PREFERENTIALISM AND MULTILATERALISM IN TRADE

POLICY

An analysis of the possible impact of TTIP on the multilateral trading system

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PREFERENTIALISM AND MULTILATERALISM IN TRADE POLICY

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“It may be logical, but rare indeed is the international system which not only accepts apparently diverging approaches to fundamental issues, but is designed specifically to accommodate them.

But such is the approach of the international trade system, as governed by the rules of the World Trade Organisation, to the great debate about multilateralism vs. regionalism in trade policy”.

Pascal Lamy, Former EU Trade Commissioner and WTO Director-General, 2002

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**METHODODOLOGY**

This work is divided into three parts, which respectively analyse the concept and recent diffusion of preferential trade agreements (PTAs), the historical background and the content of one of the most relevant PTA that is currently under negotiation, the Transatlantic Trade and Investment Partnership (TTIP) and, then, the possible impact of this agreement on the multilateral trading system. Within the current debate on the issue, the scope of this work is to determine if the conclusion of an ambitious version of TTIP could generate progress or otherwise endanger the process of trade liberalization at multilateral level.

The first part outlines the general framework, since it aims at defining the basic concepts used in the entire work, presents the recent trends and introduces the American and European approach on the PTAs subject. Among the many PTAs concluded in recent years or under negotiation, from the second chapter the attention is devoted to TTIP. The deal will probably mark a cornerstone in 21st century economic foreign policy relations and takes on a special relevance not only because of the economic power of the US and the European Union states but also for the historical interconnections between the two areas.

The second part of this work will highlight these elements as well as present the potential economic impact of the agreement, as expected by the analyses delivered by leading think tanks and research institutes. The final part, after an overview on the debate on the potential impact of PTAs over the multilateral system, extrapolates some conclusions in the attempt to foresee the possible scenarios envisaged by TTIP negotiations. In order to evaluate this impact, I choose the model proposed by Andreas Dür in the 2007 article “Regionalism: Stepping Stone or Stumbling Block for Globalisation?”, which starts from the assumption that PTAs could have both positive and dangerous effects on the multilateral trading system and, therefore, the analysis should be focused on the
identification of the conditions under which a development or the other is to be expected and then on the interaction between the strategies of a PTA’s members and the excluded countries. According to his argument, the direction of the effect depends mainly on the initial distribution of bargaining power between the PTA’s member states and excluded countries, since the strategy of a third country could vary from membership application to the PTA or association with it, call for non-discriminatory trade liberalisation through the offer of concessions in most favoured nation (MFN) negotiations, creation of a rival trading block, until the threat to impose retaliatory measures on the basis of its initial power. This model is applied to TTIP case, taking into account four groups of countries which could be relevant for their relations with the US and the EU or for their high implication in world trade. The theory helps in the analysis of third countries potential reaction to TTIP, but obviously does not allow making sure forecasts since multilateral trade negotiations implicate a very high number of countries and it is particularly challenging to make hypothesis on the result of their preferences’ aggregation. Moreover, it is to be considered that country’s political decisions are not always based on rational choices and are very much influenced by the weight of domestic political interests, since countries are not led by all-knowing and independent experts who will necessarily opt for the public interest. The relatively undisclosed content of TTIP, explained by the fact that negotiations are probably not yet in the conclusive phase, makes any conjecture on future evolution even more complicated and demanding.

**PART I**

**PREFERENTIAL TRADE AGREEMENTS**

This first part of the work is introductory and preliminary to the following and more substantial ones. It aims mainly at clarifying some notions and at giving a general
overview on key recent evolutions. The first paragraph gives a general outline on the
dynamics between protectionism and liberalization in the last century aiming at positioning
the entire discourse in an historical setting. Then it is introduced the definition of
preferential trade agreements (PTAs) and are highlighted the current trends, with a specific
focus on the recent proliferation of PTAs. The last paragraph is devoted to present the
United States and the European Union approach toward this topic. It should be clearly
stated since the beginning that both the US and the EU’s (even more) interest in the
preferential approach is quite recent, given that until few years ago they considered the
multilateral negotiations the best arena to promote free trade.

It is possible to use different terms to indicate the PTAs, the most common are probably
free trade agreements (FTAs), regional trade agreements, or also economic integration
agreements. The use of the expression PTA underlines the preference that is given to the
partners involved in the negotiation, thanks to the concluded agreement (Dür, Elsig, 2013:
1). In any case, they should not be confused with non-reciprocal agreements, where the
concessions made by the negotiating partners are not the same, which are not the subjects
of this work. The WTO allows its members to enter into PTAs in order to grant more
favourable treatment to the participating states than to the other WTO members, given that
some requirements are respected.

