



## The EU Pivoting to East Asia

### Patrick A. Messerlin<sup>1</sup>

The euro-crisis seems to calm down, but it is far from being over. The “debt walls” that budgetary cuts are leaving in many EU Member States (EUMS) are higher than those predicted a year ago. It will take several years to the agreed institutional changes (Banking Union) before making a noticeable impact.

Less visible, but more pernicious and damaging, is the attrition of competition generated by several years of crisis—in the EU as well as in the rest of the world. For instance, the financial markets have witnessed a severe decrease in the number of operators in many countries for two reasons: many incumbent banks had to retreat from foreign markets in order to consolidate their domestic situation, and the new regulations have made entry of newcomers more difficult. Such a general attrition of competition is not conducive to growth. Rather, it favors rents for the most powerful vested interests. Such a mix—sluggish growth (including in Germany), increased inequalities, never ending fiscal austerity—is a sure recipe for serious political turmoil.

At the same time, the world is a much more difficult place that it used to be. Since the Second World War, the usual solution to difficult situations like the current one was a joint effort by the major economies to improve mutual access to their markets in order to buttress their domestic reforms. Multilateral trade liberalization in the GATT forum was never done for its own sake: it was used as a key instrument for boosting the domestic growth of each country.

Unfortunately, this multilateral option is not available today since the Doha Round is probably stuck for a (very) long time. The only instrument left for boosting domestic growth and buttressing domestic reforms are preferential trade agreements (PTAs). But, PTAs are hard to

---

<sup>1</sup> ECIPE, Brussels and Sciences Po, Paris. This paper is an abridged version of two more detailed papers [Messerlin 2012a and 2012b]. I would like to thank very much Anders Ahnliid, Roy Chun Lee, Thomas Harris, Sahoko Kaji, Hosuk Lee-Makiyama, Sébastien Miroudot and Vangelis Vitalis for their very thoughtful comments. All remaining errors are mine.

master because they are intrinsically discriminatory. If they ease trade between the two signatories, it is often at the detriment of the trade between each signatory and the rest of the world.

These domestic and international difficult contexts require that the EU designs a PTA policy which offers the best solution to two key questions:

- which are the PTAs most likely to boost most EU growth, and to buttress the necessary domestic reforms?
- which are the PTAs most likely to eliminate risks of costly discrimination against EU firms that can be generated by the PTAs concluded by other countries?

Sections 1 and 2 show that these two questions have the same answer: the EU should conclude as quickly as possible a PTA with Japan and Taiwan which are the most powerful “locomotives” capable to tract the huge EU stuck train. Section 3 examines key negotiating issues raised by such a EU “pivoting” to East Asia. Section 4 concludes.

### **Section 1. The EU pivoting as a “EU growth” policy**

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. There is now ample evidence that PTAs unable to boost domestic growth will not attract the attention of EU top policy-makers (heads of state or government, key ministers). As a result, these PTAs are doomed to be captured by narrow vested interests, hence to deliver limited (if any) results while fuelling bitter political domestic fights.<sup>2</sup>

#### Criteria for choosing the best PTA partners

WTO negotiations would have effortlessly provided to the debt-ridden, no-growth EU economy what it needs most: a better access to the largest, fastest growing and best regulated market

---

<sup>2</sup> As illustrated by the endless debates in the US Congress on PTAs with countries (Columbia or Peru) too small for contributing in anyway to the U.S. pro-growth reform agenda, and increasingly by the debates at the EU Parliament.

economies. The simultaneous opening of the main world economies under the WTO non-discriminatory Doha Round would have ensured the EU businesses to always find the economies best meeting these key conditions at any point of time.

In contrast, PTAs require to find out, before entering into negotiations, which will be the most promising countries from a growth perspective for the next decade or two [Lee-Makiyama 2011]. The growth potential of a partner has two main dimensions—economic size and regulatory quality:

- the bigger the partner’s markets, the more the EU firms could 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 EU relative prices of goods and services, that is, to deliver cheaper and more diverse products and services to the EU consumers.
- the better regulated the partner, the more likely dynamic its economy, 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 trading partner to its own firms. Better regulations are powerful instruments to change the relative prices of goods and services.

Last but not least, timing is a crucial criterion of choice because 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 is of little interest for the EU 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 EU growth.

#### Which countries fulfill best these criteria?

Table 1 lists the main countries with which the EU is currently negotiating PTAs (or is prepared to negotiate). It adds the largest East Asian economies—including “Chiwan”, an entity created by the Korean press for capturing the combined operations of the Taiwanese firms in Taiwan and

in Mainland.<sup>3</sup> Columns 1 and 2 assess the pro-growth potential for the EU of these various PTAs by calculating an “EU market expansion” indicator for every PTA which is defined as the ratio of the GDP of the EU PTA partner to the EU GDP. Such ratios give a crude sense of the potential scale economies and range of varieties of goods that the PTA in question could offer to the EU firms, hence of its potential contribution to the EU pro-growth agenda.

