SciencesPo. GEM Groupe d'Économie Mondiale

Working Paper
January 30, 2012

The EU Preferential Trade Agreements: Defining Priorities for a Debt-Ridden, Growth-Starving EU

Patrick A. Messerlin

Executive Summary

The EU severe debt problem requires urgently the design and implementation of domestic pro-growth reform agendas in Europe. Opening markets to foreign competitors has always been a way to boost and buttress such agendas. A "Sleeping Doha" Round leaves preferential trade agreements (PTAs) as the only channel for opening markets to foreign competition. In this context, this paper examines two questions: do the PTAs currently negotiated by the EU fit well the EU quest for growth? If not, what would be the appropriate PTAs?

Looking at the potential sources of growth in the world during the next decades provides a first lesson. The EU needs a profound change of mind and approach in its international relations because its economic weight will decline dramatically and rapidly. Its current share in the world GDP (25 percent) will be cut by half by 2030 and by three by 2050. The cliché "*the EU is the biggest global player in international trade and investment*" has lost any credibility.

PTAs can satisfy the EU urgent quest for growth only if the EU partner fulfills three conditions:

- it has to be big enough to have an impact on the EU economy;
- it has to be big enough in the immediate future, not in two or three decades from now, because the EU quest for growth is urgent;
- it has to have a regulatory framework good enough to induce the EU Member States to improve their own regulations, another powerful way to buttress and boost their domestic pro-reform agendas.

The PTAs that the EU is currently negotiating do not meet these conditions. Almost all of them involve partners that might be an useful source of growth but only in a too much distant future, and that lack deeply the regulatory quality needed. This situation is due to an intrinsic flaw in the current EU approach: it focuses on negotiations with countries highly protected in the hope to get large preferences – a hope that economic analysis shows to be illusory.

Leaving aside the United States, the paper shows that, today, only two economies meet the three conditions mentioned above: Japan and Taiwan (Korea has already a PTA with the EU). Negotiations with these two economies should thus be launched and concluded as quickly as possible.

欧州連合の特恵貿易協定：
低成長と債務問題を抱えるEUの最優先事項を定義する
パトリック・A・メセルラン
2012年1月30日

今日、深刻な債務問題を抱えるEUは、早急に成長可能な経済再建プランを作成し実行する必要がある。外国に対する市場解放は、常に経済成長を実現する有効な手段であった。しかしドーハ開発ラウンドの交渉が難航する中、特恵貿易協定（Preferential Trade Agreements、略称PTA）が唯一市場を開く有効な手段となっている。このような状況を踏まえ、この論文では以下の二つの質問に答える。すなわち、現在EUが交渉している諸PTAは果たしてEUの求める経済成長を実現することができるのか。もしできないならば、どのようなPTAが望ましいのか。

今後数十年の世界の潜在的成長の源がどこにあるか、それを見据える事で問題の本質が見えてくる。この間、EUの経済的重要性は急激に薄れて行く為、EUは対外関係における意識もアプローチも根本的に変えなければならない。現在、EUのGDPが世界GDPに占める比率は25パーセントだが、この比率は2030年に半分、2050年には３分の１にまで減少すると見られている。「EUは国際社会における貿易や投資の最重要プレーヤーである」という決まり文句はもう信憑性を失っているのである。

EUが早急に必要とする経済成長をPTAによって実現できるのは、交渉相手が以下の三つの条件を満たす場合である。

- EUの経済に影響を与えるほどの規模を持つこと。
- EUの経済に影響を与えるほどの規模になることが、20年、30年先でなくきわめて近い将来であること。
- 相手国の規制の枠組みが、EU加盟国の規制の再考を促し改革への機運を高めるほど整っていること。

現在EUが交渉している諸PTAは、これらの条件を満たしていない。EUが交渉しているPTAのほとんどが、経済成長を促すとしても遠い将来の話である上に、相手国の規制の質が低い。このような交渉を選んでしまう理由は、保護レベルが高い国を選んで大規模な特恵を期待しているからであるが、このアプローチは間違っている。このような期待が幻想にすぎないことを経済分析が示しているのである。

本論文では、米国以外で上記三つの条件を満たすのは、日本と台湾の二カ国のみである事を示す。（韓国は既にEUとのPTAを締結している。）この二国との交渉は早急に開始され、締結されるべきである。

歐盟優惠性貿易協定：
為飽受負債之苦、渴望成長的歐盟找出優先目標

Patrick A. Messerlin

2012年1月30日

摘要

歐盟國家嚴重的債務問題，迫切需要各會員國研擬並執行有利於成長改革的方案。開放市場面對外來競爭向來是提振成長方案的方式之一。「沉睡的杜哈回合」使得優惠性貿易協定(preferential trade agreements, PTAs)
成為開放市場面對外來競爭的唯一管道。本文將在此背景下探討兩個問題：歐盟目前談判中的PTAs是否符合歐盟追求成長的目標？如果不是，誰才是適當的PTAs對象？

審視未來10年全球具備成長潛力的國家可以略見端倪。由於歐盟經濟實力將大幅且快速下滑，必須以全新思維面對其全球關係。目前歐盟占全球GDP的25%，但此一比例在2030年將減少一半，在2050年時更只剩原來的三分之一。「在國際貿易與投資方面，歐盟是全球最大的玩家」，這句老生常談已喪失意義。

惟有當PTAs的對象國符合下列三個條件，才能滿足歐盟追求成長的目標。

- 經濟規模大到足以影響歐盟經濟；
- 在最近的未來，而不是20年或30年後，經濟規模夠大；
- 必須擁有良好的法規架構，足以促使歐盟會員國改進自身法規，從而對各國的改革方案投入一股助力。

歐盟目前談判中的PTAs並未符合這些條件。雖然這些PTAs對象國中有些具備成長潛能，但都將發生在遙遠的未來，且極度欠缺必備的法規制度。歐盟目前的作法是造成此一缺失的原因：強調與高度保護的國家進行談判，期待能獲得最大的益處。經濟分析將證明此一期待是不切實際的。

本文將顯示，撇開美國不談，現今只有兩個經濟體符合上述三個條件：日本和台灣(韓國已與歐盟簽署PTA)。歐盟應與這兩個經濟體展開談判並儘速完成。

The EU Preferential Trade Agreements:
Defining Priorities for a Debt-Ridden, Growth-Starving EU

Patrick A. Messerlin[1]

30 January 2012

Since 2006, the EU has launched negotiations on preferential trade agreements (PTAs) with roughly twenty countries – the largest PTA plan in the EU history (this paper leaves aside the negotiations with the 68 African, Caribbean and Pacific countries which have a very different rationale). But since all these launches, two major events occurred. First is the much worse than expected economic and debt crisis of the Eurozone EU Members States (EUMS). Second, the Doha Round has entered a period of lethargy that is expected to last until mid-2013 at least, but that could well go beyond this time horizon if the deep disagreements on trade matters persist in the U.S. Congress.

The EU severe debt problem imposes the quest for urgent growth as the paramount goal of any EU PTA. Such a goal means that a PTA should not be judged on narrow trade criteria, but on its capacity to contribute to the much needed and wider EU domestic reform agenda capable to boost EU growth as much and as fast as possible (Findlay 2012). PTAs not fulfilling such a role will not be able to attract the attention of EU top policy-makers (heads of state or government, key ministers) [Messerlin 2011]. They are doomed to be captured by narrow vested interests, hence to deliver limited (if any) results while fuelling bitter political domestic fights.[2]

Does the current EU PTA plan contribute to EU growth? The answer is "mostly no". Hence, the paper suggests to shift gear by launching and concluding as quickly as possible PTA negotiations with Japan and Taiwan which are today the best EU partners for boosting EU domestic reforms and growth, hence for making EU debt burden bearable in the long run.[3]

---

[1] Director, Groupe d'Economie Mondiale at Sciences Po. I would like to thank very much Anders Ahnlid, Roy Chun Lee, Thomas Harris, Sahoko Kaji, Hosuk Lee-Makiyama and Vangelis Vitalis for their very thoughtful comments, Ben Hsu and Mizuha Suzuki for their great help. All remaining errors are mine.