In recent years there has been and an important and evident growth in the number of
signed PTAs. The main reason that has pushed many states to open negotiation for PTAs
has probably been the stalemate in the multilateral framework after the conclusion of the
Uruguay Round, which has led to the establishment of the WTO in 1995. The Doha
Development Agenda (DDA), which has been launched in 2001 with the intention to be
completed by the end of 2004 (Lamy, 2002: 1400), has, in fact, stalled until 2013, when in
Bali it has been achieved a, still very limited, agreement (Bendini, 2013). Apart from the
recent proliferation, new PTAs show original features, involve new regions that previously had only been partially affected by the phenomenon and include a larger number of provisions on trade related sectors than the ones signed until the 1990s. Among the around 700 PTAs that have been signed after the end of World War II, the large majority were concluded from 1990s. Only in 2009 twenty agreements were notified to the WTO and today all the members of the organization, apart from Mongolia, have entered in at least one PTA. By 1992, many countries that are quite active today, such as China or Japan, had not yet concluded a single PTA, while the majority of PTAs under negotiation today involve one or more Asian countries. Moreover, there has been also a considerable increase of cross continent agreements that have been concluded in 2000s, many of them which include also some Asian states. This recent development clearly makes not any more appropriate to use the label regional agreements. These new cross regional agreements include some of the most relevant and discussed ones, such as TTIP and TPP (Trans Pacific Partnership). Apart from the change in the most involved areas, recent PTAs tend also to differ on the content from the previous ones. They cover sectors that were not included in agreements signed in 1990s, which, apart from NAFTA, were limited to trade in goods. Newer generation of PTAs includes rules on technical barriers to trade, behind-the-border regulation, government procurement, investment protection, services, standards, and intellectual property rights (IPRs): the focus has consequently shifted from the reduction of tariff barriers to non-tariff barriers and the harmonization of the regulatory framework.

Today the United States have concluded a conspicuous numerous of PTAs with 20 countries and are involved in the two most relevant negotiations at global level, for the TPP and the TTIP. Apart from NAFTA established in 1994, the first agreement concluded by the US has been with Israel (1996). Only during the G. W. Bush era the United States
have signed and started to implement their PTAs with Australia (entered into force in 2005), Bahrain (2006), Central America FTA (concluded in 2004), Chile (2004), Jordan (2006), Morocco (2010), Oman (2009), Peru (2009), and Singapore (2004). The PTAs with Colombia and Panama entered into force in 2012, the most recent, ambitious and commercially significant PTA concluded by the US in almost two decades, the KORUS FTA (with South Korea). Even if the European Union could appear as “follower” in this new global strategy on foreign trade, especially because of the initial delay and the time that has needed to shift to a bilateral trade policy strategy, the recent activism could eventually transform it into the “leader” of the process in future (Sbragia, 2010: 379).

Today the European Union has Preferential Trade Agreements in place with Chile (into force in March 2005), Mexico (the first Latin American country to sign a partnership agreement with the EU in 1997, which entered into force in 2000), Colombia (2013), Peru (2013), South Africa (2000), the Central America states (the countries involved are Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama, 2013) and South Korea (2011). Similarly to the KORUS FTA, the EU-South Korea agreement is the first of a new generation of trade agreements and goes further than ever before in integrating the two economies.

**PART II**

**TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP**

TTIP is currently under negotiation between the European Union and the United States and aims at removing all trade barriers, tackling non-tariff barriers harmonising standards and regulations but also at opening markets for services and public procurements. The scope of the agreement is enormous, since, together with TPP, currently under negotiation too, represents the most ambitious trade agreement discussed in the last years and, if positively
concluded, will probably mark a cornerstone in 21st century economic foreign policy relations (Bendini, 2014a: 21-22). It will create the biggest free trade area in the world, with the two involved areas representing the two world biggest trade blocks and accounting for almost half of the world GDP.

The talks started in July 2013 and the initial aim was to conclude them within the end of 2014; however the schedule has already consistently lengthened and the new objective to reach an agreement within 2015 seems very optimistic. The European Commission, which is conducting the negotiations for the European side, considers the agreement a key tool to drive future growth and create jobs in Europe. As a matter of fact, apart from its economic impact, TTIP could assume a crucial geostrategic role in revamping transatlantic relations, if the two sides managed to conclude a well-balanced and comprehensive agreement that can represent a sort of economic NATO (North Atlantic Treaty Organization), as argued by many experts, included the American Ambassador to the European Union Anthony Gardner (Vincenti, 2014)\(^2\). Other scholars, however, consider this scenario way too optimistic: Uri Dadush, former director of International Trade at the World Bank, is sceptical on the conclusion of the agreement and argues that expectations are too high since there are many complicating factors that can halt the process and that, even if the treaty is concluded, it will probably deliver much less than it promised (Dadush, 2013).

