This shows how much value-added from, for example, the US that ends up in Sweden or the EU.

As shown in Figure 5, the US is the largest foreign supplier of value-added to the EU. In 2008, the US represented 20 percent of total value-added imports. Russia and China, the second and third largest supplier countries of value-added to the EU, accounted for approximately 10 percent each.

Figure 6 shows that the US is the third largest supplier of value-added to Sweden. In total, the US accounts for 7 percent of Swedish imports of value-added.

To sum up, the US is by far the largest trading partner for the EU in value-added terms, with an export share of 23 percent of total EU exports and an import share of 20 percent of EU imports. The US is also the largest destination for Swedish value-added exports. Swedish value-added exports to the US account for 12 percent of total Swedish value-added exports. The US is the third largest value-added supplier to Sweden with a share of 7 percent of Swedish value-added imports.

Figure 5. Top ten supplier countries of value-added in EU imports 2008

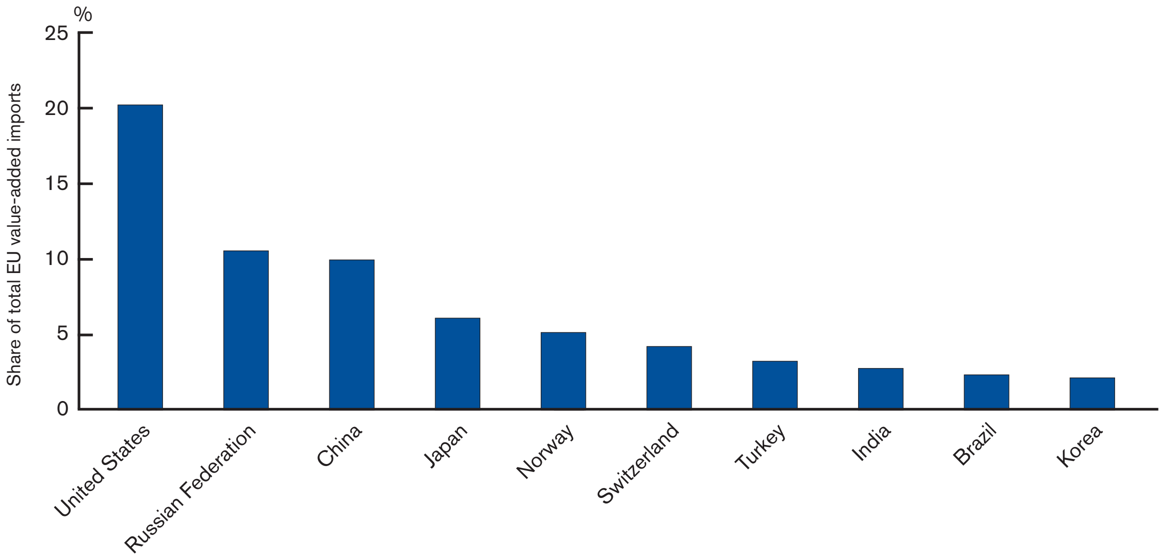
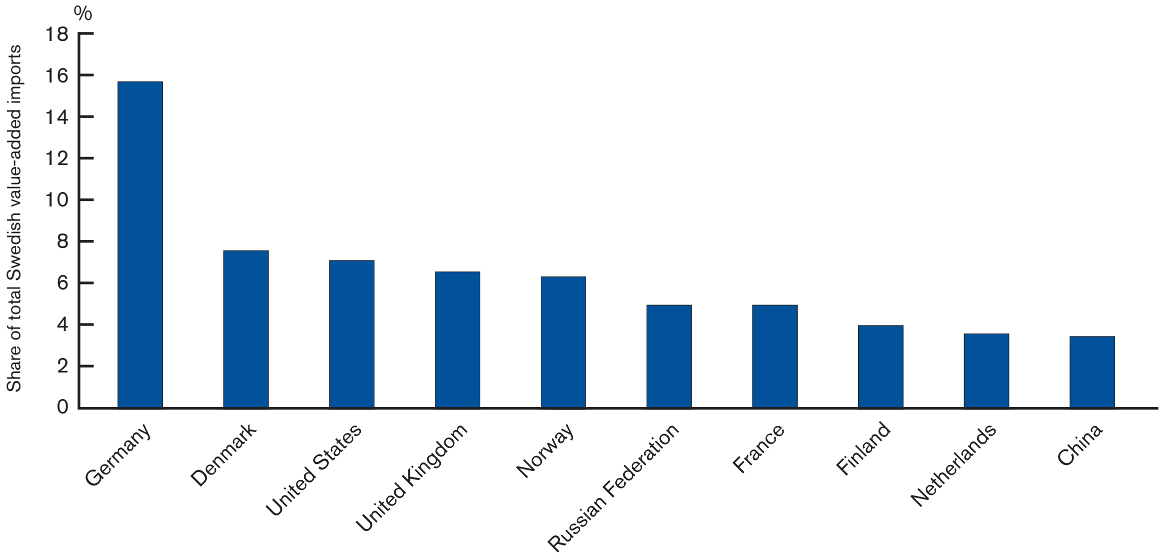


