

I want to take some time from my scarce 10 minutes to offer congratulations and felicitations to Hans-Werner for this milestone in an ongoing brilliant career, and thank him for doing so much for our profession through his leadership of CES and ifo. His own research in public economics and international economics has enriched our understanding; I want to mention in particular his Jahnsson Lectures book on systems competition. His policy writings on Europe and the Eurozone have informed a much wider readership. The CES conferences, lectures and publication series have become important parts of our calendars and bookshelves. He is a »public economist« in our technical sense as well as in being visible and influential in the real world; he is also a great provider of public goods for the economics profession. His stepping down from some of these organizational activities only means that he will become even more active in his own research and writing. When I retired I was told that retirement should be thought of as a permanent sabbatical leave. I have found that to be very true, and I am sure Hans-Werner will, too.

Let me turn to my assigned topic, namely the whole alphabet soup or spaghetti bowl or various regional trade, investment and regulatory arrangements, of which TTIP and TTP are only the latest and most prominent. The topic title asks: »Free trade with whom?« I don't have answers; only more questions.

The more recent agreements have one new feature: they are »deeper« in the sense that they cover many aspects such as investment, intellectual property rights, labor laws, environmental protection, and even currency manipulation, that were outside the narrow focus of trade liberalization in the GATT / WTO and many early free trade areas.

These developments have the potential to create trade and investment; they also raise many questions and bring risks and conflicts.

First, the deeper integration may lead to not only trade diversion, but also investment diversion: FDI may go to countries within the partnership because of the preferential treatment and standardization of regulation, even though the capital would have had higher true marginal product in some other country outside the partnership. The deeper the integration, the larger the efficiency losses from such diversion are liable to be. One estimate finds that »by 2025, the TPP could mean losses of US\$ 46.8 billion for China, and roughly \$4 billion for India, Indonesia, and Thailand«; another finds for TTIP »Argentina, Russia, and India could see welfare losses around 2 percent of GDP or higher«.

Second, the process of negotiation has its own dangers. (1) Multiple issues and their linking is a two-edged sword. It allows trade-offs across issues for greater mutual benefit, but also opens up strategies of making threats on issue A to extort benefits on an otherwise unrelated issue B. Thomas Schelling has a very nice discussion of this in his book, *The Strategy of Conflict*, pp. 50–51. (2) The complexity of multiple regulations can be costly to navigate and can be manipulated for some country's or firm's private benefit.

Then there are the real or perceived dangers that the process will be dominated by large rich countries and heavily influenced by lobbying from large multinational corporations. Even when these fears are mistaken or exaggerated, they can create mistrust and opposition that will affect the success of the negotiations and the ratification and implementation of treaties. The headline »What is TTIP? And six reasons why the answer should scare you« is just one of many that fuel these public fears, and it appeared not in an extremist or alarmist tabloid, but in the well-respected *The Independent* (UK) newspaper (on 6 October 2015).

The estimates of static and dynamic gains from TTIP and TPP vary from negligible to



Prof. Avinash K. Dixit
Professor Emeritus of Economics,
Princeton University

very large. Will the gains outweigh the losses and the risks/dangers? In face of this uncertainty, the theory of real options argues for caution in making the decision to join, which would be very costly to reverse.

The answers to these questions need much more research; I suppose that is, in a way, good news for our profession!