Table 1 calculates these indicators for 2010 and 2030. The 2030 GDPs have been calculated by using the growth rates estimated by Buitter and Rahbari [2011] for the main economic regions of the world.

**Table 1. Looking for the best PTA partners for the EU**

	EU market expansion (% EU GDP)		Regulatory quality rankings	
	2010	2030	[a]	[b]
	1	2	3	4
<b>A. Enforced EU PTAs with an East-Asian country</b>				
EU	100.0	100.0	5 to 100	2 to 83
Korea	6.3	6.7	8	22
<b>B. Main negotiations launched by the EU since 2006</b>				
Canada	9.7	10.3	13	10
Indonesia	4.4	20.3	129	44
India	10.7	49.7	132	51
Brazil	12.9	23.5	126	58
Russia	9.1	20.2	120	63
<b>C. A pro-growth EU PTA policy</b>				
Japan	33.9	36.1	20	6
Taiwan	2.7	7.6	25	13
Chiwan (low)	3.6	10.4	(na)	(na)
Chiwan (high)	5.1	14.6	(na)	(na)
China	36.2	168.6	91	27

Notes: [a] and [b] Ranks of countries: the highest the country’s rank, the poorest its regulatory performance. [a] Ease of doing business [Doing Business 2012]. [b] Overall index, Global Competitiveness Index [World Economic

<sup>3</sup> Taiwan is generally seen as a middle-sized economy (half Korea’s). But that assessment ignores the 13-15 to 20-23 millions of people working in the plants run by Taiwan-based firms in Mainland. Table 1 is based on the lowest estimate of 14 millions of workers. It calculates “low” and “high” estimates of the GDP produced by these Taiwanese firms which operate mostly in ten Mainland’s provinces. Adding these two estimates to Taiwan’s GDP gives the “Chiwan-Low” and “Chiwan-High” estimates quoted in Table 1 (for details see Messerlin [2012a]).

Forum 2011]. For the EU, only the ranks for the lowest (best) and highest (worst) EUMS are reported (no information on Malta). Sources: Buiters and Rahbari [2011] for growth estimates and WTO Trade Profiles for the GDP of the individual countries and regions. Author's calculations.

Columns 1 and 2 provide three key observations.

- in 2010, Japan's economy is as large as those combined of Brazil, India and Russia. As a result, a PTA with Japan alone provides the same market expansion opportunities (scale and scope economies) to the EU firms and consumers than the three PTAs with Brazil, India and Russia.
- shifting to 2030, only India could be expected to offer better growth opportunities than Japan whereas Brazil and Russia remain less attractive than Japan.<sup>4</sup> These results reflect partly the relative growth of India, Brazil and Russia, partly the relative decline of the EU in the world economy.<sup>5</sup> The relative growth of India, Brazil and Russia compared to the world economy (not to the EU) is not attractive either: Brazil and Russia do not improve substantially their shares in the world economy.
- China appears as the most attractive EU partner in pure economic terms. Interestingly, these results are perfectly consistent with estimates based on much more sophisticated techniques which show the China-EU and Japan-EU as the two PTAs generating the highest welfare (real GDP) gains for the EU [Kawasaki 2011].

Regulatory quality is the second key criterion for choosing the best PTA partners. "21<sup>st</sup> century" PTAs will mostly deal with regulatory issues, such as norms in goods, regulations shaping services markets, intellectual property rights, etc. PTAs with partners exhibiting better regulatory quality offer an additional channel to boost EU 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—a motive crucial in EUMS, such as France, reluctant to review their own regulations.

---

<sup>4</sup> These estimates have been used because they have a very useful feature: they are among the highest and fastest estimates growth for emerging economies (see Asian Development Bank [2011] for alternative scenarii). As a result, they underestimate the benefits of EU PTAs with the developed Asian economies, hence making even more robust the suggestions of this paper. Meanwhile, this feature has no impact on the urgency of the EU pivoting which is driven by EU domestic concerns—the urgent need of more growth in the EU.

<sup>5</sup> Buiters and Rhabari predict that the EU share in the world GDP would be divided by two by 2030.

Columns 3 and 4 of Table 1 provide two simple indicators on regulatory quality for the EU PTA partners. It also provides the highest (i.e., worst) and lowest (i.e., best) ranks among the 27 EUMS. Although these indicators rely on very different (admittedly crude) methodologies, they provide converging conclusions of the ranking in terms of regulatory quality.

