East Asia and the EU:
Which Contribution to the World Trade System?

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Introduction

The Bali WTO Ministerial may have been a successful exercise in "declaring victory and leave", but there are few hopes that the huge rest of the Doha Agenda will be subjected to negotiations in a predictable future. How to assess such a situation? On the one hand, it is very regrettable that negotiations on tariffs, quotas and subsidies will not be pursued in the WTO forum which is, by far, the best place to negotiate such issues. On the other hand, the WTO does not seem the best place to negotiate in a substantial manner about regulatory issues—be technical norms in goods, regulations shaping services markets (trade and investment) intellectual property rights, and to some extent public procurement.

All the WTO Members do not face this ambiguous situation in a similar fashion. Developed and a few emerging economies (such as China) which have reduced substantially their tariffs are mostly interested in addressing barriers associated to regulatory issues—in particular the barriers in services which constitute the lion's share of modern economies. These WTO Members are not very much concerned by the WTO current incapacity to host negotiations on tariff cuts. By contrast, most developing and the rest of the emerging economies (such as India) which have still substantial tariffs have a lot to lose from an economic point of view from the freeze of the Doha negotiations.

The main reason for the WTO relative inefficiency in regulatory matters is the absence of trust among all the WTO Members: no WTO Member trusts all its 158 WTO partners. Trust is needed to overcome two—not one—challenges. First is well known and occurs during the negotiation phase: mistrust then flows from the difficulty to assess the level of regulatory protection (that is, the level of unjustified restrictions to business generated by regulations) which exists before the negotiations. The second challenge occurs after the conclusion of an agreement, hence it is rarely mentioned though it is probably the more important: mistrust

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flows from the even higher difficulty to monitor the fulfilment of the regulatory liberalisation commitments by the trading partner. After concluding a trade deal covering regulations, the trading partner can change a services regulation (or a technical norm) with the best intentions, but can then inadvertently erode the market access negotiated in the deal. This situation (unknown in the case of tariffs where each country can easily monitor whether its trading partners keep their commitments) creates strong disincentives to negotiate on services when the negotiating partners are not trusted.

The trust argument is the economic justification of the current recourse to preferential trade agreements (PTAs).[2] But, past experiences have also shown the strong limits of PTAs even among countries sharing a high level of trust among them. Section 1 illustrates this point with the disappointing results of the European Union (EU) "Internal Market", the EU being a good example of a PTA. The too many remaining limits of the EU Internal Market suggest that there has been some systemic error in the way it was negotiated—hence they raise the often neglected issue of the quality of the negotiating instruments used for concluding deals on regulations. Section 2 examines this issue in more detail and shows that the two main negotiating instruments used to build the EU Internal Market—harmonization and mutual recognition—are indeed of poor quality for integrating modern economies. It also shows that a third instrument—mutual equivalence—is a much more promising instrument not only for the EU but also for all the mega-PTAs under negotiations. Finally, Section 3 examines the specific role that, in the current world context of major geo-political and economic shifts, East Asia (China, Japan, Korea and Chinese Taipei) and the EU could have by promoting better economic integration among them and with the rest of the world.

Section 1. The disappointing results of the EU Internal Market

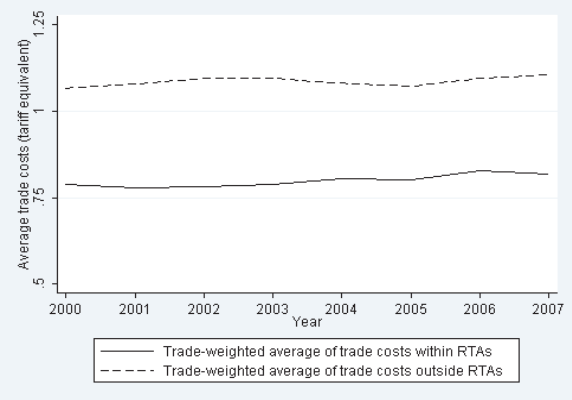
This section provides some basic evidence showing that the EU Internal Market is still a very fragmented market. The focus on the EU is for pure data convenience: it is due to the fact that there are lot of data and evidence on the regulations of the individual Member States of the EU which is the oldest PTA aiming to address technical norms, services regulations etc.

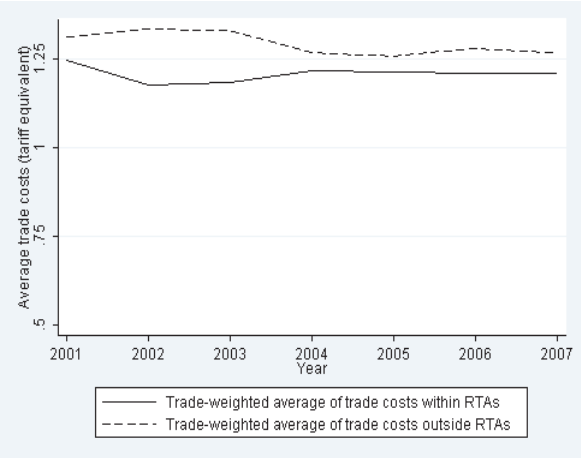
[2] There is a geo-political argument which is the deep disagreement between the US and China on WTO obligations which has been the major cause of the collapse of the Doha Round in 2008 [Messerlin 2012].

Indeed, evidence based on trade costs suggests that the EU limits are not specific to the EU, but are shared by other PTAs [Miroudot and Shepherd 2011].

In the goods sector (Figure 1 left panel), if PTAs have definitively reduced trade costs within PTAs compared to those outside PTAs, the intra-PTA trade costs have not decreased during the first seven years of the 2000s, despite the fact that these years should have benefited from the continuous efforts of integration pursued from the 1980s until the 2000s.