Figure 6. Top ten supplier countries of value added in Swedish imports 2008



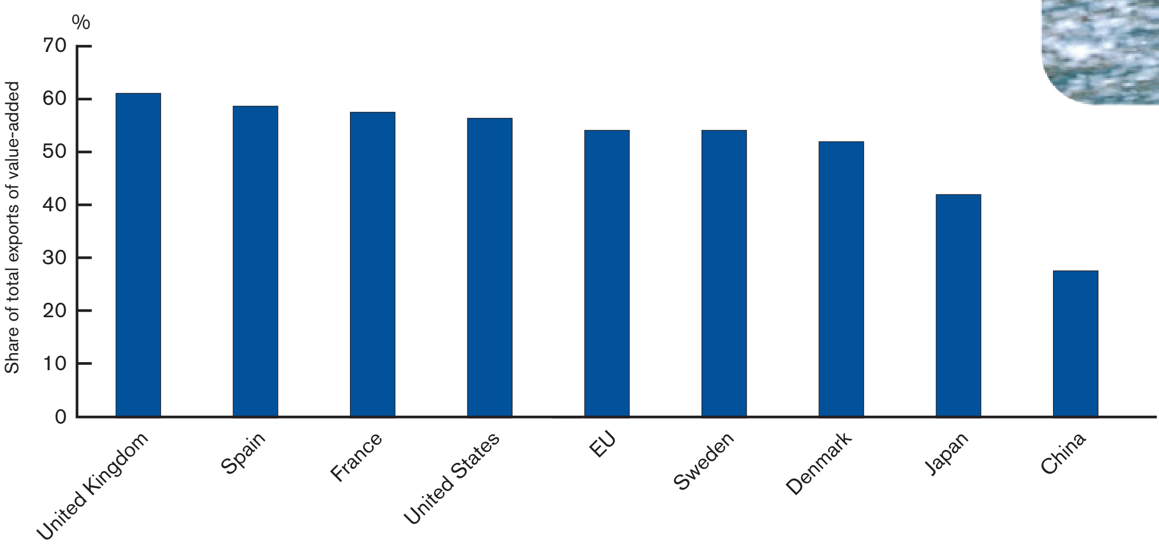
4.5 The role of services

The TiVA database also allows us to examine the role of services more closely in EU and US trade. In order to do that, we introduce a new measure derived from the TiVA database – the share of services in value-added exports. More formally, it is the share of services value-added embodied in foreign final demand. This is essentially a measure of 'servicification', i.e. the service content in production across all economic sectors.[8]

Figure 7 shows the share of services in value-added exports by country. For Sweden, services represented 54 percent of total value-added exports in 2008. The figures for the EU and the US also show that services constitute a majority of value-added exports. Services made up 54 percent of EU and 56 percent of US value-added exports in 2008. It indicates that services play a much larger role in EU and US trade than revealed by the gross figures discussed in section 4.3. The large difference is explained by the fact that the value-added measure accounts for all services ending up either directly (through services exports) or indirectly (through the service content in the export of goods) in foreign final demand.