[2] As it happened in the U.S. with the endless debates in the Congress on PTAs with countries (Columbia or Peru) much too small for contributing in anyway to the U.S. pro-growth reform agenda.

[3] This paper leaves aside the Transatlantic dimension which is extensively analyzed in a recent report [Transatlantic Task Force 2012].

The paper is organized in five sections. Section 1 describes the situation of the world trade negotiations left by a "Sleeping Doha": the options available to the four "mammoth" economies (the EU, the U.S., China and Japan); and the need to define the key criteria that should guide the choice of PTA partners by the debt-ridden, growth-starving EU.

Section 2 provides the two key lessons from the expected shifts in the world sources of growth in the coming decades. First, the EU should realize that its weight in the world economy will be massively reduced (by two) within a couple of decades, forcing the EU to profoundly revise its approach to the international economic relations, including its PTA strategy. Second, section 2 gives a sense of where and – equally crucial – when there will be the most promising sources of growth in the world economy that the EU could tap for boosting its own growth.

Section 3 shows that the current EU PTA plan does not take into account these lessons. The current PTA plan drags the EU into trade negotiations plagued by two flaws: they miss the countries that are currently the best sources of growth and of potential domestic reforms; they are stuck with countries that might be an useful source of growth, but in a too much distant future for satisfying the EU urgent quest for growth.

Section 4 suggests that the most promising pro-growth EU PTAs will be those with Japan and Taiwan. Negotiations should thus be launched and concluded as quickly as possible with these two economies. This is a major challenge for the EU which so far has been more a "follower than a forerunner" [Ahnlid 2012] in a region (East Asia) that has recently witnessed major improvements in its trade agreements [Vitalis 2010].

This paper suggests substantial changes in the EU current PTA plan which take better into account the EU urgent quest of growth. But, in turn, these changes raise a wide range of questions that need to be carefully examined. Section 5 makes a brief presentation of the most important questions that are more fully discussed in a companion paper [Messerlin 2012]. Section 5 is followed by concluding remarks.

Section 1. A "Sleeping Doha" and the need for a PTA strategy

A "Sleeping Doha" leaves two main options: inertia with the risk of a slow erosion of the world trade regime or pursuing trade liberalization on a PTA basis. In the latter case, it changes deeply the way PTAs should be perceived. PTAs can no more be seen as more or less "complementary" additions to WTO negotiations. They will be the only instruments channeling additional growth incentives from the world economy into the EU.

A wider – wilder? – game: PTAs among the mammoth economies

PTAs among mammoth economies were unthinkable during the Doha Round negotiations simply because any Round could not be concluded without a pre-agreement among the largest world economies. Table 1 summarizes the current situation in terms of PTA options among the four mammoth economies (US, EU, China and Japan) and the second tier of the permanent G20 countries. It adds Taiwan for two reasons: its economic weight (similar to Turkey if one takes into account the operations of the Taiwanese firms in China Mainland, as shown below) and the China-Taiwan PTA (Economic Cooperation Framework Agreement, or ECFA) which emerges increasingly as a game changer in East Asia, hence in the world [Dreyer and al. 2010].

Table 1. PTAs among large countries: the state of the negotiations (January 2012)

G20 Members [a]	Share (%) of world GDP	EU27	USA	China	Japan
EU27	26.6	---	*Transatlantic*		*JEU*
USA	23.9	*Transatlantic*	---		*TPP*
China	9.6			---	*CKJ*
Japan	9.0	*JEU*	*TPP*	*CKJ*	---
Brazil	3.4	ongoing			
India	2.8	ongoing		concluded	concluded
Canada	2.6	ongoing	concluded		*ongoing*
Russia	2.4				
Mexico	1.7	concluded	concluded		concluded
Korea	1.7	concluded	concluded	*initial step*	*CKJ*
Australia	1.5		concluded	ongoing	ongoing
Turkey	1.2	concluded			
Indonesia	1.2	*[c]*		concluded	concluded
Saudi Arabia	0.7	*[d]*			ongoing
Taiwan [b]	0.7			concluded	[e]
Argentina	0.6	ongoing			
South Africa	0.6	concluded			

Notes: Entries in italics indicate that the discussions are at a preliminary stage (joint study, scope exercise, etc.). [a] plus Taiwan. [b] Taiwan's GDP does not take into account the massive operations of the Taiwanese firms in China (see section 4). [c] Under the ASEAN-EU negotiating mandate. [d] negotiations suspended under the GCC-EU negotiating mandate. [e] in September 2011, Japan signed a bilateral investment agreement with Taiwan.
Source: GDP 2010 data from WTO Trade Profiles, WTO website.

Table 1 provides three key observations.

- Japan enjoys the widest range of choices: it is the only mammoth economy having an ongoing PTA option with all the other mammoth economies. From a negotiating point of view, this is a key advantage that the EU should take into account when negotiating with Japan.
- the EU and the US have only two options: a Transatlantic PTA and a PTA with Japan. The future of a Transatlantic PTA is still unclear: a "High Level Working Group on growth and jobs" has been established but, so far, it has a vague and slow work programme [TEC 2011]. The EU and Japan have started to discuss on opening PTA negotiations while the U.S. has invited Japan to join the Trans-Pacific Partnership (TPP) negotiations, with Japan having expressed some interest.
- as of today, China looks as the country with only one, relatively old and so far unsuccessful, option: talks on the China-Japan-Korea agreement (CJK) are ongoing since 1999. The TPP is not an option open to China because it includes provisions on labor or state-owned enterprises (among others) that China cannot sign. The "High Level Economic and Trade Dialogue" (HED) between China and the EU is a fuzzy forum that offers no serious perspectives to China. Its current EU motto – "accepting tough Chinese competition while pushing China to trade fairly" – suffers from two major flaws: not accepting the Chinese competition is not an option for the EU, and there is no definition of what could be "fair" trade.[4] That said, one should expect that China to get out of this uncomfortable situation. It could try to do so by re-launching the CJK or by launching a set of bilateral agreements in East Asia for counter-balancing the TPP. Alternatively, it could launch a bold initiative in the WTO, the best forum to diffuse the fears about strong Chinese competition on the widest range of trading partners. Last but not least, more options could be made available by China's trading partners. This is the case with the

[4] Moreover, the HED involves only the Commission on the EU side, not the ultimate decision-makers – the Council (EUMS) and the Parliament which are unlikely to witness passively the trade dialogue with China.

prospect (still unclear) of a China-Korea PTA agreed by both countries in early January 2012.

Concerning the second tier of the G20 countries, Table 1 provides three observations.

- Japan has already a rich network of PTAs with the second tier of the G20 countries, including a bilateral investment agreement with Taiwan, and it has a network of agreements with smaller East-Asian countries (not shown on Table 1).
- The EU and the US have different approaches. The EU has started many negotiations with new partners, but it encounters serious difficulties to conclude them with substantial results for the most important partners (Brazil, India, Argentina). By contrast, the US has not approached new partners, but tries to "deepen" its existing PTAs with the launch of the TPP.
- China is lagging behind, a situation reflecting the wide spread fear of the Chinese economic competitiveness among all its trade partners.

To sum up, rather than moving fast and energetically as required by the current tectonic shifts in international relations, the EU current PTA plan looks slow and/or hesitant with the mammoth economies and is facing (predictably as argued below) serious difficulties in the second tier of the G20 countries.

<u>Criteria for choosing the most promising growth-boosting PTA partners</u>

If successful, WTO negotiations would have effortlessly provided to the debt-ridden EU economy what it needs the most: a better access to the largest, fastest growing and best regulated markets economies. This is because the non-discriminatory approach of WTO negotiations does not require to guess, before entering into negotiations, which country will have the largest and fastest growing economy and the best regulations – nor when it will have all these features. The simultaneous opening of all the world markets means that EU businesses will find out the markets with the highest growth as and when required.