Columns 3 and 4 provide four observations:

- Japan and Taiwan are, on average, better regulated than most EUMS. Japan's rank is better than the rank of 20 and 24 EUMS (respectively Doing Business and World Economic Forum indicators) while Taiwan's rank is better than the rank of 18 and 20 EUMS.
- the largest countries with whom the EU is currently negotiating PTAs exhibit low regulatory quality, another reason for them to fail to boost EU growth.
- China's indicators are much behind in terms of regulatory quality, but they are on average better than those of the large partners involved in the ongoing PTA negotiations.
- the vastly diverse regulatory quality among the EUMS is an invitation to review the EU Internal Market. Interestingly, being among the first countries to join the EU has not been a guarantee of better regulations (the worse ranking of the six founding EUMS is 100 and 48, respectively), and joining late the EU has not been necessarily an handicap.

To sum up, the key criteria for choosing the PTA partners best capable to boost EU growth provides a very clear answer:

- the EU should “pivot” to Japan and Taiwan as quickly as possible as they emerge as the only true “locomotives” capable to move the huge EU train.
- The EU should start to prepare to do the same with China in the long term, if the Doha Round continues to be stuck and if China improves its regulatory quality.
- the current PTAs under negotiations have very limited pro-growth traction for the EU before the 2030s. The economic size and/or the regulatory quality of the countries with which the EU is currently negotiating is too low and/or too distant to boost the EU growth in a significant way.

These conclusions imply a dramatic change of the current EU PTA strategy. Managing such a change raises important problems examined in section 3. One of these problems should be addressed now: what would be China’s reaction to a Taiwan-EU PTA? The One China policy has not stopped China itself from doing a FTA with Taiwan. Taiwan is negotiating FTAs with Singapore and New Zealand. Japan, the world’s third largest economy (who is even more careful in its political consideration to China than the EU) has already signed an investment treaty with Taiwan. In these conditions, why would the case be different for the EU if the EU and Taiwan ensures that a Taiwan-EU PTA will be beneficial to China?

**Section 3. The EU pivoting as an “insurance” policy<sup>6</sup>**

The Doha Round stalemate has sent the world trade system into uncharted waters. Highly unlikely until now, PTAs among the largest world countries are to become a reality. Table 2 describes the current situation of the four world largest economies, and stresses how different it is. Far to be the “demandeur”, as often believed in the EU, Japan is in the best situation because it enjoys the widest range of choices: it is the only mammoth economy having an ongoing PTA option with the three other mammoth economies; and it has already a rich network of PTAs with the ASEAN countries as well as a bilateral investment agreement with Taiwan. The EU and the US have only two options: a PTA with Japan and a PTA among themselves. China looks in the least enviable situation, with an elusive China-Korea-Japan (CKJ) PTA. But, Korea is changing the game by pursuing bilateral talks with China, clearly a process that should re-energize the CKJ project.

**Table 2. PTAs among large countries: the state of the negotiations (November 2012)**

	Share (%) of world GDP	EU27	USA	China	Japan
<b>EU27</b>	<b>26.6</b>		<i>Transatlantic</i>		<i>JEU</i>
<b>USA</b>	<b>23.9</b>	<i>Transatlantic</i>			<b>TPP</b>
<b>China</b>	<b>9.6</b>				<i>CKJ</i>
<b>Japan</b>	<b>9.0</b>	<i>JEU</i>	<b>TPP</b>	<i>CKJ</i>	

<sup>6</sup> This section relies heavily on Messerlin [2012b] which examines the insurance objective in more details.

Notes: Entries in italics indicate that the discussions are at a preliminary stage (joint study, scoping exercise, etc.). CKJ: China-Korea-Japan PTA. JEU: Japan-EU PTA. TPP : TransPacific Partnership. Source: GDP 2010 data from WTO Trade Profiles, WTO website.

## The TPP and Japan

Table 2 allows to realize that the main risks of discrimination against EU firms come in the short run from the TransPacific Partnership (TPP). As of today, the TPP involves ten countries in addition to the US (Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam, Canada and Mexico). Japan is invited to join. It is by far the largest economy of the TPP11 (all the above countries, including Japan and excluding the US) since it represents 55 percent of the TPP11 GDP. In other words, the risks of discrimination against EU firms associated to the TPP are largely related to the Japanese membership to the TPP.