Figure 1. Average trade costs within and outside PTAs, goods and services





Source: Miroudot and Shepherd 2011.

In services (Figure 1 right panel), PTAs show definitively very little impact on trade costs among the PTA members, compared to non-members. As services are sectors dominated by regulations, this observation suggests that the EU—as well as the other PTAs existing in the 2000s such as NAFTA—has failed to provide the expected deep integration in services.

The still highly fragmented EU Internal Market in services

A more detailed information on barriers in services among EU Member States (EUMS) is provided by the internationally comparable OECD Product Market Regulation (PMR) indicators [OECD 2011]. PMR indicators measure the degree to which competition is inhibited or distorted by regulatory barriers, such as legal and administrative barriers to entrepreneurship, state control of business enterprises, sector-specific anti-competitive regulations, etc. The indicators range from 0 to 100, with 0 standing for a completely open market and 100 for a completely closed market.[3] Table 1 presents the available PMR indicators on the EUMS regulatory barriers in key services for the years 2003 and 2007.

Table 1. Regulatory barriers in EUMS services, 2003 and 2007

	2003	2007					
	Highest PMR	A: Highest PMR		B: Highest PMR in large EUMS		C: Lowest PMR	
		PMR	EUMS	PMR	EUMS	PMR	EUMS
	1	2	3	4	5	6	7
Electricity	60.0	41.7	Sweden	33.2	France	0.0	Britain
Construction	12.8	12.2	Belgium	10.0	Italy	3.6	Sweden
Distribution	41.5	40.9	France	40.9	France	12.7	Sweden
Tourism	16.5	13.2	Slovakia	7.6	Italy	3.4	Sweden
Transport	55.8	43.8	Greece	28.9	Italy	9.1	Denmark
Post & telecoms	32.6	27.8	Slovakia	24.2	France	12.0	Netherlands
Financial services	46.8	45.9	Slovakia	29.4	Italy	10.5	Ireland
Real estate	9.5	7.6	Poland	4.3	Germany	1.5	Greece
Renting of machinery	42.4	42.0	Austria	39.2	Germany	10.5	Sweden
Prof. & Business	41.3	40.8	Austria	38.5	Germany	10.0	Sweden

Source: OECD 2011.

Table 1 provides bad news and good news for negotiations in services in the context of PTAs, and particularly of "mega-PTAs" among the world largest economies.

The bad news is the survival of huge differences between the highest and lowest PMR among the EUMS, despite a massive regulatory integration programme: the Internal Market which was supposed to bring down the intra-EU barriers consists in more than 600 EU laws ("Directives"). Such differences are the best (though indirect) indicator of a still fragmented Internal Market for the following reason: it would make no sense for a EUMS to keep high

[3] The initial range of the PMR indicators used is 0 to 6 from least to most restrictive [Conway, Janod and Nicoletti 2005]. The range 0 to 100 is used in order to have a presentation more similar to tariff rates although it should be stressed that the PMR indicators are not equivalent to tariffs: they are mere estimates of the existing regulatory barriers in the services sectors covered.

PMR (protection) with respect to non-EU countries if the firms from non-EU countries could operate from the low-PMR EUMS without similar intra-EU barriers. In sum, there are good reasons to believe that those PMR reflect the true extra- and intra-EU level of protection.

This first result suggests an important question. Does a similar picture prevail in the other mammoth economies, such as the US (barriers among US States) China (barriers among Chinese provinces) or Japan (barriers among Japanese prefectures)?

Table 1 provides also a good news about the dynamics of negotiations of mega-PTAs. The EUMS with low PMR are probably as eager to open the markets of the EUMS with the high PMR as any pro-freer trade EU trading partner. These low-PMR EUMS will thus look actively for building coalitions with the pro-freer trade entities (States, Provinces, Prefectures, etc.) of the EU trading partner(s). Of course, the same behavior should be expected from the high-PMR EUMS which will try to make alliance with the anti-free trade entities of the EU trading partner(s). As a result, negotiating on regulations opens the possibility of "trans-negotiating partners" coalitions during these negotiations.

This configuration does not fit the stereotype of country-to-country conflicts (in case of tariff negotiations) and seems to be much more promising in terms of the possible outcome of the negotiations. For instance, the negotiations of the EU-Japan Free Trade Agreement could witness a coalition of certain Japanese railways companies making an alliance with British railways companies for opening the Japanese and EU government procurement markets whereas other Japanese railways companies would make an alliance with the French railways company for keeping as closed as possible the Japanese and EU government procurement markets.

In the context of such negotiating dynamics, Table 1 gives an additional interesting observation: there is always a large EUMS with a relatively high PMR (Table 1 column 5). This probably reflects the capture of the whole EU by very few firms from the large EUMS. Once again, it would be interesting to know whether the same observation could be done for the other largest world economies.

The highly fragmented Internal Market in foreign direct investment

Table 2 presents the foreign investment restrictiveness indicators provided by the OECD Secretariat [OECD 2006].[4] It should be specified that these indicators measure the level of restrictions against non-EU services providers. Unfortunately, OECD indicators provided since 2006 do not disaggregate non-EU and intra-EU restrictions—hence they give a rosy picture of the level of protection in the EU (that explains that Table 2 does not use OECD data provided since 2006).

Table 2. Regulatory barriers in EUMS foreign direct investment, 2006.