In sharp contrast, PTAs require to find out, before entering into negotiations, what will be the most promising countries from a growth perspective [Lee-Makiyama 2011]. For the debt-ridden and growth starving EU, this choice is absolutely crucial. It has two main components: the growth potential *per se* and the timing of growth since the EU needs additional growth fast.

The growth potential *per se* of a partner has two main dimensions – economic size and regulatory quality:

- the bigger the partner's markets are, the more the EU firms will be induced to expand the scale economies of their operations and the scope of varieties of their products, hence the more the PTA in question has the capacity to change the EU relative prices of goods and services, that is, to deliver cheaper and more diverse products and services to the impoverished EU consumers.[5]
- the better regulated the partner is, the more the EU will be induced to improve its own regulations in order to offer to EU firms the same regulatory quality than the one supplied by its partner to its own firms. Better regulations are powerful instruments to change the relative prices of goods and services, hence to increase the consumers' welfare. This dimension is so important that PTAs can be seen as convenient "excuses" to make domestic reforms. The EU itself illustrates this point: the "Internal Market" has been a way to sell what were fundamentally EUMS domestic reforms.

Timing is a criterion as crucial as growth potential since the EU is in such an urgent need to boost its growth. Entering too early into negotiations with a partner too small today to have an impact on the EU mammoth economy makes no contribution to the EU domestic pro-growth agenda even if this partner has huge growth potentials in some (far away) future. Entering into negotiations too late – once the partner has passed its peak capacity of channeling growth and reform opportunities – has a huge (opportunity) cost for the EU growth.

[5] In the paper perspective, GDP data provide a more robust, less distorted information on economic potentials than trade data. Trade data are mere differences between production and consumption. They are polluted by a host of other factors (tariffs, subsidies, other trade barriers, transport costs, traditional international relations) which could evolve rapidly, including under the influence of PTAs.

These criteria have been used by a few countries in the past when choosing their PTA partners, as best illustrated by Korea (Chile and Singapore have had the same approach). By signing 12 PTAs only during the late 2000s, Korea has been able to open 77 percent of the world markets to its firms, an achievement close to reach what could have been delivered by the Doha Round [Messerlin 2011]. By contrast, during the 1990s and 2000s, the EU has signed 32 PTAs which have opened a paltry 17 percent of the world markets to the EU firms.

Section 2. A broad view of the growth pattern in the world (2010-2050)

In order to assess the current EU PTA policy (section 3) and to suggest a better one (section 4), Table 2 gives a broad view of the growth pattern (economic size and timing) in the world split in ten regions by presenting their shares in the world GDP from 2000 to 2050 [Buiter and Rahbari 2011].

Table 2 provides also information on the two main GDP components, namely populations and GDP per capita, and on their growth pattern (size and timing). Of course, all this information is far to be precise science. It is a compilation of the best available "guess-estimates" which should to be taken with extreme care – those for the year 2050 more than those for the year 2030, and those on GDP more than those on populations. The EU27 covers two regions of Table 2: the Western Europe region and a part of the Central Europe region (which also covers Turkey and the Balkans which are not yet EUMS). However, this is not a serious problem for this paper which focuses on the sources of growth outside Europe.

Table 2 suggests four main observations:

- the EU share in the world GDP is expected to be divided by two by 2030 and by three by 2050.[6] Hence, the EU weight in the world affairs will change much more profoundly in

[6] Note that the possibility that these expectations will not be met is not necessarily reassuring. It may mean that something deeply wrong would happen in the emerging economies, definitively a source of deep international instability.

the four next decades to come that it has changed until now – an evolution that seems to escape too often the attention of EU officials.

Table 2. Growth pattern (economic size and timing) for ten world regions, 2000-2050

	2000	2010	2015	2030	2050	2030/10	2050/10
Gross Domestic Product	Shares in world GDP, in %					Changes in shares	
Western Europe	26.4	25.4	21.8	13.5	8.6	53.1	33.9
Central Europe [a]	2.2	2.8	3.0	2.7	2.2	96.4	78.6
North America	33.0	26.5	24.0	16.5	10.3	62.3	38.9
Advanced Asia	17.0	11.8	10.5	7.3	3.8	61.9	32.2
Australia+NZ	1.5	2.2	1.8	1.4	1.0	63.6	45.5
Emerging Asia	7.0	15.0	22.0	38.0	46.0	253.3	306.7
China [b]	3.8	8.2	10.1	18.8	20.2	230.9	247.9
India [c]	1.4	2.1	2.8	6.5	9.3	301.6	435.8
Latin America	6.6	7.7	8.1	7.9	7.9	102.6	102.6
Middle East	2.3	2.8	2.6	3.2	3.6	114.3	128.6
CIS [d]	1.1	3.2	3.7	3.9	3.2	121.9	100.0
Africa	1.8	2.6	2.7	6.0	13.0	230.8	500.0
Population	Shares in world population, in %					Changes in shares	
Western Europe	6.4	5.9	5.7	5.1	4.6	86.4	78.0
Central Europe [a]	3.2	2.7	2.6	2.4	2.1	88.9	77.8
North America	5.1	5.1	5.0	4.9	4.9	96.1	96.1
Advanced Asia	3.3	3.1	3.0	2.6	1.9	83.9	61.3
Australia+NZ	0.4	0.4	0.4	0.4	0.4	100.0	100.0
Emerging Asia	50.0	52.0	52.0	50.0	47.0	96.2	90.4
Latin America	8.5	8.5	8.5	8.4	8.0	98.8	94.1
Middle East	5.2	3.5	3.7	4.2	4.8	120.0	137.1
CIS [d]	4.6	4.1	3.9	3.4	3.0	82.9	73.2
Africa	13.0	14.8	15.7	18.7	23.4	126.4	158.1
GDP per capita	Indexes (Western Europe=100)						
Western Europe	100.0	100.0	100.0	100.0	100.0	--	--
Central Europe [a]	16.3	24.0	29.1	43.1	56.8	--	--
North America	154.6	120.5	123.3	126.9	112.3	--	--
Advanced Asia	121.6	88.5	92.0	107.7	108.1	--	--
Australia+NZ	93.3	131.1	117.9	132.9	145.3	--	--
Emerging Asia	3.4	6.7	11.0	28.2	51.9	--	--
Latin America	18.7	21.0	21.1	35.4	52.3	--	--
Middle East	15.2	18.6	18.0	28.9	40.0	--	--
CIS [d]	5.7	17.9	24.2	43.0	57.6	--	--
Africa	3.3	4.1	4.4	12.1	30.7	--	--

Source: Buiter and Rahbari (CITI) 2011. Notes: Columns in grey are expected shares. [a] includes Turkey and the Balkans. [b] the GDP shares for China are based on the Emerging Asia growth rate calculated by CITI minus half a point. [c] the GDP shares for India are based on the Emerging Asia growth rate calculated by CITI plus one point for India. The 2050 shares would have been 24.7 and 6.8 percent, respectively, if the regional growth rate were applied to the two countries. [d]: Commonwealth of the Independent States.

- the Advanced Asia countries (Korea, Japan, Taiwan, Hong Kong, Macao and Singapore) are expected to have significantly better growth prospects than the EU until 2030. Their faster GDP decline from 2030 to 2050 reflects largely the much sharper decrease of their population compared to the EU one. Interestingly, this region is expected to have a higher GDP per capita than the EU before 2030, and to be close to catch up with US GDP per capita while the EU would be still at pain to do so.