For countries such as the United Kingdom, Spain and France the service share is even higher. The shares for countries such as Japan and China are lower.

Figure 7. Service share of total exports of value-added 2008



Transatlantic trade in services

As illustrated in Figures 8 and 9, the share of services in both EU and Swedish value-added exports to the US is higher than the share of services in total EU and Swedish value-added exports.

For the EU, services constitute 60 percent of value-added exports to the US. For Sweden, the service share of value-added exports to the US is 62 percent. This indicates that services play a dominating role in trade with the US both for Sweden and for the EU as a whole.

To sum up, the importance of the US market increases for both Sweden and the EU as a whole when exports are measured in value-added terms (compared with gross exports). Similarly, the significance of services increases substantially with a value-added measure, both generally and, especially, in trade with the US.

Figure 8. EU exports of value-added 2008

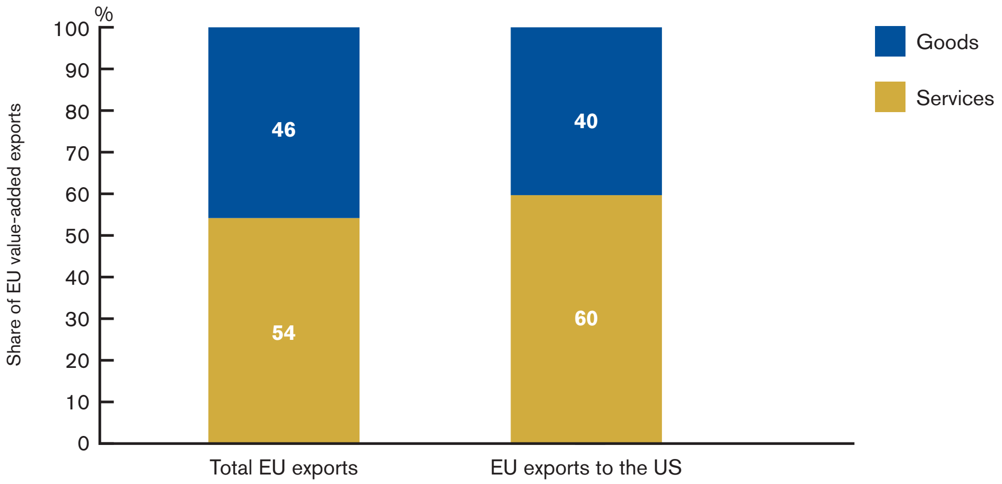
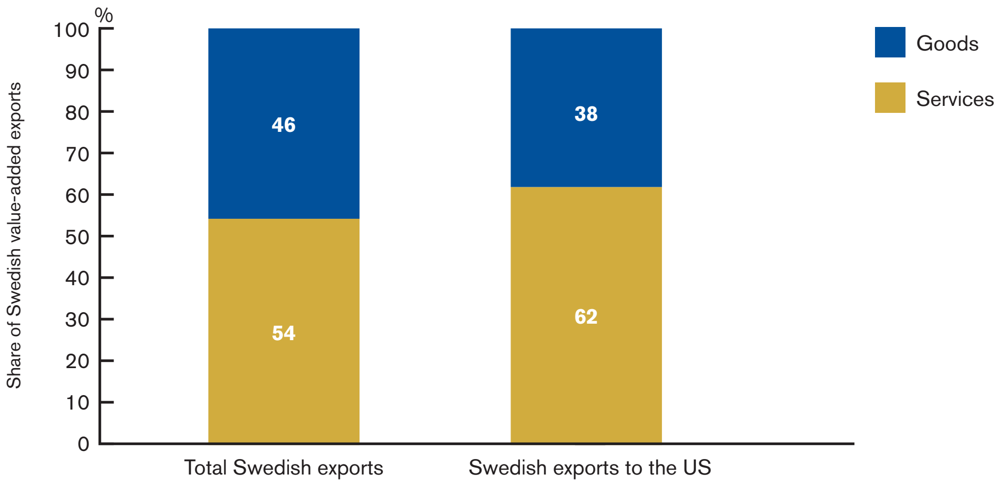


Figure 9. Swedish exports of value-added 2008



5. Policy Options in the Context of a Transatlantic Trade and Investment Partnership

The regional nature and intensity of GVCs is one of the strengths of the EU, whose internal market and strong regional linkages have made it into a prominent GVC hub. The focus of the single market on 'four freedoms' also makes the Union into something of an international role model in terms of supporting cross-border production networks.