	1. Legal services	2. Accounting	3. Architecture	4. Engineering	5. Fixed telecoms	6. Mobile telecoms	7. Construction	8. Distribution	9. Insurance	10. Banking	11. Hotels/Resto	12. Air transport	13. Maritime transp	14. Road transport	15. Electricity
Belgium	22	22	22	22	72	72	22	22	44	44	22	122	248	72	22
France	233	33	33	33	72	72	22	22	138	94	22	198	198	72	322
Germany	22	22	22	22	122	122	22	22	116	72	22	248	198	22	122
Iraly	22	22	22	22	72	72	22	22	88	144	22	494	66	22	122
Netherlands	11	11	11	11	11	11	11	11	55	33	11	411	355	11	611
Austria	348	348	348	348	172	172	172	172	272	172	172	322	472	222	172
Denmark	1000	562	22	22	72	72	22	22	44	22	22	422	22	122	122
Finland	550	550	110	110	110	110	110	110	110	160	110	310	210	154	210
Greece	462	506	462	462	122	122	22	22	88	88	22	522	254	22	1000
Ireland	22	22	22	22	122	122	22	22	88	44	22	466	66	22	1000
Portugal	22	66	22	22	122	122	22	22	116	172	22	1000	122	22	122
Spain	512	66	22	22	322	322	22	22	226	182	22	304	316	22	22
Sweden	556	292	66	66	166	166	66	66	116	116	66	316	266	166	166
Britain	17	17	17	17	17	17	17	17	83	67	17	267	361	17	17
Czech Rep.	125	375	50	50	50	50	100	50	150	150	50	450	100	100	450
Estonia	1000	22	22	22	22	22	22	22	122	22	22	322	366	22	622
Hungary	100	100	100	100	200	100	100	100	150	100	100	500	400	150	200
Latvia	0	0	0	0	0	0	0	0	0	0	0	132	0	100	1000
Lithuania	50	50	50	50	50	50	50	50	50	100	50	350	94	50	650
Poland	225	175	75	75	375	375	75	75	75	325	75	375	75	125	175
Romania	250	50	50	50	150	150	50	50	50	175	50	750	150	50	450
Slovakia	75	375	75	75	72	72	72	72	172	172	72	372	122	72	322
Slovenia	125	125	100	100	200	100	100	100	100	100	100	740	244	100	700

Source: OECD 2006.

Table 2 provides the same observations on barriers to foreign direct investment than the ones just presented on services: wide differences among EUMS which make sense only if the EU Internal Market remains highly fragmented. As a result, it also suggests the same dynamics of "trans-negotiating partners" coalitions during the negotiations of a mega-PTA between the EU and another large economy.

The highly fragmented Internal Market in government procurement

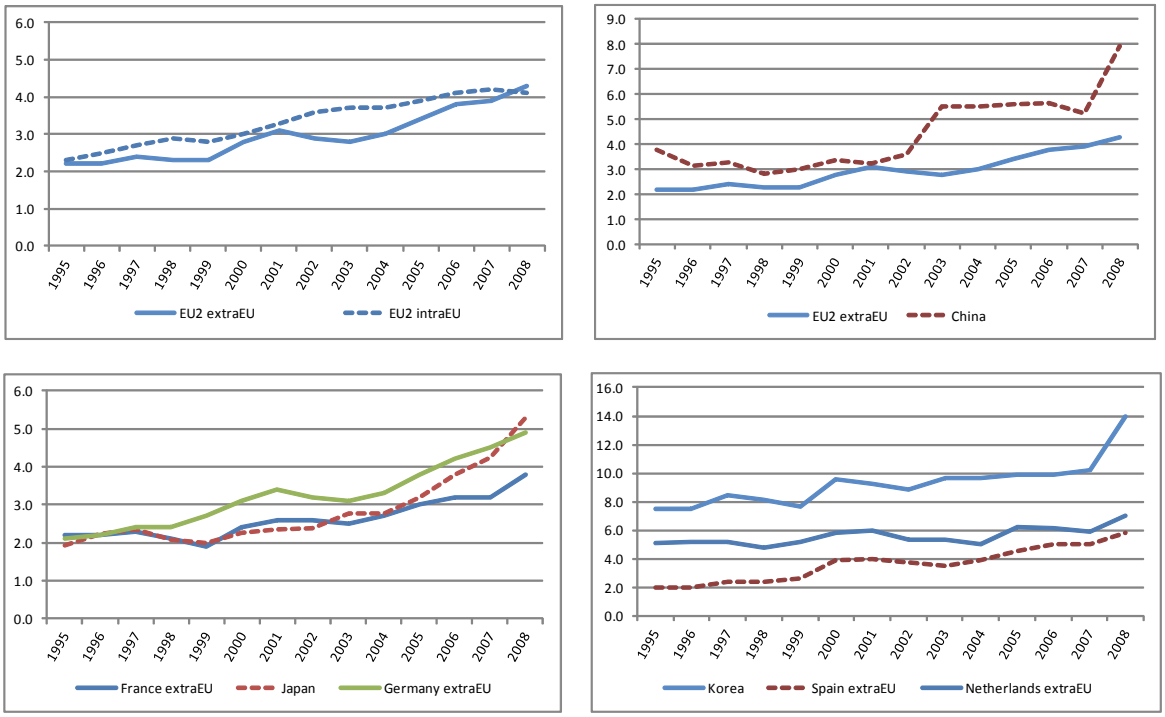
Also high on the agenda of negotiators of mega-PTAs is the opening of the government procurement markets. The recently published World Input-Output Database (WIOD) allows

[4] Indicator 0 means no barrier on FDI from non-EU origin for the sector in question. Indicator 1000 means a complete ban on FDI from non-EU origin for the sector in question.

to calculate the penetration ratios in government procurement (these ratios are defined as the imports of foreign goods and services used in domestic government procurement markets divided by the total public demand in government procurement markets).