- only two regions fill up the space left by the "EU and US diminishing giants": Emerging Asia and Africa. But the dynamics of these two regions are quite different. Emerging Asia will have a bigger share of the world GDP because its people will become richer. That said, the GDP per capita of this region by 2050 will still be half the EU GDP per capita, meaning that this region will still offer large growth prospects well beyond 2050. By contrast, Africa will get a bigger share of the world GDP between now and 2050 largely because its population will grow. In fact, its pro-growth potential based on GDP per capita growth will really emerge only after 2030.
- Latin America and the Commonwealth of Independent States (Russia and Central Asia) are not expected to increase their limited economic weight in the world economy. The Middle East gains some weight, but remains relatively small compared to the EU economy. As a result, the pro-growth potential of these regions is not very attractive in relative terms.

As said above, timing is a critical factor in the EU quest for growth because the EU debt problems are pressing. Concluding PTAs that would deliver a noticeable boost to EU growth during the next (two) decade(s) is what should be done. Table 2 provides a sense of the timing at which a given EU PTA could be expected to channel its strongest pro-growth incentives:

- Advanced Asia offers the best prospect for the immediate future, with its economies large enough to exert some traction on EU growth. And, as shown below, their performances in regulatory matters of Advanced Asian economies are often better than those of many EUMS, triggering a new powerful – largely domestic – source of EU growth (see section 4 below).
- PTAs with the largest countries of Emerging Asia will be at the core of the EU PTA policy in a more distant future. The key country is undoubtedly China (China is expected to reach in 2030 the share in the world GDP that the EU will have by 2015). During the 2010s, the difference in growth pattern (size and timing) between Japan and China remains limited enough to make Japan a partner much more attractive to the EU if one takes into account the (much) higher (domestic and international) difficulties to negotiate

with China, compared to those to negotiate with Japan. But, by 2030, China will become a "must" partner for the EU if the WTO negotiations continue to be stuck. Indeed, one of the most attractive aspects of the Taiwan-EU PTA is to prepare the EU and China to serious bilateral negotiations. By contrast, India is not really large enough to boost EU growth before the 2030s. The ASEAN countries are somewhat in the middle – smaller than India but more advanced on their growth path. But, they have the handicap to remain fragmented: an EU-ASEAN agreement will be based on bilateral PTAs between the EU and each ASEAN member, meaning that it will take time for a full impact of ASEAN growth on the EU.

To sum up, the expected growth in these ten world regions for the next four decades and the timing of this growth suggests to focus on the Advanced Asian economies first, before turning to the Emerging Asian economies (China within a couple of decades, India later). Africa would emerge as a potential substantial pro-growth machine for the EU at a later stage (assuming that it will be less fragmented than today) while the Commonwealth of Independent States, the Middle East and Latin America do not offer better than average performance in terms of growth pattern. An efficient use of the EU limited negotiating capital – staff and other resources in the EUMS and at the Commission – should take into account all these fundamental evolutions.

Section 3. The current EU PTA plan: inappropriate to the EU quest for urgent growth

It is now possible to assess the growth potential of the current EU PTA plan. This section argues that the economic size and/or the regulatory quality of the countries with which the EU is currently negotiating is too low and/or too far away in time to boost EU growth in a significant way. It concludes by examining the main reason for such an inappropriate choice.

Economic size: too small or too far away

Table 3 assesses the pro-growth potential of the current EU PTA plan by calculating an "EU market expansion" indicator for every PTA under ongoing negotiations (blocks A and B). The

"EU market expansion" indicator is defined as the ratio of the GDP of the EU PTA-partners to the EU GDP (columns 3 and 4). It gives a crude sense of the potential scale economies and range of varieties of goods that the PTA in question could add to the EU domestic market, hence of its potential contribution to the EU pro-growth agenda.

Table 3 calculates these indicators for 2010 and 2030 (the 2030 GDPs have been calculated by using the average growth rates of the region to which the country in question pertains in the Buiter and Rahbari's report).[7] For comparison sake, block C of Table 3 presents Korea which has already a PTA with the EU.

Columns 3 and 4 of Table 3 provide three key observations.

- in 2010, the total EU market expansion provided by all the PTAs under negotiations would increase by 65 percent the 2010 EU GDP. Countries in block B are unable to have any notable impact on the EU growth.
- but this global result requires the successful conclusion of negotiations with no less than 29 countries. The average "productivity" of the current EU PTA plan (defined as the global market expansion divided by the number of partners) is very low, roughly 2 percent of EU market expansion by PTA. An alternative way to underline this point is to note that Brazil, the largest partner in the current EU PTA plan in 2010, has a GDP which is only slightly more than one tenth of the EU GDP.
- Shifting to 2030, the total EU market expansion would be almost twice the 2030 EU GDP. But, this result depends critically from one country (India). Interestingly, Brazil which is the largest EU partner in 2010 in the current EU PTA plan is much less attractive by 2030 in relative terms.

To sum up, the current EU PTA plan has a very limited pro-growth traction in the coming years. Better prospects could be expected for the 2030s, but this result depends critically from India which is notoriously difficult in terms of trade policy and regulatory quality (see below Table 4 and section 4).

---

[7] Calculating variants by changing by a percentage point (at most) the regional growth rates does not change the conclusions of this section. Uncertainty for the regional growth rates for the period 2030-2050 is so large that it does not seem appropriate to use such variants systematically on a country basis.

Columns 5 and 6 of Table 3 provide another key information, namely the extent to which the current EU PTA plan could approximate a WTO agreement. This is an important aspect to keep in mind if the WTO negotiations continue to be stuck. A crude sense of this approximation is obtained by calculating the global size of markets opened by a set of PTAs compared to the size of the world markets that a WTO Round would open.

Table 3. The low pro-growth potential of the current EU PTA plan

Countries	Number		EU market expansion (% EU GDP)		WTO approximation	
	PTA	Partners	2010	2030	2010	2030
	1	2	3	4	5	6
A. Negotiations launched by the EU since 2006						
Canada	1	1	9.7	10.3	3.5	1.8
ASEAN	1	10	11.4	53.2	4.1	9.3
Indonesia			4.4	20.3	1.6	3.5
Malaysia			1.5	6.8	0.5	1.2
Singapore			1.4	6.4	0.5	1.1
India	1	1	10.7	49.7	3.8	8.7
Mercosur	1	4	15.5	28.3	5.6	4.9
Brazil			12.9	23.5	4.6	4.1
Russia	1	1	9.1	20.2	3.3	3.5
GCC [a]	1	6	5.8	11.6	2.1	2.0
B. Negotiations launched by the EU in December 2011						
Georgia	1	1	0.1	0.2	0.0	0.0
Moldova	1	1	0.0	0.1	0.0	0.0
Egypt	1	1	1.3	5.6	0.5	1.0
Jordan	1	1	0.2	0.3	0.1	0.1
Morocco	1	1	0.6	2.3	0.2	0.4
Tunisia	1	1	0.3	1.1	0.1	0.2
Total A and B	12	29	64.7	183.0	23.3	31.9
Subtotal [b]			32.7	93.3	11.8	16.3
C. Negotiations already concluded by the EU						
Korea	1	1	6.3	6.7	2.2	1.2

Notes: [a] GCC: Gulf Cooperation Council. [b] Subtotal for Brazil, India and Russia. Sources: Buiter and Rahbari [2011] for growth estimates and WTO Trade Profiles for the GDP of the individual countries and regions. Author's calculations.

Blocks A and B of Table 3 shows that altogether the 29 partners involved in current negotiations would open only 19 percent of the world markets in 2010, to be compared to a WTO deal which would have opened roughly 80-90 percent of the world markets (not 100 percent because the past ten years of the Doha negotiations have accumulated many exceptions in favor of many developing countries). By 2030, the approximation would be better, but would remain modest, with less than 32 percent of the world markets open to the EU producers.

Regulatory quality in the current EU PTAs policy: too poor and a costly trap for EU firms

"21st century" PTAs deal mostly with regulatory issues (sometimes called non-tariff measures by the negotiators): norms in goods, regulations in services. By doing so, such PTAs offer another possible channel to boost growth: by interconnecting two legal systems of market regulations, they reveal the strengths and the weaknesses of the regulations of each partner. Each partner is then induced to improve its own regulations in order to face the challenges raised by the partner's better regulations.