This work considers the Transatlantic Trade and Investment Partnership as the more recent step of the long process of structural integration and interconnection between the transatlantic countries. For this reason, before analysing specifically the TTIP negotiations, it seems appropriate to present a brief historical overview, in order to catch the main trends characterising the evolution of the transatlantic economy, that is to say the system of links

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2 The definition is, however, considered very much exaggerated and inappropriate by some scholars, for more details see, for example: Tentori, D. (2013), “The TTIP: an Ambitious Step Forward but Not an ‘Economic NATO’”, in ISN Blog, 12 June. The European Commission does not share this point of view too, highlighting the evident differences between the economic and the military fields.
and interconnections between the European and the American economic structures. A first part is devoted to some key moments in the evolutions of transatlantic economic relations (the interwar period, the Marshall Plan, the Bretton Woods framework); then there is leap ahead towards more recent issues, in particular the efforts to establish institutional frameworks to foster transatlantic cooperation, such as the Transatlantic Economic Partnership (TEP) or the Transatlantic Economic Council (TEC), until the constitution of the High Level Working Group on Jobs and Growth, preliminary to the launch of TTIP. These initial elements will pave the way to the last part, devoted to the description of the transatlantic economy’s state-of-art: the attention will be focused mainly on the key sectors addressed by TTIP, trade and investments, but it will also, more briefly, touch other issues, such as services and jobs. The third chapter will address the context, the content and the possible impact of TTIP. It is devoted to the description of the issues negotiated, highlighting the high importance of non-tariff barriers, the expected economic benefits, the more controversial and criticized topics and the possible global impact of the agreement.

This entire part aims at presenting the importance of this negotiation and the key elements, in order to explain why it could be interesting to try to foresee which kind of impact the agreement could have on the multilateral framework. As we have seen, in the last years a great number of PTAs have been concluded; all of them have could create relevant effects on the multilateral negotiations, however, TTIP, because of the importance of the parties involved and their great involvement in global trade, represents a particular case study worth to be analysed in more detail.

The idea to establish a Trans-Atlantic Free Trade Agreement (TAFTA) is not new as it was proposed, the most recent time before the launch of TTIP, in the post-cold war scenario and immediately after the conclusion of NAFTA in 1995 by the Minsters of Foreign Affairs of the United Kingdom and Germany, Malcolm Rifkind and Klaus Kinkel.
Anyway the proposal, after an intense but quite short debate, did not gain momentum and was abandoned since it was considered both “too small” (tariffs between the two shores of the Atlantic were, and are, already very low) and “too big” (just as today, many interests were touched in such ambitious project) (Ries, 2014: 2). The proposal re-emerged quite unexpectedly in 2011, since it was not included in the Trade Growth and World Affairs strategy, published just the year before. The decision was mainly taken by the Obama administration at the beginning of the President’s first mandate that, after some cautious initial months, started to greatly count on an aggressive trade policy in order to revamp both American global role and domestic economy after the crisis. The first step towards the beginning of TTIP negotiation was the establishment of a High-Level Working Group on Jobs and Growth (HLWG) at the EU-US Summit meeting held in November 2011 aimed at developing a strategy for new transatlantic trade negotiations. The HLWG final report was issued in February 2013 and suggested general recommendations for the structure and the contents of a future transatlantic preferential trade agreement. The report calls for the establishment of a “comprehensive, ambitious agreement that addresses a broad range of bilateral trade and investment issues, including regulatory issues, and contributes to the development of global rules” (European Commission, 2013a: 6). After some months of consensus building upon the project in the European Union and within its member states, the European Council approved the mandate for the European Commission in June 2013 and the first round of negotiation was officially launched in July 2013.