The four panels of Figure 2 provides two main observations. First (top left panel) is the disappointing result of intra-EU liberalization of government procurement compared to the extra-EU liberalization for the two major EUMS (France and Germany, or EU2).[5] Intra-EU openness ratio is not much higher than extra-EU ratio. Moreover, there is a clear worsening of this result at the end of the period. In short, there is little trace of a differential impact of the EU body of law on the openness ratio in EUMS government procurement.

Figure 2. Openness ratios in government procurement, selected countries 1995-2008



Source: WIOD, Messerlin and Miroudot 2012.

Second, in 2010-2011, the EU Commission claimed that the extra-EU government procurement sector was more open than the government procurement sectors of the EU trading partners. This claim is not supported by evidence: China openness ratio (top right panel) has always been higher than the joint ratio of France and Germany (the combined GDP of these two EUMS is not too far from the size of the Chinese GDP); Japan (bottom left

[5] The same result is also observed for the 18 EUMS of the WOID. But, the accession of many small EUMS in 2004 introduces some discontinuity over the whole period in favor of high penetration ratios since smaller economies tend to be more open than larger economies.

panel) has caught up the openness of the French or German economies; and Korea (bottom right panel) is more open than the larger Spain (1.2 times Korea's GDP size) and even than the notably smaller Netherlands (0.7 times Korea's GDP size).[6]

The implementation issue

Enforcement is essential in regulatory matters. In particular, harmonizing regulations may have very little positive impact (if any) if enforcement procedures are not harmonized. In this perspective, it is useful to ask two questions: have the EU efforts to create an Internal Market generated relatively similar enforcement capabilities in the EUMS? And does one observe some regulatory differences between the founding EUMS and the most recent EUMS? Table 3 provides some sense of what has happened with a rough indicator—the rank for "Ease of doing business" [World Bank Doing Business website].[7] For answering the second question, EUMS ranks are presented by "EUMS cohorts" aggregating EUMS having acceded to the EU the same year

Table 3. Ranks for "Ease of doing business", selected countries 2012

EU Members States by cohort		EU Partners	
EUMS	Rank	Partner	Rank
		Singapore	1
EU-1973	7		
		Korea	8
		Canada	13
		Malaysia	18
EU-1995	19		
		Japan	20
EU-2004b	24		
		C. Taipei	25
EU-1958	41		
EU-2004a	50		
EU-1980s	58		
EU-2007	66		
		China	91
		Argentina	113
		Russia	120
		Brazil	126
		India	132

Notes: EU-1973: Britain, Denmark, Ireland. EU-1995: Austria, Finland, Sweden. EU 2004b: Estonia, Latvia, Lithuania. EU 1958: Belgium, France, Germany, Italy, Luxembourg, Netherlands. EU 2004a: Cyprus, Czech Rep., Hungary, Poland, Slovakia, Slovenia. EU-1980s: Greece, Portugal, Spain. EC 2007: Bulgaria, Romania.

[6] Bilateral comparisons have to account the size effect (a small economy is likely to open more widely its government procurement markets than a large economy) hence the changes of the EU counterparts of the non-EU countries in Figure 2 panels.

Source: Doing Business, World Bank.

Table 3 provides two observations. First, emerging or recently developed Asian economies are better ranked than a large number of EUMS, including the founding EUMS. Second, some very recent EUMS (the Baltic countries, EUMS 2004b) have better ranks than the founding EUMS (EU-1958) suggesting that even a PTA like the EU has little impact on the regulatory quality of its members—in other words, this regulatory quality is above all a question to be recognized and taken care internally.

Section 2. Better PTAs require better negotiating instruments

The limits of the EU Internal Market are so frequent across sectors that they suggest a systemic mistake in the integration process. A persistent lack of willingness to deepen the EU does not appear a good candidate for explaining this observation. Of course, the enthusiasm for European integration did face ups and downs during the 1980s-2000s. But, there were no systematic drag on the whole endeavor, and political conflicts among EUMS were minor. Those existing between the Central European countries which were directly inherited from the late 19th early 20th century turbulent Baltic and Balkan history and which were artificially frozen under Soviet rule re-emerged in the early 1990s, but were progressively appeased during the EU accession process and in the following decade. In Western EU, the recurrent British willingness to "opt out" did not prevent Britain to be very influential in building the EU "*acquis communautaire*" (EU body of law)—probably more than any other EUMS. And, the current mounting resentment with respect to the EU endeavor in many EUMS is largely due to the fact that the EU Internal Market did not deliver what was announced, and is rather perceived as a source of more constraints and costs than of benefits.

Other explanations are thus needed. One attractive candidate is that there may have been a systemic failure in the way intra-EU negotiations on norms of goods and on services regulations were conceived. If correct, this explanation should be of great interest for the coming negotiations of all the mega-PTAs, and especially of those between East Asia and the EU. This is because these mega-PTAs will deal with the same issues than the Internal Market—how to negotiate on technical norms for industrial and agricultural goods and on regulations shaping markets in services.

The question is thus: What are the most efficient instruments to negotiate on regulations? The history of tariff negotiations of the last 150 years amply shows that inefficient negotiating instruments (requests and offers on tariff cuts on a product basis, tariff-rate quotas, etc.) don't bring the expected benefits from market opening and that they can even deliver costly—distorted—liberalizations.

In this perspective, it is fascinating to observe how the negotiators of the current mega-PTAs are vague and/or confusing when they evoke the way they will conduct negotiations on regulations. They mention almost indifferently 'harmonization', 'mutual recognition', 'equivalence' or 'regulatory convergence'. Clarification is thus needed, and it helps to spot the most efficient instrument of negotiations in matters of regulations—be those defining technical norms or those shaping services markets.

Basic questions

Before clarifying all these terms, it is useful to underline that there are two very different ways to look at regulatory differences.