It is thus crucial to assess the existing EU PTA plan in terms of its potential contribution to regulatory improvement in the EU. Table 4 gives a sense of such a contribution by using the ten indicators of Doing Business (the global indicator of the ease of doing business, column G) and its ten components (columns S1 to S10) for all the countries with ongoing PTA negotiations with the EU. It is worth stressing that using other indicators (such as the Global Competitiveness Indexes of the World Economic Forum) based on totally different methodologies confirms the observations based on Doing Business (with one nuance mentioned below).

For making comparisons with the EU, Table 4 also provides indicators by "EUMS cohorts" (a cohort is defined by the year of accession of the EUMS, except for Greece, Portugal and Spain grouped together) rather than an average indicator for the EU (cohorts' indicators are the simple average of the indicators of the cohort's members). This presentation allows three useful observations.

- the regulatory quality is still very diverse among the EUMS cohorts, despite the fact that the EU is up to sixty-years old. This is an invitation to great modesty in what PTA can really achieve if the partners are not strong supporters of the PTA liberalization process;
- being the first countries to join the EU is not a guarantee of better regulations;

- joining late the EU is not necessarily a heavy handicap: it does not prevent latecomers to get quickly a high level of regulatory quality. This is the only result on which the Global Competitiveness Indexes of the World Economic Forum will bring some nuances, by restricting this observation to Estonia only.

Table 4. PTAs as a source of regulatory quality, selected countries

	Ease of doing business	Starting a Business	Dealing with Construction Permits	Getting electricity	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving insolvency
	G	S1	S2	S3	S4	S5	S6	S7	S8	S9	S10
EC cohorts											
EC-1958	41	66	54	65	111	69	82	70	30	37	29
EC-1973	7	21	20	41	53	11	15	14	14	38	8
EC-1980s	58	98	59	60	79	84	99	70	55	55	33
EC-1995	19	73	48	18	26	37	76	53	13	25	15
EC-2004a	50	73	82	90	63	51	72	103	59	67	47
EC-2004b	24	65	83	71	17	31	65	60	15	20	48
EC-2007	66	56	126	149	68	8	46	112	82	72	94
B. Negotiations launched by the EU since 2006											
Canada	13	3	25	156	41	24	5	8	42	59	3
Indonesia	129	155	71	161	99	126	46	131	39	156	146
Malaysia	18	50	113	59	59	1	4	41	29	31	47
Singapore	1	4	3	5	14	8	2	4	1	12	2
India	132	166	181	98	97	40	46	147	109	182	128
Argentina	113	146	169	58	139	67	111	144	102	45	85
Brazil	126	120	127	51	114	98	79	150	121	118	136
Russia	120	111	178	183	45	98	111	105	160	13	60
C. Negotiations launched by the EU in December 2011											
Georgia	16	7	9	89	1	8	17	42	54	41	109
Moldova	81	88	104	160	18	40	111	83	134	26	91
Egypt	110	21	154	101	93	78	79	145	64	147	137
Jordan	96	95	93	36	101	150	122	21	58	130	104
Morocco	94	93	75	107	144	98	97	112	43	89	67
Tunisia	46	56	86	45	65	98	46	64	32	76	38
D. Negotiations already concluded by the EU											
Korea	8	24	26	11	71	8	79	38	4	2	13

Source: Doing Business (2012) website. Ranks of countries: the highest the country's rank is, the poorest its regulatory performance is. Note [a]: Simple average of the indicators of the EUMS having acceded to the EU during the year mentioned. Greece, Spain and Portugal have been grouped together for simplicity sake. EUMS 2004b cover the Baltic States (Estonia, Latvia, Lithuania). EUMS 2004b cover the other Central European EUMS.

These observations give clear lessons for the EU PTAs with third countries. Harmonization or regulatory convergence are not a realistic agenda (indeed, there are good reasons to argue that it is probably not a desirable one). Rather, the appropriate objective of PTAs should be mutual recognition and evaluation. This is a difficult objective because it requires the involvement of each partner's regulatory authorities in the negotiating process. The companion paper will address extensively these issues [Messerlin 2012].

That said, Table 4 shows a striking difference between two groups among the current PTA partners with which the EU is currently negotiating.

- A first group (Canada, Georgia, Malaysia and Singapore) shows outstanding regulatory performances – on average (much) better than those of many EUMS. As a result, even if these countries are not large compared to the EU, PTA with such countries could induce the EU to improve its own regulations simply because these relatively "small" countries could inspire the EU reform agenda (one could even argue that good ideas from small partners may be seen as less threatening than good ideas from large partners).
- By contrast, the other EU partners show regulatory performances so poor that there is no hope that these countries could provide any support to EU domestic reforms, hence to EU growth. In fact, such a poor regulatory quality raises serious doubts on the capacity of the negotiated PTAs to improve the regulatory quality of the EU partners themselves. Rather, it suggests two possible outcomes. Either, the PTAs will be unable to change substantially the situation in the EU partners – the case of complete failure of the PTA. Or, the PTAs will open to EU firms badly regulated markets, full of distortions and often sources of economically unjustified rents that the EU firms could then try to tap in. But, there is ample evidence that such rent-grabbing may provide some benefits in the short term, but that they generate large costs in the medium and long term when the EU firms will have to face preference erosion for the reasons to be examined now.

<u>Why such a disappointing assessment?</u>

How to explain the disappointing perspectives of the current EU PTA plan? Despite its permanent references to growth and jobs, the EU current PTA agenda is much more driven by the desire to negotiate PTAs with highly protected countries [Commission 2006] than by the quest for growth.

This choice was largely driven by political economy forces. In the EU – as in any country – businesses tend to focus on the highest barriers (from tariffs to behind-the-border regulations) they face in foreign markets without taking into account the (severe) scarcity of the negotiating resources (Commission and EUMS in the EU case) needed for addressing all these barriers. Ignoring this constraint induces EU businesses to draw a too long wish list of the PTAs to be negotiated, all the more because every business is interested in its own narrowly defined markets. PTAs with the most protected partners reach easily the top of such a wish list simply because it is much easier to attract the attention of the Commission and EUMS by mentioning high barriers than moderate barriers.

Would the EU businesses take into account the scarcity of the EU negotiating capacity, they would have had raised the key question: is it more profitable to open very large markets with moderate protection than small markets with high protection? Economic analysis suggests that the former option is generally the more profitable one (hence suggesting to shorten the wish list) even in a static context ignoring the ongoing PTA proliferation.

Introducing the ongoing dynamics of PTAs creation (PTA proliferation) adds one strong argument against the choice of the most protected partners. It makes such a choice illusory because PTAs with highly protected countries trigger self-destructing dynamics.[8] Once a country has signed a PTA with the EU, it is much more inclined to sign PTAs with other countries. Why would the partner in question grant to the EU alone a substantial preferential market access which will prove to be very costly for its consumers when EU firms are less competitive than suppliers from third countries (a logical consequence of the high level protection of the EU partner with respect to non-EU countries)? In fact, it can be argued that the more protected a country is (hence the higher the preferences granted to the EU are), the more induced the EU partner will be to negotiate PTAs with other countries than the EU. The final outcome of such PTA dynamics is to generate severe backlashes: the initial supporters of the

[8] The rest of the paragraph assumes that PTAs with highly protected partners are successful substantial liberalization. This is an assumption far to be necessarily met, as seen with the case of the EU-Mercosur or EU-India ongoing negotiations.

PTA feel that they have been fooled once they face the erosion of their preferences in the partner's economy, and have to implement adjustment policies for coping with such an erosion.

The "high protection" criterion on which the current EU PTA plan relies generates two other intrinsic costs for the EU. First is that, the high protection of the partner slows down the partner's growth, hence indirectly reduces the capacity of this country to boost EU growth. This is also the case with the regulatory performances: poor regulatory quality curbs the growth of the country in question.