In a report to the heads of state and government ahead of the 7-8 February 2013 European Council, the European Commission made the following GVC analysis (p 3):

> The rapid development of regional and global value chains has been a step change for trade policymaking. Today, products are no longer made in one place from start to finish. Instead, they are put together in a long series of steps, often in different parts of the world. This new organisation of production blurs economic frontiers and transforms trade relations…**This means that national exports and imports can no longer be approached from a narrow, mercantilist angle**. It is not just exports that are essential to economic growth and job creation but increasingly also imports. [bold in the original]

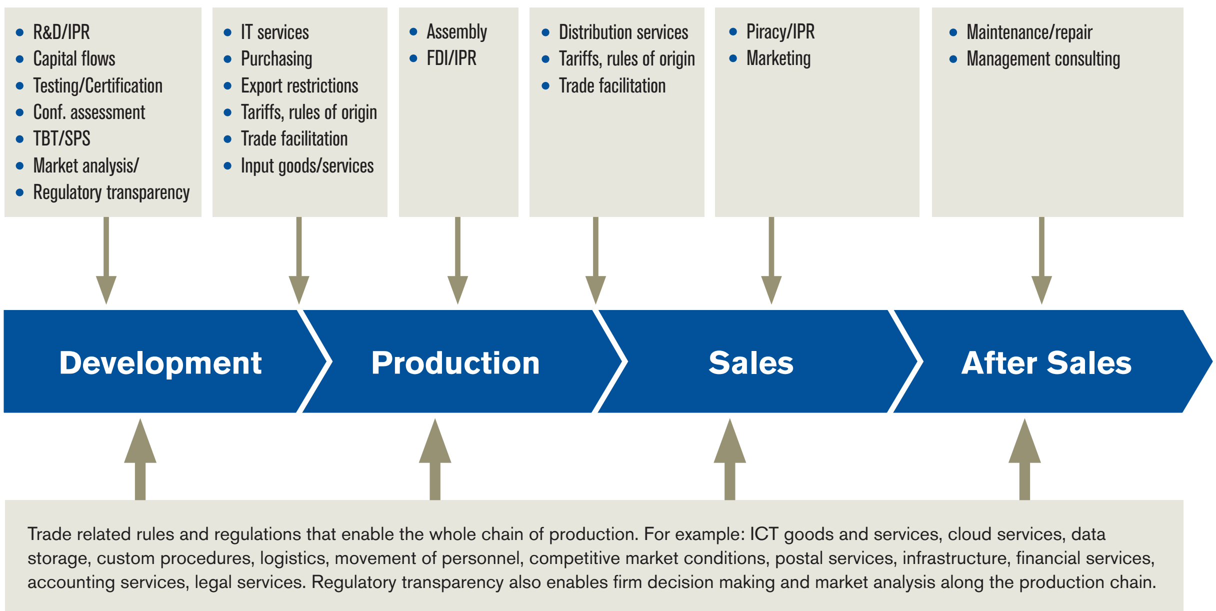
With this transformation of production, trade relations, and trade policymaking in mind, the question that arises is how it influences EU trade negotiations. In this final section of the report, we therefore discuss options for the TTIP negotiations from a GVC perspective by applying the general insights discussed in section 3.

5.1 A value chain approach to TTIP negotiations

From the firm's perspective, TTIP negotiations should be about reducing cost and improving logistics along the production chain. The schematic presentation in Figure 10 of a production chain is an example of how such an approach could be pursued.

With a value chain approach there is a better chance that the negotiations will focus on the economically most important issues. The key question is where the major (unnecessary/non-legitimate) costs are located along the production chain. It would also underline the mutual interest in eliminating trade barriers. With a value chain approach, a more pragmatic, problem-based perspective could replace strict reciprocal thinking in the negotiations.