A first view—probably the most widely accepted—is that regulatory differences are "bad" because they impose costs on foreign producers in the domestic market (and vice-versa). Such differences should thus be eliminated (by harmonization, see below) or, at least, the negative consequences of such differences should be reduced as much as possible by an appropriate legal regime (mutual recognition, see below). This is a producer-driven perspective insisting on a (somewhat mythical) level plain field.

The second view is that regulatory differences are "good" because they reflect different "varieties" in supplied goods or services. As a result, they increase the consumers' welfare because they offer them more choices. In this consumer-driven perspective, regulators should welcome regulatory differences among by the trading partners, hence should focus on assessing the equivalence among the competing regulations (mutual equivalence). A crucial condition for such a view is the existence of trust among the negotiating partners.

Not surprisingly, the producer-driven and consumer-driven approaches are opposed. The first approach aims to limit differences, hence choices for the consumers. The second approach aims to keep as large as possible choices among varieties, hence differences among regulations since there are interactions between varieties and regulations (some regulations favour some varieties which then call from some regulations for further development). Interestingly, the consumer-perspective emerges in the EU legal history with a famous ruling by the EU Court of Justice (the so-called 1979 "*Cassis de Dijon*" case). This case did echo the wide perception in the EU in the 1960s and 1970s that the major achievement of the EU Internal Market was not prices decreases, but the huge increase in varieties (diversity)—such as Italian low-end cars competing with high-end German cars and middle-of-the road French cars.

Harmonisation: unfounded assumptions

It seems fair to say that today, harmonization still remains the preferred negotiating instrument for most negotiators dealing with mega-PTAs—probably because negotiators face much more often producers' lobbies than consumers' associations. That said, negotiators know very well that harmonization is an ideal awfully difficult to meet. As a result, they have increasing recourse to the vague notion of "regulatory convergence" which is a weak form of harmonization postponed in an undefined future: if harmonization is not possible now, then why not hope that convergence will occur over time?

These views rely on three unfounded assumptions.

- First, there would always exist a technical norm unambiguously superior to all its alternatives. This assumption does not fit modern economies characterized by a huge number of varieties for almost every product and by two decades of intensive norm setting, as best illustrated by a recent EU case in the car sector (see Box1). A norm can be better from one point of view, and not from another. What is true for technical norms is even truer for services regulations. Comparing services regulations suggests that very few regulatory features have an unambiguously detrimental impact on the efficient provision of a service.
- Second, harmonization would be a science-driven process. In fact, harmonization is often a heavily loaded political process where firms are trying to avoid increased

competition and negotiators are fighting for their national champions. Such a negotiating process is extremely tough, hence often fails for the following reason. The firms which impose their norms as the harmonized ones keep intact their "human (technical and legal) capital" while the other firms will have to rebuild their human capital (learn how to use the new techniques and the new regulations). In short, when a firm is in favour of harmonization, it is always almost about harmonization to its own norms. Such a tough negotiating process is largely dominated by the negotiating leverage of the countries and firms, hence it is far to guarantee the choice of the intrinsically 'best' norm (assuming that such a norm exists).

- Last but not last, harmonised norms would raise relatively negligible implementation problems. In fact, implementation problems are a serious problem once combined with the uncertain outcome of harmonization. Harmonised norms delivering small gains (if any) coupled with costly enforcement are not desirable from a welfare point of view. This aspect is essential for understanding the current resentment against the EU endeavour: most producers and consumers did not realize how constraining and burdensome—hence costly—enforcing the new regulations was.

Box 1. The battle of the EU air coolants, 2006-2013

The EU car industry is one of the very few sectors mostly covered by the harmonization approach which went in much details on rear mirrors size, colour and locations of the lights, etc. In 2006, the EU Directive 2006/40/EC banned the air coolant R134a on the basis of pollution level and imposed a less polluting alternative R1234yf for all the cars to be produced in Europe after 2012. However, later Daimler engineers discovered that the new coolant R1234yf was much more flammable than the old one. As a result, Daimler refused to introduce the new coolant in its 2013 Mercedes cars. The German Federal Office in charge of car safety agreed with Daimler's analysis and granted to Daimler an authorization to sell cars with the old coolant in Germany and in the EU.

Then, the French government, supported by the EU Commissioner for Industry, decided to ban the sales of Daimler cars in France. After some fights between EU, French and German regulators, the Conseil d'Etat (the highest administrative Court in France) ordered to resume the sales of Mercedes in France. The two coolants are now used in the EU—mirroring the absence of an unequivocally superior norm.

Finally, there is a last—very powerful—argument against harmonization in the current context of competing mega-PTAs. It is hard to see how US and EU negotiators could

harmonise norms or regulations in the Transatlantic Trade and Investment Partnership (TTIP) context, while EU and Japanese negotiators will do it in the Japan-EU Free Trade Agreement, and Japanese and US negotiators in the Trans-Pacific Partnership (TPP) context.

To sum up, harmonization does not look an economically-sound and promising negotiating instrument except in very special cases. By the same token, this whole discussion also casts serious doubts on the value of the 'regulatory convergence' notion. Indeed, if norms reflect the creative process of varieties, there is no strong forces leading to regulatory convergence: norms could converge at some periods of time, and diverge at others.

Mutual recognition: an unstable and disappointing hybrid

In the late 1960s to mid-1980s, the EU tried hard to harmonized EU technical norms and services regulations in the Internal Market context. It was such a frustrating failure (there were very few agreements on harmonized technical norms and almost none in services) that the EU decided to shift to a new instrument—"mutual recognition" (MR)—inspired by the key 1979 *Cassis de Dijon* ruling of the European Court of Justice.