TTIP could represent a cornerstone in 21th century trade agreement, not only because the parties involved share a large and dynamic trade and economic relationship, account for nearly half of world GDP, 30% of global trade and have investments of more than $3.7 trillion in each other’s economies, but also because of the nature of the deal. If an ambitious agreement is indeed reached, TTIP could represent the model for a new
generation of PTAs, encompassing provisions on many different sectors and focusing much more on the reduction of NTBs than on tariffs, distinct from most other PTAs both the EU and the US already negotiated with other countries. Given that the tariffs between the EU and the US are already very low, many studies suggest that the greatest economic gains would come from enhancing regulatory cooperation and compatibility, opening services and government procurement markets and developing new rules (Akhtar, Jones, 2014). Only in this way could the relationship reach its full economic potential. According to the recent documents disclosed by the European commission, the agreement should be composed by 24 chapters divided into three parts: better access to each other’s markets (for trade in goods, services and in the public procurement sector), enhance regulatory cooperation cutting red tapes and other costs developing and new rules to make easier for firms to import and export. All studies realised until now agree on the fact that almost all the foreseeable economic advantages would emerge from the reduction of NTBs, since, as it has been presented, tariffs are already very low. On the issue, the majority of studies rely on an analysis realised by Ecorys in 2009 (Berden et al., 2009). According to it, the elimination of all actionable non-trade obstacles, which, as said before, amount to 50% of the actual barriers, between the two economies would boost European Union countries’ GDPs in the long term (it was hypothesized by 2018) by 0.7% per year, with regards to the baseline scenario (the situation without this common initiative) and the United States GDP by 0.3% compared to the baseline. This prevision foresees an annual potential gain of EUR 122 billion for the EU and EUR 41 billion for the US in 2008 prices. Even if there is a common agreement on the beneficial effect that would have the overall dismantlement of all the actionable non-tariff barriers and measures, the envisaged scenarios by various analyses are substantially

3 The general overview on the structure of the agreement is presented on EU Commission website: http://ec.europa.eu/trade/policy/in-focus/ttip/about-ttip/contents/
different. The European Commission firstly commissioned a study to CEPR (Francois, 2013), published in March 2013. The study is based on Computable General Equilibrium (CGE) economic model and foresees that, if negotiators manage to reach an ambitious and comprehensive agreement, this could bring EUR 119 billion a year (0.5% of GDP) of economic gains to the EU and EUR 95 billion a year (0.4% of GDP) to the US by 2027 (the moment when the expected economic benefits reach their full level) relative to their levels without the TTIP in place. Bertelsmann Stiftung German foundation (Felbermayr et al., 2013b) used a different method in order to esteem the effects of TTIP. The study compares a first scenario, dismantlement of all tariff barriers, and a second scenario, the liberalization scenario in which also all non-tariff trade barriers are abolished, with the baseline situation. In the tariffs only scenario, the effects on real per capita GDP are quite limited, while in the liberalization scenario, the results are substantially different, since the expected gains are some 23 times higher, even if less equally distributed.

Apart from the economic impact that could generate, which is still debated, TTIP not only involves two geographical areas that have been historically deeply interconnected and able to influence the evolution of world commercial flows but also shows new features and elements, which were not present in the majority of PTAs concluded until today. Since it differs in many ways from other agreements, it seems useful to try to understand which impact it could generate on the multilateral trade framework. The next part will introduce the recent debate on the relation between preferentialism and multilateralism in trade policies; then, through a qualitative analysis, I will present some hypothesis on the future impact of the agreement on the behaviour of third countries.

PART III
PREFERENTIALISM VS MULTILATERALISM
This final part of the work enters into the merits of the issue and finally gives some suggestions and reflections on TTIP global impact. After a first part devoted to understand the PTAs phenomenon and its rising importance as instrument to promote world trade, a second long one focused on TTIP and aimed at presenting the very specific significance of the deal, this concluding section gives, first of all, a general overview of the debate over the role and impact of PTAs over the multilateral trading system. The treatise is synthetic and does not yearn for completeness; it aims, however, at presenting the two main visions on the issue and the common terminology used. It illustrates the arguments of both the stumbling blocks and the stepping stones perspective’s advocates, who respectively argue that preferential agreements could endanger or favour the evolution of multilateral trade negotiations. It is then presented a synthesis between the two arguments, which suggests that PTAs could generate different impacts on the basis of how the bargaining power is distributed among world’s countries. According to this vision, in order to forecast the potential impact of a PTA, it is not sufficient to analyse its impact on excluded countries but it should also be take into account the interaction between the strategies of the PTA’s members and third countries.

In the last chapter, this model is applied to TTIP case: it is estimated the bargaining power of four groups of countries, through their balance of trade, trade openness and regional concentration of trade data. These are, in fact, the economic elements which most influence a country’s power in trade policy field. To conclude, this model allows inferring some qualitative comments and conclusions on the possible future evolutions even if, it should be highly underlined, the analysis is partial and a more sophisticated model would be useful to aggregate to data.