Since the TPP is so crucial, it is important to understand the motives driving the strong US push for the TPP. One could invoke many trade-related motives: the failure of Doha negotiations at the WTO, the fact that TPP is a preferential trade agreement, hence benefits from a better support from the US business community than WTO negotiations, the domestic fight between Republicans and Democrats on trade policy, the US foreign policy's willingness to regain a foothold in this key part of the world—the TPP has prepared the US “pivoting” to East Asia.

But, the most important motive behind the strong US involvement in the TPP is the frontal opposition of China and the US on China's role in the world governance, hence in the world trading system among other international fora. The US does not want China to continue to benefit from the (limited) “special and differential treatment” it enjoys in the current WTO. As a result, the US is looking at the TPP as the future multilateral trade institution—a WTO “version 2.0”. The best chances to get such a result is to first negotiate the TPP rules and disciplines among the ten (small to middle) countries involved, then ask Japan to join with little room for amending those rules and disciplines (a kind of remake of the British accession to the EU). A



TPP including Japan would then compel China to join the TPP with no “special and differential treatment”.

In sharp contrast, China is very frustrated by the fact that the very drastic conditions for its WTO recent accession have not induced its WTO partners to lower their demands of concessions from China in the Doha Round. And China stresses that the large share of truly poor people in its total population makes it clearly eligible as a developing country. Last but not least, China feels unprepared for playing a leading role in world affairs—echoing the US difficulties to play such a role during the first half of the 20th century.

### Assessing the risks of discrimination of the TPP for the EU firms

The risks of TPP discriminatory impacts on EU economies depend on three key components of trade policy that distort TPP and EU countries’ comparative advantages:

- the initial protection of the TPP countries,
- the TPP ability to achieve a “deep” liberalization by eliminating all the tariffs, removing the barriers to trade in goods behind the borders, opening widely services markets, etc.
- the long term competition dynamics that TPP common rules could generate.

The higher the initial protection of the TPP countries, the deeper the intra-TPP liberalization, and the stronger the long term competition dynamics, the higher the risks of massive discriminatory impacts on the EU firms.

What follows focuses on the first factor—the initial protection in TPP member countries because it is too early to assess the second and third factors. It is limited to barriers on product markets, on service markets and on international investment since there are still a lot of uncertainties on other key issues, such as intellectual property rights and public procurement.

Table 3 presents the magnitude of the discriminatory risks, calculated as the sum of the TPP11 GDPs fulfilling the defined protection criterion. Table 3 shows many sources of important risks:

- in agriculture, three-fourth of the eleven East Asian TPP countries will discriminate against the EU, mostly via tariffs. As the TPP includes five of the most efficient and

important world exporters for many agricultural products (Australia, Canada, Chile, New Zealand and the US) the agreement will obviously constitute a deadly threat to European exporters of agricultural products. French farmers are expected to be the most hurt.

- in manufacturing, risks seem low, as far as applied tariff averages are considered. However, low tariff averages could co-exist with high tariffs on products of key interest to European firms. There are many such high tariffs (over a quarter of the lines in the Community Customs Code of these countries). Moreover, many TPP11 countries have not consolidated yet their customs duties at the WTO. Should imports from other TPP countries increase strongly, the TPP11 countries with no PTA with the EU could increase their applied tariffs up to their consolidated level without any infringement of WTO rules. Risks would be lower with the TPP11 countries having already a PTA with the EU only if the PTA between the EU and those countries has eliminated these high tariffs, a feature to be checked.

**Table 3. Assessing the risks of discriminatory impacts of the TPP against EU firms**

	Magnitude of the risks [a]	Criteria used to classify a TPP country as "highly protected" [b]
<b>Border barriers</b>		
<b>Tariffs</b>		
<b>agriculture</b>		
applied	73.4	TPP11 countries with average tariff higher than 10 percent
bound	75.7	TPP11 countries with average tariff higher than 10 percent
<b>manufacturing</b>		
applied	0.0	TPP11 countries with average tariff higher than 10 percent
bound	13.9	TPP11 countries with average tariff higher than 10 percent
"high"	29.5	TPP11 countries with high bound tariffs lines > 25% all tariff lines
Trans-border trade	43.3	TPP11 countries not included in the 18 top countries [c]
	30.5	TPP11 countries not included in the 36 top countries [d]
<b>Behind the borders barriers</b>		
Norms in agriculture and industry		no systematic information available
Services	89.9	TPP11 countries with an index > 30 [e]
	28.5	TPP11 countries with an index > 40 [e]
<b>International investment</b>		
transport	100.0	TPP11 countries with an index > 20 [f]
telecoms	96.2	TPP11 countries with an index > 20 [f]
media	40.9	TPP11 countries with an index > 20 [f]
financial services	12.3	TPP11 countries with an index > 20 [f]
real estate	11.3	TPP11 countries with an index > 20 [f]
all others	0.0	TPP11 countries with an index > 20 [f]