MR means that each party accepts the norms of its partner for the goods at stake *conditionally* upon the adoption of a "core" of common provisions or principles ("essential requirements" in the legal jargon of the EU Internal Market). MR is thus an hybrid instrument: the core has to be harmonized through negotiations, and only the other provisions are subject to mutual recognition. From 1979 to 2006, MR was the exclusive approach used by the EU for dismantling barriers caused by unjustified regulations and for building the EU Internal Market. It has been also widely used in international agreements.

MR has rapidly shown its limits: as the "core" is harmonized, the whole MR approach suffers from the limits attached to harmonization. Political pressures fuelled by anti-competitive business pressures have created, then expanded the core provisions (for instance, the number of words defining the core in the EU Toys Safety Directive has increased 1.6 times over time.

As a result, MR is subjected to intrinsic forces drifting it ever closer to harmonisation. In the EU, this evolution has been accelerated by the accusations of certain EUMS against the 'regulatory dumping' of other EUMS which were allegedly adopting a 'loose' interpretation

of the core provisions. These accusations have been dealt with by imposing increasingly tight constraints on certifications procedures.

In the rest of the world, MR has never solved the problem of very costly double certification requirements—but in very special cases, such as aircraft bodies (a situation probably more due to the strong duopoly of Airbus and Boeing and their intricate value chains, than to the influence of the regulatory bodies).

"Mutual equivalence": the promising instrument

Mutual equivalence (ME) means that, for a given product or in a given service, each party recognizes the norms or regulations of its partner, and their implementation process, as fully equivalent to its own norms or regulations. For instance, cars produced under Japanese norms and certified by Japanese bodies could be sold in the EU with no additional procedure—and conversely for cars produced under EU norms and certified by EU bodies in the Japanese market.

To be politically acceptable, ME requires a systematic preliminary step: a joint process of 'mutual evaluation' of the norms and regulations at stake by the two partners. This trust-building process allows the two parties to decide whether the norms or regulations examined will be covered by ME or not (hence remaining under mutual recognition or harmonization, or even outside any agreement).

At a first glance, ME seems a bold move in the unknown. But actually, it has been implemented in both goods and services—in the Australia-New Zealand Trans-Tasmanian Agreement on norms for goods [Laplagne 2009] and in the EU 2006 Services Directive in services—the only EU Directive to cover a very wide range of services, from logistics to hotels to retail, etc..

Another interesting illustration of (a somewhat limited) ME is provided by the supplemental agreement to the Korea-US FTA in the automotive sector. This agreement:

- Allows 25,000 cars per US automakers to be imported into Korea if they meet the existing US (hence lower than Korean) safety norms.

- Exempts low-volume imports of US cars from Korean ultra-low emissions vehicle (ULEV) norms to be in force in 2015 if US cars achieve greenhouse gas emissions to 167 grams per kilometre, that is, 1,19 times higher than the Korean level (Korean cars will be required to achieve 140 grams per kilometre).

These provisions implicitly rely on the idea that US norms were "somewhat equivalent" to Korean ones. But, they impose limits (the quota in terms of cars in safety matters, and the quantitative limit on the "permissible norm in excess" in emission matters) that will be discussed briefly below.

One may wonder why such a simple approach as ME has not yet been widely adopted (in particular within the EU) whereas the joint evaluation process offers a strong guarantee that there will be no "race to the bottom". The best answer seems very simple. ME increases tremendously the level of competition among firms—and indeed, as seen in section 3, among countries' regulatory bodies. As any pro-competitive instrument, it maximizes the welfare of the consumers of the negotiating countries—but at the "cost" of more competition among firms and regulators which then collude to minimize the use of this instrument.

Last but not least, the mutual evaluation preliminary step of any ME requires the participation of the partner's regulating bodies in the negotiating process—something which is generally missing in PTAs negotiations. Indeed, the mutual evaluation step suggests some specialisation between trade negotiators and sectoral regulators. Trade negotiators would provide broad areas of goods and services to be considered as candidates for the MR approach. Regulators in charge of these sectors will then undertake the mutual evaluation process, including the clarifications, exceptions or reviews to be done. The EU Services Directive even suggests some ideas on how to combine trade negotiators and sectoral regulators, as illustrated by Box 2. Such a process offers an unique opportunity to build, restore or improve trust among the signatories—in particular, if it includes systematic reviews of the situation at definite periods of time.

Box 2. A model for combining trade negotiators and regulators: The 2006 EU Services Directive

Two articles of this Directive are particularly useful for today PTAs negotiations. Article 14 lists provisions in the existing regulations of the partners which represent indisputable barriers to market access (nationality clause, obligation to have an establishment in more than

one location, etc.). This list could guide the trade negotiators for picking the goods and services as possible candidates for ME status.

Article 15 draws the list of the provisions that should be mutually evaluated (quantitative or territorial restrictions, requirements on shareholding, etc.) because they have the potential to restrict market access, a point to be clarified or amended before being covered by a mutual equivalence agreement. This list defines the typical content of the topics to be subjected to mutual evaluation by the regulators of the negotiating countries.

Last but not least, it is essential to note that Article 15 changes the perspective on liberalization and its dynamics: it is not so much liberalization that counts than the dynamics of better regulation that should go with it. In short, Article 15 takes a trade agreement for what it should be: an opportunity for each signatory to improve its domestic regulations.

Section 3. East Asia and the EU: their comparative advantages in the mega-PTAs game

The negotiators of the ongoing mega-PTAs do not miss an opportunity to claim that they want to achieve the "highest possible level of integration" [see for instance, TTIP High Level Working Group Report 2013]. The previous section suggests that, if they are not rhetorical, these claims would require substantial changes in the negotiating instruments adopted so far in the negotiations.