Second, PTA negotiations with relatively highly protectionist countries are by definition difficult. Most of the largest EU partners listed in Block A of Table 3 are notorious for their unpredictable trade policies and domestic regulatory reforms. Argentina is one of the most (if not the most) frequent sources of increased protection since 2008. Brazil has hard time to choose between its defensive (mostly industrial) and offensive (mostly agricultural) interests. India has been a permanent source of problems in the Doha Round due to very difficult domestic political debates generated by years of massive rent-seeking protection. It took Russia sixteen years to be the last large economy to join the WTO, and observers have doubts on its capacity to be a strong enforcer of WTO rules. Last but not least, one wonders why and how the EU would get from bilateral negotiations with such difficult partners more than that it was unable to get in the WTO forum where the EU requests were supported by all the other major WTO Members. It could be argued that these points are not acceptable because it would be too difficult to stop ongoing PTA negotiations. However, the above EU PTA partners have offered plenty of occasions during the recent months to suspend the negotiations.

Section 4. A EU PTA policy adapted to the EU quest for urgent growth

This section provides evidence that the EU PTAs with the Advanced Asian countries will be vastly superior to the current EU PTAs plan in terms of economic size, timing, and regulatory quality – hence that they will much better fill the EU urgent need of growth. It focuses on Japan and Taiwan since the Korea-EU PTA is being implemented and since PTAs with Hong Kong and Macao are not within reach for reasons related to both sides (anyway, they are too small).

The economic size and timing dimensions

Table 5 gives for Japan and Taiwan the same information than Table 3. It also provides a broader and longer term perspective by covering China Mainland and "Chiwan" – a word created by the Korean press for referring to the combined operations of the Taiwanese firms in Taiwan and in Mainland. Table 5 on "Chiwan" gives a sense of the size of these combined operations by estimating a virtual "Chiwan's" GDP defined as the sum of Taiwan's GDP and of a rough estimate of the Mainland's GDP generated by the Taiwanese firms operating in Mainland.

- in 2010, the Taiwanese firms are credited for employing 13-15 to 20-23 millions of workers in Mainland. In order to provide conservative estimates, Table 5 is based on the lowest estimate of 14 millions [Hung and Tung 2009]. In 2009, the Mainland's GDP per worker was roughly 7,100 US$ per worker [China Daily 2010-05-12]. This figure was multiplied by a (again conservative) factor of 1.3 in order to take into account the fact that the Taiwanese firms have invested 90 percent of their total investment in ten provinces which have a GDP per capita 50 to 60 percent higher than the GDP of the whole China.[9] The resulting GDP generated in Mainland by Taiwanese firms is roughly US$ 140 billion in 2010. Adding this to Taiwan's GDP (US$ 430 billion) gives the so-called "Chiwan-Low" estimate because the Mainland's GDP per worker takes into account China's farm labor force which generates a much lower share of Mainland's GDP than the industrial workers who are those employed by Taiwanese firms. As Taiwanese firms are mostly operating in the manufacturing sector, calculations have been made on the basis of the average urban wage 17,175 US$ [China Daily 2010-03-02] (the 1.3 factor has not been used in this estimate, again in order to provide conservative estimates). The "Chiwan-High" estimate is then roughly US$ 690 billion, and this is probably the most accurate estimate.

[9] The ten provinces are: Jiangsu, Guangdong, Shanghai, Fujian, Zhejiang, Tianjing, Shandong, Beijing, Hubei and Chongqing [Chen 2010].

- in 2030, "Chiwan's" GDP estimates have been calculated by using a growth rate which is the simple average of the growth rate of Taiwan (Advanced Asia) and of the growth rate of China (Emerging Asia) used in the Buiter and Rahbari's report.

Table 5. The best pro-growth EU-PTA policy, 2010-2030

Countries	Number		EU market expansion (% EU GDP)		WTO approximation	
	PTA	Partners	2010	2030	2010	2030
	1	2	3	4	5	6
A. A pro-growth EU PTA policy						
Japan	1	1	33.9	36.1	12.2	6.3
Taiwan	1	1	2.7	7.6	1.0	1.3
Total	2	2	36.5	43.7	13.2	7.6
B. Long term perspective: China, Taiwan, Chaiwan						
China	1	1	36.2	168.6	13.1	29.4
Chiwan-Low	--	--	3.5	10.1	1.3	1.8
Chiwan-High	--	--	4.3	12.2	1.5	2.1

Sources: Buiter and Rahbari [2011] for growth estimates and WTO Trade Profiles for the GDP of the individual countries and regions. The growth rate of Chiwan is the simple average of the growth rates of Advanced Asia and of Emerging Asia in order to reflect the two activities of the Taiwanese firms. Author's calculations.

Comparing Tables 3 and 5 reveals the vast superiority of a strategy coupling the Japan-EU (JEU) PTA and the Taiwan-EU (TEU) PTA over the current EU PTA plan.[10]

- in 2010, the JEU and TEU PTAs offer prospects in terms of EU market expansion (34 percent of the EU GDP) equivalent to the sum of those offered by the EU PTAs with three difficult partners (India, Brazil and Russia) altogether (column 3).
- in 2010, the JEU and TEU PTAs combined would open 13-14 percent of the world markets, that is, two-third of the approximation level offered by all the countries included in the current EU PTA plan and three times more than the largest partner (Brazil) in the current EU PTA plan (column 5).
- in 2030, the expected EU market expansion associated to the JEU and TEU PTAs combined is surpassed only by the one associated to India (column 4).
- in 2030, the JEU and TEU PTAs combined would still provide a WTO approximation higher than any other country included in the current EU PTA plan (except possibly

[10] For simplicity sake, the generic term PTA is used in the paper. The most frequently official term used for an agreement between Japan and the EU is Economic Partnership Agreement (EPA).

India) and almost a third of the WTO approximation which could be expected from a China-EU PTA, in case of no resumption of the Doha negotiations (column 6).

Crucial additional factors make even more attractive the JEU and TEU PTAs compared to the current EU PTA plan.

- The above results in terms of economic size are achieved by negotiating only two PTAs. In other words, the "productivity" of a JEU-TEU PTA policy is roughly ten times higher than the productivity of the current EU PTA plan. This means that the concentration on two negotiations could allow to get more and better skilled staff in the EU negotiating teams, hence to get a sounder and better outcome of better prepared negotiations.
- These two PTAs involve partners which have shown their willingness to negotiate with the EU and have followed consistently liberal trade policies during the last years. In particular, it should be stressed that Japan and Taiwan apply tariffs at their WTO bound level – a feature that they share with only the EU and five other countries in the world.[11]
- These two partners have developed substantial PTA networks. Japan and Taiwan have close links with the ASEAN countries, and Taiwan has a game-changer agreement with China. In other words, the JEU and TEU PTAs are the best preparation for the EU to deepen its links with the ASEAN countries and China Mainland. The EU firms connected with Japanese and Taiwanese firms will not have to wait for long EU negotiations with the ASEAN countries and with China for getting better access to these crucial markets. As argued in the companion paper [Messerlin 2012], these connections would be of crucial importance for the many EUMS which, unlike Germany, have small and medium firms still hesitating to enter large Asian markets or having comparative advantages in middle-of-the range products or in services.

<u>The regulatory quality dimension</u>

Table 6 provides for Japan and Taiwan the same information on regulatory quality than Table 4 for the countries covered by the current EU PTA plan. Again for comparison sake, it gives this information for China and the Mainland component of "Chiwan". Indicators for the Mainland

[11] The other countries are the US, Canada, China, Hong-Kong and Macao.

component of "Chiwan" are only available in four regulatory domains. Unfortunately, these figures cannot be directly compared to the other figures of Table 6 because they give the ranking among the Chinese provinces on a narrower information basis than the ones used for ranking the countries listed in the rest of Table 6. These ten provinces have a weighted average rank of 3.1 to 3.7 in the 30 Chinese provinces.[12] This result suggests that these provinces may fare well compared to some EUMS cohorts (at least on the indicators covered).