Source: Annex A. Notes: [a] the magnitude of the discriminatory impacts is calculated as the share of the GDP of the “highly protected” TPP11 countries in the GDP of all the TPP11 members. TPP11 countries are all the countries at some stage of the negotiations (excluding the US) plus Japan. [b] This column presents the various criteria for defining a “high” level of protection. [c] The indicator is the rank of the Doing Business indicator on trans-border trade. Only Japan is among the 18 top countries. [d] The indicator is the rank of the Doing Business indicator on trans-border trade. Only Japan and Australia are among the 36 top countries. [e] OECD PMR (Product Market Regulations) indicators (0 means a totally open country, 100 a totally closed). [d] OECD foreign direct investment restrictiveness indicators (0 means a totally open country, 100 a totally closed).

- cross-border trade barriers are important non tariff measures. One third to half of the TPP11 countries ranks poorly in this field. They may thus discriminate heavily against European exporters, either by applying the discriminatory rules which could be generated by the TPP, or by discriminatorily enforcing rules that are not discriminatory *per se*.
- in services and international investment, a vast majority of the TPP11 countries show important risks of discriminatory impacts towards the EU in services and international investment—with a strong concentration of risks on services crucial for international trade (transportation, telecoms, etc.). As France is a large exporter of services, it is expected to face strong discriminatory impacts.

To sum up, the insurance objective—the precautionary principle—dictates to the EU to negotiate a PTA with Japan as quickly as possible for insuring EU firms against any risk of discriminatory treatment because of the TPP. Arguing that the EU should wait for a successful conclusion of the TPP negotiations misses two important points. First is the urgent EU quest for more growth. Second, an insurance works only if implemented before the accident: the EU would have much more difficulties to conclude a meaningful PTA with a Japan member of the TPP than with a Japan before joining the TPP. Such a late move of the EU will be seen by Japan and all the major countries as an inglorious surrender.

### The CKJ, ECFA and Taiwan

The TPP is potentially the most discriminatory PTA against EU firms in the short and medium term because it is larger and much deeper than its emerging challenger—the China-Korea-Japan (CKJ) agreement. Moreover, the TPP has re-energized East Asian efforts to build an East Asian free trade area, as best illustrated by the re-launch of the discussions on the CKJ agreement last

year. There is no doubt that the CKJ will generate severe risks of discriminatory impacts against EU exporters in the long run.

In this context, the Taiwan-EU PTA fulfills also an insurance objective, and the EU should be well advised to mimic what Korea is doing. Like the EU, Korea is threatened by the TPP to the extent that it has not yet a PTA with Japan, and by the China-Taiwan ECFA [Dreyer et al. 2010] to the extent that it has not yet a PTA with China.<sup>7</sup> As a result, Korea has started bilateral trade negotiations with China in January 2012. In turn, these negotiations have also re-energized the CKJ agreement which can then play a dual role for Korea: the CKJ “Japanese leg” is Korea’s insurance policy against a TPP that would include Japan; the CKJ “Chinese leg” is Korea’s insurance policy against the China-Taiwan ECFA.<sup>8</sup>

### **Section 3. Managing the pivoting to East Asia**

The EU pivoting to East Asia will be successful—that is, will boost EU growth—only if it generates “deep” integration. Achieving such a goal requires addressing the complex obstacles to a better functioning of the markets in modern economies, such as unjustified technical norms or inappropriate market regulations in services, etc. As a result, negotiators face a serious challenge. On the one hand, the Japan-EU and Taiwan-EU PTAs have to deliver some results fast enough in order to convince the world markets that the signatories are serious about boosting growth by opening mutually their domestic markets. On the other hand, these PTAs have to deal with intrinsically complex issues, some of them easy, but others being much more difficult, hence requiring time to be solved in a satisfactory way.

---

<sup>7</sup> However, there is one important difference between Korea and the EU: Korea is less exposed to the Atlantic component of the TPP since it has already a trade agreement with the US.

<sup>8</sup> Korea’s PTA policy offers a striking contrast to the EU one. By signing 12 PTAs only during the late 2000s, Korea has been able to open 67 percent of the world markets to its firms, an achievement not so far from what could have been delivered by the Doha Round. 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.

Facing successfully this challenge requires an honest reality check from the EU, the use of the best negotiating tools that have emerged from the last sixty years of trade negotiations, and a careful management of the EU trading partners other than Japan and Taiwan.

### The great need for a reality check

The last two years, the EU has entered into the Japan-EU discussions with the assumption that Japan is more closed than the EU.