Table 4. Existing and under negotiation mega-PTAs, December 2013

	TTIP	EU-Japan	APEC	TPP	RCEP	CJK	ECFA	Frequency
Japan		X	X	X	X	X		5
China			X		X	X	X	4
Korea			X	X	X	X		4
United States	X		X	X				3
EU	X	X						2
Ch. Taipei			X				X	2
Other countries	0	0	15	10	13	0	0	-
Shares in world GDP, trade flows and FDI stocks								
GDP	0.45	0.31	0.57	0.38	0.30	0.21	0.12	-
Trade flows	0.45	0.39	0.41	0.27	0.26	0.16	-	-
FDI stocks	0.58	0.43	0.36	0.27	0.13	0.09	-	-

Sources: GDP and Trade: World Bank. FDI stocks: OECD.

An interesting question is then: which could be the mega-PTAs the most ready to undertake such changes among all those listed in Table 4? Have negotiations among East Asia and the

EU some comparative advantages in this respect? And, if yes, how could East Asia and the EU use these advantages for improving the welfare of the whole world, despite the intrinsic discriminatory biases generated by any PTA?

The political will factor

Political will—in particular at the level of the top politicians (Heads of State or government)—is needed for a swift conclusion of any substantial PTA. In this perspective, a simple observation deserves attention: the smaller the economy of a country compared to its negotiating partner is, the stronger the political will of the smaller country may be. This is because the PTA with a (much) larger economy is more likely to modify the domestic relative prices in the small negotiating partner—hence bringing gains from trade and boosting growth. The best illustrations of this simple observation are the Korea-US and Korea-EU PTAs. By conceiving these PTAs as an unique opportunity for the Korean economy to accelerate its domestic reforms, to put the Korean economy as a hub and ultimately to boost its growth, the Lee Myung-bak Administration has accepted to pay the price required by the EU and the US, such as the opening of the audiovisual sector.

This observation leads to two remarks. First is that it would not be surprising that the mega-PTAs under negotiation would not reach the level of ambition that the Korea-US and Korea-EU PTAs have achieved. This is because these mega-PTAs are negotiated among partners of relatively similar size—hence they are less able to mobilize the top-politicians of at least one negotiating side than the two very asymmetrical Korea-related PTAs.

Second, East Asia and the EU have different sensitivity to the size argument. The two cases of China and the EU are particularly complex:

- China may become less and less interested in bilateral agreements when its economy will become bigger—hence all the candidate partners smaller, meaning less able to bring substantial changes in Chinese domestic relative prices. The trade agreements which will then bring enough gains to China will be increasingly those covering at least several mammoth economies, possibly the entire world—that is, the WTO.
- The EU as a whole is still the largest economy in the world for a decade or so. But, political will in the EU remains located at the level of the EUMS, and most of the

EUMS economies are relatively small: Germany and France (the two largest EUMS economies) have together the same size than Japan, Germany, France and Britain the same size than China. As a result, political will in the EU may be more present than often believed. The problem may be then the Commission which, by its own nature, tends to be misled by the artificial size of the EU as a whole.

These complex evolutions may create a propitious situation for East Asia and the EU in the years to come. A Chinese economy of a still relatively limited size compared to the world economy may nurture a political will in Beijing in favour of mega-PTAs. Meanwhile, EUMS increasingly aware of their future size limits may feel that it is the perfect time to strengthen their economic ties with East Asia via innovative mega-PTAs.

A bilateral or a plurilateral approach?

The section 2 discussion on liberalisation in regulatory matters stresses the key role of trust. Trust is easier among economies of the same level of development. For instance, it is much easier to share the same concerns on environment if the countries have relatively similar GDP per capita (incomes). This simple fact makes good sense, but it has been deliberately ignored in the EU during the 1990s and 2000s—triggering in the recent years bitter fights between the "rich" and "poor" EUMS on the burden sharing of the environmental obligations and costs. These fights were all the more acrimonious because the rich EUMS are also those producing (including by granting lavish subsidies, such as in the case of German solar panels) the environment-friendly products and services to be bought by the poor EUMS.

This "similarity" bias of trust has an immediate consequence on the geographical scope of negotiations. It makes (much) more difficult to negotiate a plurilateral agreement than a bilateral agreement when the plurilateral dimension involves (very) different economies. It happens that the TPP is based on a plurilateral approach among very different countries (though its bilateral component seems stronger and stronger as time goes) while so far the East Asia-EU PTAs under negotiation are based on bilateral agreements.

The present circumstances of the world economy—with the huge ongoing economic and geo-political shifts—suggest the bilateral approach as the best to be followed by East Asia and the EU in their coming PTAs.

This is not the traditional recipe for trade negotiations. Inviting the maximum number of negotiators at the negotiating table and putting on the table the maximum number of topics has been the maxim of GATT-WTO negotiations. It was argued that a successful negotiation does need the maximum of options at its start, and that time will tell which negotiator will leave the table, and which topic will be too hard to crack. This approach has proven its value during the last six decades. But, it has done so for well formatted topics of negotiations, such as tariffs of various forms, quantitative restrictions, etc. But it did achieve very little for the more complex, trust-thirsty regulatory agenda—technical norms and services regulations.