Figure 10: TTIP negotiations from a production chain perspective



5.2 An open agreement

Out of the five aspects of 'open regionalism' that are listed in section 3.4, at least three could realistically be applied in a TTIP context.

Openness with respect to membership

In a world of global value chains, the positive effects of a transatlantic agreement in terms of expanded trade and investment will be larger over time if it is designed as an open agreement that allows other parties to join when/if they should like so. An open agreement in this sense would have significant benefits from a GVC perspective.

Commitment to multilateralism

During ten years of Doha negotiations, the EU showed a clear commitment to multilateralism at the WTO. Since the TTIP is partly a response to the failure to conclude a comprehensive Doha agreement, it is difficult to see how the EU can make a commitment to multilateralism beyond continued good faith in the current WTO negotiations.

Prioritization of reforms that do not lend themselves to preferential treatment

An open agreement might give priority to WTO plus/beyond provisions that are not possible to apply on a discriminatory basis. This could be, for instance, provisions related to TBT and SPS measures, mutual recognition, harmonization, trade facilitation, as well as good governance (transparency, anti-corruption) measures.

In this context, conditions for regulatory convergence that allow third countries easier access to an expanded transatlantic market could be created. This could be achieved if the EU and the US agreed on harmonizing some SPS measures or technical regulations. With respect to SPS, this option is the easiest when new SPS measures are introduced and the acceptable level of risk is similar in the EU and the US.

Another option that would signal openness and facilitate trade with third countries would be to introduce provisions that recognize legislation as equivalent between the EU and the US. For example, the current EU-US agreement to recognize each other's standards for organic production could be extended to third countries. This would allow, for instance, a Colombian organic coffee producer that has been certified for the US market in accordance with USDA's organic standard, to be able to export organic coffee to the EU market, without the need for additional certification to confirm compliance with the EU's organic regulation.

Transparency with respect to future rule making

Transparency with respect to future TTIP rule making, NTB negotiations, and discussions on regulatory issues could be provided for in the new institutional structure that is expected to be set up under the TTIP.

MFN liberalization between the parties

TTIP liberalization between the EU and the US on an MFN basis is not realistic, but could be employed in a mini-version, where tariff and quota liberalization under TTIP are extended to all least-developed countries.

5.3 A level playing field for firms that rely on global value chains

EU and US firms that depend on global value chains beyond the transatlantic area should be able to take full advantage of liberalization of goods and services under the agreement. Firms that rely heavily on GVCs must not be disadvantaged compared with firms that source primarily within the EU or the US.

To achieve this, more liberal rules of origin could be considered for TTIP, along the lines that the Board proposed in *Business Reality and Trade Policy – Closing the Gap*. The four reform proposals discussed in that report were the following:

- allow full cumulation
- no prohibition of duty drawback
- avoid multiple product-specific criteria and allow for greater relaxation in product-specific rules
- increase the general tolerance rule and include all HS chapters

According to the telecommunications manufacturer Ericsson, the cost of analyzing content, in order to meet rules-of-origin requirements, generally exceeds the benefits of preferential treatment in RTAs (Ulf Pehrsson at the WTO Public Forum, 2012). Similar conclusions can be found in academic studies (e.g. Brenton and Manchin, 2003).

Ultimately, it is important that ICT companies such as Ericsson do not lose competitiveness under the TTIP because their products, parts and components do not qualify for duty-free treatment as a result of their global sourcing strategy. The same goes for all EU firms that have a large third-country import share in their exports.[9]

5.4 Integration of goods and services

Manufacturing companies buy, use, produce and sell more services (a so-called 'servicification' process) than before. In relation to global value chains, services function both as enablers of the chains and as specific links in the production chain.

Moreover, as shown in section 4.5, services represent more than 50% of EU value-added exports generally and 60% of EU value-added exports to the US.

With these considerations in mind, it is important to make services a TTIP priority and to treat goods and services as an integrated area of negotiation in the TTIP. As far as possible, the traditional silos that separate goods and services should be abandoned. Openings in one field should not be undermined by restrictions in another. Sensitivities in one area should not stand in the way of progress in the other. From a GVC perspective, it is also essential that negotiation take into account the impact of digitalization and servicification.