There is no proof supporting this assumption. Indeed, recent evidence goes in the opposite direction, as best illustrated by the issue of public procurements which has been one of the most contentious points of discussions between the EU and Japan. Table 4 summarizes the results of the impact assessment working study done by the Commission as a background paper for the Regulation establishing rules on the access of third countries' goods and services to the EU internal market in public procurement [Commission 2012]. Only the so-called *de jure* figures of this study have been quoted by EU officials: they suggest a huge gap between the shares of the public procurement markets open to foreign competition in the EU (85 percent) and in Japan (28 percent).

But this is not the real story. The Commission's study notes *en passant* that the EU does not fully apply its *de jure* commitments, but reduced them by using "selective derogations". As a result, the Commission's study concludes that the *de facto* openness of the EU public procurements markets for Japanese firms is not 85 percent, but only 70 percent. By contrast, the Commission's study recognizes that Japan does not use protectionist measures in many public procurement markets not open *de jure*. As a result, it concludes that the *de facto* openness of the Japanese public procurements markets for EU firms is not 28 percent, but 72 percent. In short, the Commission's study shows the Japanese public procurement markets as more open than the EU ones [Messerlin 2012c].

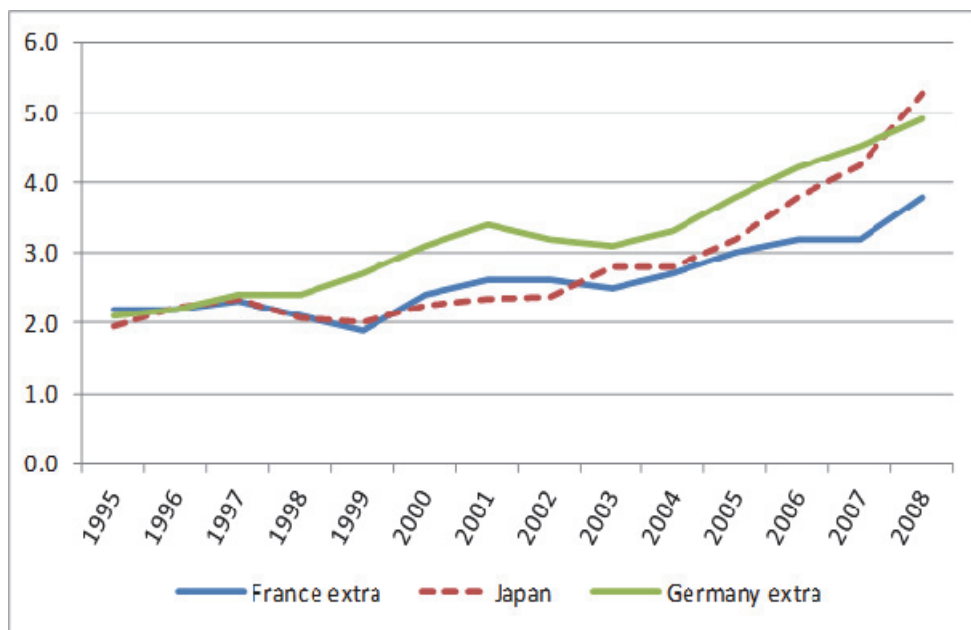
### **Table 4. Reality check in public procurement markets, the EU vs. Japan**

	EU	Japan
<b>de jure openness</b>	<b>85</b>	<b>28</b>
<b>minus specific derogations</b>	<b>15</b>	<b>--</b>
<b>plus effective openness</b>	<b>--</b>	<b>44</b>
<b>de facto openness</b>	<b>70</b>	<b>72</b>

Note: Figures are the shares (in percentage) of the public procurement markets considered as open—at de jure and de facto levels—in the total public procurement markets subjected to GATT disciplines. Source: Commission’s Impact Assessment Working Study, Annex 3, COM(2112) 124 final. Messerlin [2012c].

These results may come as a big surprise for the EU. But, they are corroborated by an analysis based on a very robust and encompassing source—the National Accounts [Messerlin and Miroudot 2012]. Graph 1 compares the openness ratios of France, Germany and Japan (these ratios are defined as the shares of the foreign goods and services consumed by the importing administrations and public entities in the total demand of these administrations and public entities). Clearly, Japanese public procurements markets have become more open than those of France’s and Germany’s.

**Graph 1. The openness ratios in public procurement markets, selected countries, 1995-2008**



Note: Figures are the shares of the foreign goods and services consumed by the country’s administrations and public entities in the total demand of these administrations and public entities. “Extra” means extra-EU trade flows. Source: Messerlin and Miroudot, 2012.