The debate on the issue is not a recent one but it is still very lively and animated, in particular thanks to the new wave of PTAs since early 1990s. Both advocates of the
stumbling stones’ and the building blocks’ positions can refer their theories to some empirical relevant cases to back up their arguments. Since both perspectives are backed up by logical arguments and historical examples, Andreas Dür in his 2007 study “Regionalism: Stepping Stone or Stumbling Block for Globalisation?” starts from the assumption the integration of the two perspectives in a comprehensive model it is needed in order to provide satisfying explanations of the actual phenomena, since neither of the two theory is sufficient to capture the complex effects generated by PTAs on the globalisation process. Given that both effects seem plausible, the analysis should be focused on the identification of the conditions under which the one or the other development is to be expected and then on the interaction between the strategies of a PTA’s members and the excluded countries. According to the theoretical argument developed by Dür, the direction of the effect depends mainly on the initial distribution of bargaining power between the two groups, since an excluded country would have different tools to react on the basis of the distribution of bargaining power between itself and the member countries. Dür selects some economic indicators to calculate the bargaining power of each country, including the relative strength of import-competing interests compared to exporters, the degree of regional concentration of a country’s exports and the importance of trade relative to the economic size of a country. From these three elements it is possible to infer that the higher the trade surplus, the more concentrated the exports within a region involved in the PTA and the more trade contributes to the country’s GDP, the lowest would be the national bargaining power.

This last part paragraphs aims at finally answering to this work’s research question. As in Dür analysis that has been previously presented, the starting point is to accept that both positive and negative effects of PTAs are empirically relevant and that the two perspectives need to be integrated in a comprehensive model in order to yield a satisfying
explanation, since the available evidence does not provide a unique answer. The reasoning, as the model proposed by Dür, considers that the direction of a PTA effect depends mainly on the distribution of bargaining power between the excluded states and the deal’s The evaluation of these criteria for all world countries would have been surely possible but it would have probably been not particularly useful, given the fact that multilateral trade negotiations are greatly influenced by the preferences of the most important commercial players. However, instead of focusing only on the biggest traders, I decided to analyse TTIP’s impact of four groups of countries. member states and the evaluation of these variables by both sides (Dür, 2007).

From the analysis of the countries’ data it does not emerge a clear-cut scenario. However, it is possible to gather some conclusions and to highlight some critical aspects that could be worth of a more detailed analysis and should be carefully taken into account by TTIP negotiators. What can be clearly stated is that the only group of countries which have an evidently low bargaining power relatively to the EU and the US are their closest neighbours. The other groups have a higher bargaining power, since they are not so strongly dependant from trade with the EU and the US and, therefore, would not be compelled to offer concessions in order not to lose access to TTIP’s countries markets. Moreover, any of the biggest traders show a particularly high surplus that proves the power of its exporters’ interest at domestic level. However, the situation is more complicated since the framework is not homogeneous and some countries enjoy a high level of trade surplus with the US or the EU, which makes their exporters particularly interested in these markets. Among these countries, China stands out for its enormous surplus with the US. The high bargaining power of the majority of the countries, included many of the biggest traders, do not create a particularly favourable scenario for further liberalization. In fact, TTIP conclusion does not seem to be sufficient in order to push many countries to offer
concessions at multilateral level, which could have been the case if they were more dependent from trade with the US and the EU and they had a lower bargaining power. To conclude, from the analysis of the economic data of the selected countries and according to Dür model, TTIP does not produce enough incentives to engender a process of liberalization, since only few countries are extremely dependent from its members and have a very low level of bargaining power. However, the sizes of the US and EU economies and their interconnections with all the world areas makes difficult to imagine the emergence of many closed rival trading blocks.

**Final Remarks**

This work is focused on the recent proliferation of PTAs and their potential impact on the multilateral trading system. Among all the PTAs already concluded or under negotiation, I devoted my attention to TTIP, which quite suddenly, a bit more than two years ago became one of the greatest priorities of the European Union and, since that moment, has been incessantly debated, criticized and flattered. After a first part focused not only on the definition of PTAs but also on the, initially very different, American and European approach to the theme, the second part concerns directly TTIP and analyses in detail its background, in order to evocate the peculiarities of the deal and some important passages in the history of transatlantic economic relations. The third part draws some conclusions and, on the basis of some economic parameters, argues that the agreement does not produce sufficient economic incentives to foster a global liberalization process at multilateral level.

The analysis offers a fairly aggregate economic approach and it is plainly partial, since not all the countries are taken into account. However, it aims at offering some original reflections on a topic which has been quite neglected until now, since the debate has been
much more focused on the content of the agreement rather than on the effects that could engender. Even if the chapters included in the deal clearly need to be carefully analysed and discussed, it seems important to draw the attention also on the bigger framework and to consider the strategic implications that the conclusion of an ambitious TTIP could generate.
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