5.5 Movement of personnel

If anything, a trade-in-task economy underlines the need for a better flow of personnel with the right skills to perform certain tasks or instruct others how to perform them. From this perspective, an ambitious transatlantic agenda to speed up mobility of personnel in key sectors is critical. Such an agenda would require moving beyond the traditional issue of market access and include other aspects of movement of personnel, such as speedy and transparent visa procedures.

5.6 Business involvement

In section 3.6 we observed that it is essential that trade negotiators acquire a genuine understanding of the evolution of modern trade. That is particularly important in a transatlantic context because value-chain trade, digitalization, and servicification are already dominant features of the business models of EU and US firms. The best way to keep up with the changing nature of trade is to maintain a close dialogue with the transatlantic business community.

There has been business involvement in the process towards deeper transatlantic economic integration for a long time. In 1989, the European Community Chamber of Commerce (ECCC) in the United States was founded. Seven years later, it was renamed the European-American Business Council (EABC). In 1995, the Transatlantic Business Dialogue (TABD) was formed. It was set up to offer a framework of cooperation between the transatlantic business community and the governments of the EU and the US. In 2007, the level of ambition was raised with the formation of the Transatlantic Economic Council (TEC). The purpose of the TEC was to accelerate government-to-government cooperation in order to advance economic integration between the EU and the US. The TABD along with two other 'dialogues', the Transatlantic Legislators Dialogue and the Transatlantic Consumers Dialogue, became advisory groups within the TEC where they continue to provide input on regulatory cooperation. On 1 January 2013, a merger between the TABD and the EABC created the Transatlantic Business Council (TBC). Its mission is to promote a barrier-free transatlantic market.

The institutional framework for business involvement in the TTIP negotiations is therefore already in place. The question is how such involvement can be made more operational. High-level meetings in the TEC will not be sufficient. There also must be channels for continuous information and feedback on an operational level throughout the negotiations.

5.7 Small and medium-sized enterprises

As mentioned in section 3.11, SMEs are affected disproportionately by fixed trade costs along the production chain. Recent improvements in trade logistics, such as 'authorized economic operators' and other trusted trader programs, also typically benefit large economic actors.

In order to facilitate SME access to EU-US production networks, TTIP could raise current de minimis levels that allow goods under a certain threshold value to forgo customs control. Because the objective of TTIP is to eliminate all but the most sensitive tariffs, the principal benefit for SMEs with such a reform would be the costs saved through the reduction in custom delays and documentation. According to a recent study on de minimis thresholds in the Asia-Pacific Economic Cooperation (APEC) region, a new threshold value of US$200 could amount to cost savings of $30 billion per year for the APEC economies (CAPEC, 2011).

Notes

1 The document was made public on 13 February 2013.

2 'WTO-plus' refers to commitments that are more ambitious than existing WTO disciplines. 'WTO-beyond' refers to entirely new disciplines that are not reflected yet in the WTO agreements.

3 Nakatomi (2012), who first floated the proposal, thinks that an ISCA should be outside the institutional framework of the WTO, however.

4 The exception here is movement of personnel under GATS mode 4, where most countries are still very far from applying non-discriminatory rules.

5 See http://stats.oecd.org/Index.aspx?DataSetCode=TIVA_OECD_WTO.

6 The figures are taken from Eurostat's Balance of Payments data (current account). The figure for total gross exports is thus the sum of the subitems goods exports and services exports in the current account.

7 For an introduction to the term 'servicification', see for example Kommerskollegium (2010).

8 For an introduction to the term 'servicification', see for example Kommerskollegium (2010).

9 The reason why some firms do not make full use of preferences under an FTA also has to do with the margin of preference. If the margin of preference between the preferential tariff rate under the agreement and the MFN rate is small, a global value based firm might opt out even if the costs are relatively low. In other words, it is a cost benefit analysis that involves two factors: the costs involved in meeting origin requirements vs. the value of the preference.

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