Table 6. PTAs as a source of regulatory quality, selected countries

	Ease of doing business	Starting a Business	Dealing with Construction Permits	Getting electricity	Register Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving insolvency
	G	S1	S2	S3	S4	S5	S6	S7	S8	S9	S10
A. EU cohorts [a]											
EU-1958	41	66	54	65	111	69	82	70	30	37	29
EU-1973	7	21	20	41	53	11	15	14	14	38	8
EU-1980s	58	98	59	60	79	84	99	70	55	55	33
EU-1995	19	73	48	18	26	37	76	53	13	25	15
EU-2004a	50	73	82	90	63	51	72	103	59	67	47
EU-2004b	24	65	83	71	17	31	65	60	15	20	48
EU-2007	66	56	126	149	68	8	46	112	82	72	94
B. The most promising pro-growth EU-PTA partners											
Japan	20	107	63	26	58	24	17	120	16	34	1
Taiwan	25	16	87	3	33	67	79	71	23	88	14
C. Looking ahead											
China	91	151	179	115	40	67	97	122	60	16	75
Chiwan [b]	--	(3.3)	--	(3.7)	(3.1)	--	--	--	(3.1)	--	

Source: Doing Business 2012 website. Ranks of countries: the highest the country's rank is, the poorest its regulatory performance is. Notes [a]: Simple average of the indicators of the EUMS having acceded to the EU during the year mentioned. Greece, Spain and Portugal have been grouped together for simplicity sake. EUMS 2004b include the Baltic States (Estonia, Latvia, Lithuania). EUMS 2004b include the other Central European EUMS. [b] There is no data for the indicators S2, S5 to S7 and S9. Simple average of the available rankings of the ten provinces in which the Taiwanese firms are investing the most.

Tables 4 and 6 reveal the vast superiority of the JEU-TEU PTA track, compared to the current EU PTA plan:

- Japan and Taiwan have by far much better indicators than the largest partners included in the current EU PTA plan. This is not astonishing: the criterion to negotiate PTAs with countries highly protected has biased the EU policy in favor of partners with obsolete regulations. Again, what is astonishing is the confidence of the EU negotiators to be capable to modify such an entrenched situation via the negotiation of PTAs – a

[12] The average ranking of the ten provinces in which the Taiwanese firms have invested the most heavily is weighted by the shares of these various ten provinces in Taiwan's total investments in Mainland.

confidence which is not supported by what can be observed within the EU itself, among the various EUMS cohorts.

- The EU, Japan and Taiwan have clearly a lot of potential to emulate each other since many indicators for Japan and Taiwan are better than or similar to those of certain EUMS cohorts.
- China's indicators are on average better than those of the largest partners included in the current EU PTA plan. This is an important information to monitor during the coming decades as and when the question of a China-EU PTA will become more pressing (if the WTO negotiations are still stuck).
- the ten Chinese provinces in which the Taiwanese firms have heavily invested are always in the top tier in China.

In short, the JEU and TEU PTAs offer much better opportunities of regulatory improvement in the EU than the current EU PTA plan, hence can much better contribute to the EU pro-growth reform agenda.

Section 5. Questions raised by the JEU and TEU PTAs

The JEU and TEU PTAs are the best trade deals for buttressing and boosting the EUMS domestic pro-growth agendas (leaving aside a Transatlantic PTA). That said, they raise a wide range of questions that go well beyond the scope of this paper and that are addressed in a companion paper [Messerlin 2012]. This section presents some of these key questions.

First, there are questions related to the negotiating process *per se*. Japan, Taiwan and the EU have to find innovative solutions to address the following questions:

- is it possible to design the PTAs in such a way that first results could be reached and implemented quickly? A "sequencing" is desirable because negotiating a fully-fledged PTA could easily require three years – a long delay before PTAs could fully play their key role as a support to domestic pro-growth agendas. A sequencing is fully compatible with ambitious PTAs. Studies show that markets do recognize the value of early even though incomplete regulatory reforms, creating by the same token dynamics favorable to deeper domestic reforms. For instance, industrial tariffs among EU countries were cut by almost half when the EUMS could reach an agreement on how to deal (arguably badly, but that is not the point) with farm products, consolidating the EU integration process.

- such a sequencing is useful because the JEU and TEU PTAs will focus on regulatory issues (norms, services, etc.) very demanding in terms of new negotiating principles (mutual evaluation, negative lists) and negotiating machinery. Add in the EU case that the EUMS are still largely dominant in writing regulations, and that they are totally in charge in implementing them – both features explain the wide variations in the regulatory quality of the various EUMS cohorts. How then to re-shape the existing EU negotiating machinery that was well adapted to the trade issues of the 1980s-2000s (tariffs or rules of origin) but that is not well suited to the regulatory issues?
- finally, such a sequencing would allow to build trust not only among Japan, Taiwan and the EU, but also with third countries closely connected with Japan, Taiwan and the EU, as illustrated by two emblematic countries, Korea and China. The case of Korea copes with the past. The current Korea-EU PTA has no "most-favored nation" (MFN) clause for critical issues (norms in goods, services). As a result, more favorable concessions between (say) Japan and the EU could reduce the benefits of the Korea-EU PTA which in turn could trigger negative spill-over impacts on the EU and Japan. The case of China copes with the future. The TEU PTA raises obviously the question of the future China-EU trade and economic relations which could well require a PTA if the WTO negotiations are not reactivated. Far to be a political threat, the TEU PTA should thus be designed in such a way that it offers attractive prospects for truly meaningful China-EU trade and economic relations. Last but not least, both cases (Korea and China) represent a trust-building exercise essential for minimizing the damages that these PTAs could do to the world trade system.

Second, the JEU and TEU alone don't constitute a fully fledged EU PTA "strategy" in Asia, if only because they involve no country from the "Emerging Asia" region, except China via the TEU PTA. The close trade and economic links between Japan and Taiwan on the one hand and on the other hand the ASEAN countries (as well as the EU PTAs with Singapore and Malaysia) suggest the ASEAN countries, Australia and New Zealand as the first "natural" components of such a EU strategy. In this context, it is interesting to note that the "ASEAN centrality" has many common points with the “Benelux centrality” that played such a key role in the creation of the EU from the 1950s to the 1970s.

Concluding remarks

To sum up, the current EU PTA plan does not fit the quest for urgent growth needed by an heavily indebted EU. It cannot buttress and boost the EUMS domestic pro-growth agendas because it includes too many EU partners which are too small compared to today EU mammoth economy, too hesitant (to say the least) in their trade and regulatory policies, and not really attractive before (at least) a couple of decades in terms of growth.

Negotiating with Japan and Taiwan offers a much better support to the EUMS domestic pro-growth agendas because these countries are large enough to have the fastest impact on the EU economy, persistent enough in their pro-market trade and regulatory policies, and rich enough in their PTAs networks in Asia (including with respect to China) to offer long term perspectives to the EU in the whole East Asia.

More broadly, the upcoming tectonic shifts in the international relations call for serious thinking on how to combine trade policy and foreign policy – not an easy exercise, particularly for the EU. On the one hand, imposing overly idealistic foreign policy objectives on trade policy by coupling “framework” agreements with trade agreements does not serve well both policies. On the other hand, trade policy should be subjected to foreign policy to the extent that the latter has a wider, longer term perspective (including with the EU close neighbours [Messerlin et alii 2011]), compared to a trade policy too easily myopic.