Keeping a bilateral approach will give to East Asia-EU PTAs the flexibility required by the fast evolution of the East Asian region. It will allow to define variable contours of negotiations as time flows. Yesterday Korea-EU PTA and present Japan-EU PTA can cover a different range of regulatory issues than to-morrow China-EU PTA. This is not a serious problem as long as all those regulations-focused PTAs are conceived as "living agreements"—a term defined in this paper as a negotiating approach combining a broad framework agreed since the start and translated, as time goes, into concrete commitments in a sequence of detailed agreements focusing on the achievable parts of the framework at a given period.[8]

By contrast, a wide, detailed and once-for-all East Asia-EU trade package would face a major problem, as best illustrated by the China-EU case. Negotiators of a once-for-all China-EU trade package are not in the position to anticipate the speed and magnitude at which the Chinese economy will change, hence to address the correct issues. They are likely to deliver an agreement which will be largely obsolete or inappropriate from the first years of its implementation. Or alternatively, the ambition of an once-for-all trade package would induce negotiators to postpone for too long negotiations on the first elements of a PTA that could be tabled and concluded much more rapidly.

That said, a bilateral approach raise a couple of challenges which are not exactly the same for East Asia and the EU.

- East Asia is relatively accustomed to an "living agreement" approach, with its sequence of increasingly constraining and detailed agreements based on an initially

[8] "Living agreements" can be seen as a variation on what was called "progressive liberalization" during the Uruguay Round negotiations.

"light" basis (see for instance PTAs in South East Asia). By contrast, the EU will have to abandon its current approach of negotiating both wide and detailed packages. But it should be stressed that this EU approach is relatively recent (it dates from the 1990s). It was definitively not the case of the Treaty of Rome which founded the EU and has been *de facto* a "living agreement" [Messerlin 2012].

- It will force East Asia and the EU to set up ways for reviewing their existing agreements in order to ensure consistency between the older and newer PTAs—for instance, to review the Korea-EU PTA once the Japan-EU PTA will be concluded. That said, inconsistencies in a sequence of bilateral PTAs or inter-actions between concessions negotiated with two different PTA partners at two different periods may not be the serious limits they seem at a first glance for two reasons. First, regulations (particularly in services) are so country specific that inter-actions between concessions may not be so frequent and costly. Second, as underlined in section 2, the mutual evaluation preliminary step of the "mutual equivalence" instrument would normally require a mechanism of reviews.

A "norm setting" or a "norm attracting" approach?

The most dangerous aspect of TTIP—for its two members as well as for the rest of the world—is that it is a negotiation between two very similar economies at the same end of the level of development. As a result, TTIP is doomed to be subjected to strong intrinsic forces drifting it away from the concerns and interests of the "rest of the world". This aspect is emphasized by an expression often used by the TTIP negotiators: TTIP should be "norm-setting". Even if one discounts the often emphatic tone of trade negotiators, such a notion is worrisome.

A potential advantage that the East Asia-EU PTAs should cultivate is the alternative approach of "norm attracting"—meaning East Asia and the EU working hard to make their PTAs a source of norms which would be attractive to the rest of the world.

This is possible with the "mutual equivalence" approach. ME happens to be not only the most promising instrument for the negotiating partners, but also the most promising instrument for the third countries which are not part of the mega-PTAs under negotiations for the following reason. Under ME, even the large signatories of mega-PTAs have interest to make their

regulations attractive to third-countries providers because this attractiveness will make these signatories the preferred hub for the firms from the third-countries which want to enter the mega-PTA markets. In short, a firm from a third country will still face tariffs at the mega-PTA borders (hence trade diversion) but it could reduce the costs related to regulations by aligning its regulations to those of the mega-PTA member which has tried harder to conceive its own regulations with the interests of the world in mind.

To sum up, ME can have a positive impact on both the mega-PTA members and on the rest of the world (that is, all the WTO Members). By stirring competition among the regulators of the mega-PTA members, it will induce them:

- To improve the welfare of the consumers of their respective jurisdictions.
- To induce third countries to adopt the regulations of the signatory which has been able to design the most attractive regulations—meaning achieving at lower costs the regulatory objectives considered as equivalent by its mega-PTA partner(s).

In other words, far to try to reinforce a duopoly of shrinking (in relative terms) developed economies trying to impose their existing regulations to the rest of the world (as it is implicit in the TTIP notion of norm-setter) ME creates a competition among large economies for achieving better regulations while not endangering the regulatory equivalences agreed among them.

That said, it is fair to recognize that this strong competition dimension of the ME instrument explains probably the reluctance to introduce systematically ME in PTAs. In this context, the negotiators of the East Asia-EU PTAs should get some inspiration from the above-mentioned Korea-US approach in the automotive sector in order to balance the pro-competitive feature of ME with the political realities afraid of a too stiff competition among firms and regulators. However, the limits (static quotas) agreed in the Korea-US approach have the usual limits of such instruments. There is thus a need to find some kinds of "evolving" limits which could appease political fears at the beginning while leaving to competition its long term power.

To sum up, most trade observers have expressed the need to find ways to "multilateralize" PTAs. In fact, ME blurs the frontier between multilateral and bilateral negotiations by creating permanent incentives among PTA members (particularly the large members of the

mega-PTA) to take into account a 'multilateral' dimension when designing their domestic regulations. In short, ME is an intrinsic instrument for "multilateralizing" PTAs .

Concluding remarks

The paper has first surveyed the limits of the EU Internal Market as a good illustration of the limits of any PTA relying on the current negotiating instruments dealing with regulations—technical norms for goods, regulations shaping markets for services. Second, it has identified a more promising negotiating instrument—mutual equivalence—which fits better the need of modern economies characterized by a wide diversity (varieties) of products, increases the competitive pressures among the firms of the PTA members, and reduces the trade distortions (trade diversion) generated by PTA with respect to the rest of the world by inducing PTA signatories to be "norm-attracting"—not "norm-setting".

The coming decade may witness East Asia and the EU in a very good position to conclude negotiations on bilateral PTAs relying as much as possible on this "mutual equivalence" negotiating instrument. By the same token, these PTAs would have an intrinsic multilateral component, hence would contribute to the world welfare.

References (to be done)