### Using the best negotiating tools

The last sixty years of trade negotiations have shown that a few tools are absolutely critical to make trade agreements capable to boost the domestic growth of their signatories. Interestingly, all these tools were included in the 1957 Treaty of Rome even if some of them have been fully developed only in the following decades.<sup>9</sup> These tools are as follows:

- the agreement should have the most comprehensive possible coverage in terms of sectors to be opened and of barriers to be eliminated. The Treaty of Rome has been the first one to cover explicitly the whole universe of trade in goods and services, and of labor and capital movements.<sup>10</sup> In terms of trade barriers, comprehensiveness requires the notion of “equivalent effect”: all the measures having “equivalent effect” to basic trade barriers (tariffs, export taxes) should be eliminated. If the text of the Treaty of Rome included this notion, it is only in 1979 that the “*Cassis de Dijon*” ruling of the European Court of Justice has made this notion operational for eliminating unjustified technical barriers in goods.
- the exceptions to the coverage should be defined by listing clearly the sectors (products or services) to be excluded from the agreement. All the sectors not listed are deemed fully open. Ideally, such “negative” lists should be reviewed on a regular basis in order to check the legitimacy of the exceptions in the light of public interest. Article 115 of the Treaty of Rome allowed for transitory protection with an annual review mechanism in case of difficulties faced by one EUMS.
- “mutual recognition” among national regulations should be the pillar when dealing with norms in goods or market regulations in services. This notion was also first formulated by the 1979 *Cassis de Dijon* ruling, but it was truly developed much later—by the 1998 Australian-New Zealand Agreement on technical norms in goods and by the 2006 EU Services Directive on regulations in services. Both texts are based on the “unconditional” mutual recognition of their respective regulations by the signatories. Unconditional

---

<sup>9</sup> to understand the reasons of the Treaty success, despite—a point totally forgotten today—the fact that the gap between EUMS GDP per capita was larger than those between the EU’s, Japan’s or Taiwan’s. In the mid-1960s, the GDP per capita of the richest EU region (Hamburg, Germany) was five times the one of the poorest region (Molise, Italy). That did not stop the negotiators to design a very ambitious Treaty.

<sup>10</sup> There were only two exceptions in terms of goods: green coffee and bananas (the latter has been a nightmare for the EU trade policy for the next sixty years). The other “exception” (the steel and coal products subjected to the 1951 Treaty of Paris) also took somewhat 40 years to really include them in the integrated universe of goods.

mutual recognition means that each signatory considers the regulations of the other signatories as fully equivalent to its own regulation. Such an approach often requires a mutual evaluation of their respective regulations by the signatories—an exercise which has the great advantage to induce each signatory to review its own regulations, to check whether they are still justified, and to improve them if necessary in the light of the other signatory's regulations. Unconditional mutual recognition was felt necessary because mutual recognition conditional to some common negotiated principles (as done in the EU services sectors between 1979 and 2006) has led to very disappointing results in terms of effective improved market access because the common negotiated principles have often inhibited potential competition.

- the implementation of the agreement should be progressive, that is, based on a sequencing which makes comprehensiveness politically sustainable. The Treaty of Rome defined three phases for implementing industrial tariff cuts, each phase being conditional to the successful achievement of the previous one (in particular, the second phase was conditional to the adoption of the common agricultural policy). Sequencing is crucial because it gives time to build trust among the signatories. Trust often does not prevail at the start of the implementation of an agreement: in the early 1960s, many observers had strong doubts about the capacity of France and Italy to go very far into the EU integration process.

Sequencing is probably the most difficult part of the exercise. Studies show that markets do recognize the value of early though incomplete regulatory reforms, hence create dynamics favorable to further domestic reforms. A too slow sequencing is unlikely to convince markets of the benefits from the PTA under negotiation. Too fast a sequencing makes politically unbearable comprehensiveness, does not give the time needed for many mutual evaluations (hence limits the use of unconditional mutual recognition) and does not give enough time to build trust.

Caring about the other EU trading partners



Negotiating with Japan and Taiwan requires an EU careful approach of what to do with three countries or groups of countries: the US, China and Korea, and the (too) many countries with which the EU has ongoing negotiations.

Clearly, the US fits the three key conditions for being a good PTA partner of the EU: it is large, dynamic and well regulated. As a result, the EU pivoting to East Asia should not stop the US-EU negotiations on a “Transatlantic marketplace”, and the deep economic links between the US and the EU make this endeavor very attractive. But, paradoxically, these negotiations may be the most difficult ones for the EU, and maybe also for the US. This is due to the fact that the TPP is at the top of the US agenda. As far as one knows, TPP negotiations do not use intensively the four key tools mentioned above—particularly unconditional mutual recognition. In regulatory matters, the US is rather in the negotiating mood that the EU used to have a decade ago: export the US rules and disciplines in order to shape the TPP as much as possible. This is very clear in intellectual property rights, international investment, state-owned enterprises, etc. As a result, the US approach to TPP in the Pacific region seems hard to reconcile with the mutual evaluation approach that the EU will advocate in the Atlantic region (and with Japan and Taiwan).