The cliché “*the EU is the biggest global player in international trade and investment*” still prevails in Brussels. It is much less so in the EUMS which have a deeper sense of foreign policy matters – it is not an accident that a relatively small EUMS is taking the initiative to put the Japan-EU PTA on the EU agenda. The Brussels cliché will be totally outdated within a few years. The large emerging countries followed by the rest of the world have already factored in this historic turn (with the great help of the euro crisis). As a result, sticking to statements that become less credible every day would be a fatal mistake for the EU.

These upcoming deep changes may trigger a deep feeling of powerlessness among the Europeans who have been accustomed to see their country as the "largest" world powers for two centuries. But, the Europeans should learn their full history, not only its last episode. Their brightest successes were when they were small economies facing the mammoth economies of China and India (from the 15th to the 17th century in particular). The European history itself is full of cases where smaller but smarter European countries have successfully challenged larger European countries – Netherlands and France in the 17th century, Britain and France in the early 19th century, etc.

Finally, it is important to stress that the huge EU handicap in East Asia has not its origins in East Asia. East Asian countries have been patient "demandeurs" of EU as a source of diffusing the mounting tensions in their region. The EU ignorance of East Asia during the 1980s, its patronizing approach during the 1990s, and its inertia during the 2000s have been the main problems.

The worst mistake that the EU could do at this stage is to believe that it has time to correct its past errors. It has not. India is emerging fast as the substitute to the EU "balancing" role in East Asia. Its expected GDP growth for the years 2010-2050 as well as the almost certain fact that India will be by far the most populated country in the world by 2050 (India's population is expected to be 30 to 50 percent larger than China's population) leave no chance to a slow moving EU. In short, the EU should become a trusted partner of key East Asian countries by 2020 if it wants to be a significant player in this region, hence in the world, in the long term.

Nothing is lost for the EU if it grabs energetically the existing opportunities in the coming few years. But, that requires swift and deep changes in the EU mindset and strategy.

References

Ahnlid, Anders. 2012. The EU Meeting the Asian Trade Challenge – from Follower to Forerunner? In "EU-Asia and the re-polarization of the global economic arena". Lars Oxelheim, Editor. World Scientific and Imperial College Press. Singapore and London.

Buiter, Willem and Ebrahim Rahbari, 2011. Trade transformed –The emerging corridors if trade power. 18 October 2011. CITI Global Perspective Solutions (GPS). CITI.

Chen, Yung-hsiang, 2010. Contributions of Taiwanese companies to the economic development of Mainland China. (document in Chinese) Center for Asian Studies. National Tapei University.

Dreyer, Iana, Fredrik Erixon, Hosuk Lee-Makiyama and Razeen Sally, 2010. Beyond geopolitics – The case for a free trade accord between Europe and Taiwan. Occasional paper 3/2010. ECIPE, Brussels.

European Commisssion, 2006. Global Europe: Competing in the World – A contribution to the Growth and Jobs Strategy. European Commission. Brussels.

Findlay, Christopher, 2012. The EU crisis: Where is the growth strategy? January 2012. Draft mimeo. Groupe d'Economie Mondiale at Sciences Po. Paris.

Hung, Jia-ke and Chen-yuan Tung, 2009. Contributions of Taiwanese Businesspeople to the economic development of China, 1988-2008. (document in Chinese) Graduate Institute of Development Studies, National Chengchi University.

Lee-Makiyama, Hosuk, 2011. Multilateralism or bilateralism – which path for Europe? ECIPE. Brussels.

Messerlin, Patrick. 2011. Motives and political economy of preferential trade agreements: Lessons for the U.S. and the EU. November 2011. Draft mimeo. Groupe d'Economie Mondiale at Sciences Po. Paris.

Messerlin, Patrick, Michael Emerson, Gia Janderi and Alexandre Le Vernoy, 2011. An appraisal of the EU's trade policy towards its Eastern neighbours: The case of Georgia. Groupe d'Economie Mondiale at Sciences Po and Center for European Policy Studies. Paris and Brussels.

Messerlin, Patrick. 2012 (forthcoming). The EU Preferential Trade Agreements: Negotiating with Japan and Taiwan. Groupe d'Economie Mondiale at Sciences Po. Paris.

Transatlantic Task Force on Trade and Investment. 2012. A New Era for Transatlantic Trade Leadership. ECIPE and German Marshall Fund of the United States. Brussels and Washington.

Vitalis, Vangelis. 2010. The Rise of Asia-Pacific FTAs: 'Stumbling Blocks' no More? Conference Paper presented at Asian FTAs: The Way Forward. Asian Development Bank Boao Forum. Beijing 8-9 December 2010.

Annex A. More on the desirability of the Japan-EU and Taiwan-EU PTAs

The main text of this paper has voluntarily relied on facts as simple as possible in order to be as robust as possible. It did not mention the available estimates of the real GDP gains that would be delivered to each of four largest world economies by PTA with other countries. This is because such estimates depend on a host of assumptions that make them hard to interpret by non-economists.

However, it is important to check whether the policy recommendations of the main text are supported or not by the available economic calculations on real GDP gains focusing on Asian economies (Kawasaki 2011). To keep things as simple as possible, Table A1 gives an index of 100 to the bilateral PTA that would provide the highest real GDP gains for the large country in question – for instance, the China-EU PTA in the case of the EU. It ranks the other partners as a proportion of the gains provided by a PTA with the large country in question: for instance, the Japan-EU PTA is the second most profitable PTA for the EU, and it is expected to provide real GDP gains amounting to 57 percent of those provided by the China-EU PTA.[13] All the real GDP gains mentioned in Table A1 are due to the elimination of the tariffs between the two PTA partners. They do not take into account regulatory barriers ("non-tariff measures").

Table A1. Estimated real GDP gains from bilateral trade agreements, selected countries

	EU		USA		China		Japan		Korea	
Rank	Partner	Index	Partner	Index	Partner	Index	Partner	Index	Partner	Index
1	China	100	EU	100	EU	100	China	100	China	100
2	Japan	57	China	92	USA	76	USA	60	USA	43
3	Russia	48	Japan	62	Japan	67	Thailand	57	EU	41
4	India	38	Korea	27	Korea	4	EU	47	Japan	38
5	USA	38	Taiwan	19	Taiwan	4	Australia	25	Thailand	2
6	Thailand	33	Thailand	17	Thailand	2	Korea	23	Vietnam	2
7	Korea	33	India	15	Hong Kong	2	Taiwan	13	India	1
8	Taiwan	19	Malaysia	14	Malaysia	1	Malaysia	13	Malaysia	1

Source: Kawasaki 2011.

Table A1 suggests three key lessons in the case of the EU.

[13] Such indexes allow to focus on the ranking, that is, the most urgent PTA to conclude.

- The PTA with China would provide the highest real GDP gains to the EU. This result reflects the fact that the calculations reported in Table A1 are limited to the goods sectors, hence that they leave aside services which are likely to be the key source of gains of a PTA with the US (for instance). However, the ongoing rapid growth of the services sector in China implies that this result is likely to foreshadow the situation within a couple of decades.
- The JEU PTA would provide the second highest real GDP gains to the EU, confirming the urgency to open negotiations with Japan and to conclude them. Table A1 shows an interesting symmetry: this PTA exhibits a relatively similar index for Japan's real GDP gains. Such a symmetry suggests potential balanced benefits for both sides.
- An EU PTA with Taiwan ranks eight. This score deserves four remarks. First, Table A1 calculations have been done before the Russian accession to the WTO, meaning that they over-estimate the gains from a Russia-EU PTA (a substantial amount of these gains will be now channeled by Russia's liberalization within the WTO context). Second, as underlined above, it takes two to tango: Russia's and India's current trade policies are not very much inclined to further liberalization. Last but not least, these calculations do not take into account the full magnitude of the activities of the Taiwanese firms (the "Chiwan" perspective).

In short, the above estimates support largely the policy recommendations of the main text.

Reference

Kawasaki, Kenichi, 2011. Impact of Trade Liberalization: Economic Model Simulations. Conference on the Future of the Japan-EU Free Trade Area, Keio University. October, 29, 2011.