Second, as already mentioned the EU pivoting to East Asia has backward and forward spillovers in East Asia. Backward spillovers are the indirect negative consequences of the Japan-EU PTA on the Korea-EU PTA. Every time that the Japan-EU PTA would be deeper than the Korea-EU PTA, there will be a need to “upgrade” the Korea-EU PTA. The EU should care about this upgrade in order not to hurt the EU firms which have invested in Korea (and Japan has the same incentives for its firms having invested in Korea). Forward spillovers are the indirect consequences of the Taiwan-EU PTA on the China-EU PTA. It has already been stressed that the Taiwan-EU PTA should probably take the form of a series of partial agreements concluded as time flows rather than one text concluded at the beginning of the implementation period. However, the difference may be more formal than substantial if one takes into account sequencing which implies that some chapters of the Japan-EU will be developed when other chapters will be implemented.

Third, the EU should address the problems generated by its too many ongoing PTAs negotiations. Most of these negotiations are going on for many years (13 years for Mercosur). Such lengthy negotiations have a devastating effect on markets: markets do not expect anymore that such PTAs could have a notable effect on EU growth (leaving aside the substantial reasons justifying markets low expectations mentioned in section 1). The EU has two main options:

- for countries willing to sign a deal, some thinking on an appropriate sequencing should allow to conclude quickly on a large enough number of topics, to start the implementation of “phase one”, while negotiating on “phase 2”.
- for countries which are not so deeply interested in PTA with the EU, such as Brazil and India, it would be better for both sides to give up the notion of a PTA, and to focus negotiations on the few issues where some results could be achieved, such as transfers of technologies, some mutual recognition agreements for some agricultural or industrial norms and for some services.

### **Concluding remarks**

This paper argues for an EU pivoting to East Asia aiming at concluding PTAs with Japan and Taiwan as quickly as possible. These PTAs offer the best available support to the urgent EU need to boost its growth because these two countries are large enough to have the biggest and 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.

This is a critical time for the EU. The time where “*the EU is the biggest global player in international trade and investment*” is gone, a perspective already factored in by all the large countries in the world. In this new context, the notion of “reciprocity based on threats” (i.e., the EU threatening to close its markets in order to get market access to foreign markets) is not credible anymore simply because it causes more harm to the EU than to its large partners. For instance, what can be obtained by threatening to close the EU public procurement markets to Chinese firms when the Chinese public procurement markets have increased from one-eighth of

the combined French and German markets in 1995, to one-third in 2000 and to almost the parity in 2008? What can be obtained to make the negotiations with Japan conditional to the opening of the Japanese beef market to French beef (i) when the EU beef market is not open to Japanese beef, and (ii) when such a request can only push a frustrated Japan into the TPP, opening its beef markets to the Australian and US beef, the end forever of French food—not only beef—exports to Japan?

In short, it is urgent for the EU to adopt an “economic diplomacy” which takes into account the broad key parameters of the emerging new world and which frees governments in charge of the public interest from the narrow-minded, self-defeating private interests.

## References

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

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 Commission. 2012. Commission Staff Working Document. Impact assessment accompanying a proposal for a Regulation establishing rules on the access of third countries' goods and services to the EU internal market in public procurement. COM (2012) 124 final and SWD (2012) 58 final. 21 March 2012.

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.

Lee-Makiyama, Hosuk, 2011. Multilateralism or bilateralism – which path for Europe? ECIPE. Brussels. Available on <http://www.ecipe.org>

Messerlin, Patrick, 2012a, The EU Preferential Trade Agreements: Defining Priorities for a Debt-Ridden, Growth-Starving EU. Available on <http://gem.sciences-po.fr>

Messerlin, Patrick, 2012b, The TPP and the EU policy in East Asia (China Mainland excluded), French Ministry of Foreign Affairs, Direction Générale de la Mondialisation in partnership with Asia Center, Paris. Available on <http://gem.sciences-po.fr>

Messerlin, Patrick. 2012c. Openness in public procurement markets: A fair report of the results of the EU impact assessment. Available on <http://gem.sciences-po.fr>

Messerlin, P. and S. Miroudot. 2012. EU public procurement markets: How open are they? Available on <http://gem.sciences-po.fr>