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Negotiating Mega-Agreements: Lessons from the EU

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Introduction

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

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

The main reason for the WTO relative inefficiency in regulatory matters is the absence of trust among all the WTO Members: no WTO Member trusts all its 159 WTO partners. Trust is needed to overcome two—not one—challenges. First is well known and occurs during the negotiation phase: mistrust then flows from the difficulty to assess the level of regulatory protection (that is, the level of unjustified restrictions to business generated by regulations)

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which exists before the negotiations. The second challenge occurs after the conclusion of an agreement, hence it is rarely mentioned though it is probably the more important: mistrust flows from the even higher difficulty to monitor the fulfilment of the regulatory liberalisation commitments by the trading partner. After concluding a trade deal covering regulations, the trading partner can change a services regulation (or a technical norm) with the best intentions, but can then inadvertently erode the market access negotiated in the deal. This situation (unknown in the case of tariffs where each country can easily monitor whether its trading partners keep their commitments) creates strong disincentives to negotiate on services when the negotiating partners are not trusted.

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

Section 1. The disappointing results of the EU Internal Market

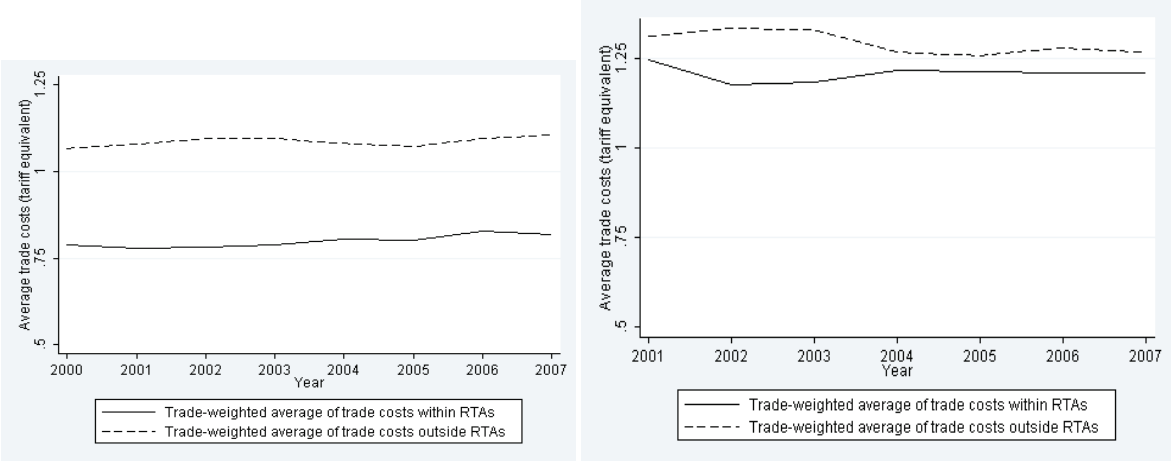
This section provides some basic evidence showing that the EU Internal Market is still a very fragmented market. The focus on the EU is for pure data convenience: it is due to the fact that there are lot of data and evidence on the regulations of the individual Member States of the EU which is the oldest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

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

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

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

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



Source: Miroudot and Shepherd 2011.

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

The still highly fragmented EU Internal Market in services

A more detailed information on barriers in services among EU Member States (EUMS) is provided by the internationally comparable OECD Product Market Regulation (PMR) indicators [OECD 2014]. PMR indicators measure the degree to which competition is inhibited or distorted by regulatory barriers, such as legal and administrative barriers to entrepreneurship, state control of business enterprises, sector-specific anti-competitive regulations, etc. The indicators range from 0 to 100, with 0 standing for a completely open

market and 100 for a completely closed market.[3] Table 1 presents the available PMR indicators on the EUMS regulatory barriers in key services for the years 2003, 2008 and 2013.

Table 1. Regulatory barriers in EUMS services, 2003-2013

	Highest PMR		A: Highest PMR 2013		B: Highest PMR in large EUMS 2013		C: Lowest PMR 2013	
	2003	2008	PMR	EUMS	PMR	EUMS	PMR	EUMS
Electricity	68	67	54	Estonia	53	France	15	Spain
Gas	89	69	63	Greece	42	France	0	Britain
Post	78	72	56	Slovenia	56	Italy	11	Netherlands
Telecoms	52	38	33	Slovenia	19	Germany	5	Britain
Airlines	82	83	59	Slovenia	8	France	0	5 EUMS [b]
Rail	100	88	81	Ireland	67	Spain	4	Britain
Road	100	71	71	Italy	--	--	25	8 EUMS [c]
Retail	78	76	68	Belgium	53	Italy	10	Sweden
Prof. services [a]	59	50	48	Hungary	44	Germany	9	Sweden

Notes: [a] Accounting, Architect, Engineer, Legal. The "large" EUMS are Britain, France, Germany, Italy and Spain. [b] Austria, Germany, Greece, Hungary, Slovakia. [b] Austria, Denmark, Finland, Germany, Ireland, Slovakia, Sweden and Britain. Source: OECD [2014].

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

The bad news is the survival of huge differences between the highest and lowest PMR among the EUMS, despite massive integration efforts—the so-called Internal Market programme which was supposed to bring down the intra-EU barriers consists in more than 600 EU laws ("Directives"). Such differences are the best (though indirect) indicator of a still fragmented Internal Market for the following reason: it would make no sense for a EUMS to keep high PMR (protection) with respect to non-EU countries if the firms from non-EU countries could operate from the low-PMR EUMS without similar intra-EU barriers. In sum, there are good reasons to believe that those PMR reflect the true extra- and intra-EU level of protection. This first result raises an important question. Does a similar picture prevail in the other mammoth economies, such as the US (barriers among US States) China (barriers among Chinese provinces) or Japan (barriers among Japanese prefectures)? Anecdotic information suggests that it is the case indeed.

[3] The initial range of the PMR indicators used is 0 to 6 from least to most restrictive. The range 0 to 100 is used in order to have a presentation easier to be read (but it should be stressed that the PMR indicators are not equivalent to tariffs: they are mere estimates of the existing regulatory barriers in the services sectors covered).

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

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

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

The highly fragmented Internal Market in foreign direct investment

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

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

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

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

Source: OECD 2006.

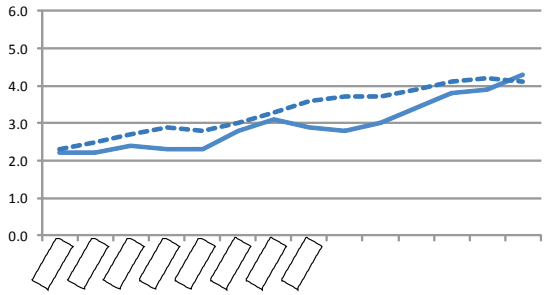
Table 2 provides the same observations on barriers to foreign direct investment than the ones just presented on services: wide differences among EUMS which make sense only if the EU Internal Market remains highly fragmented. As a result, it also suggests the same dynamics of "trans-negotiating partners"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

The highly fragmented Internal Market in government procurement

Also high on the agenda of negotiators of mega-PTAs is the opening of the government procurement markets. The recently published World Input-Output Database (WIOD) allows to calculate the penetration ratios in government procurement (these ratios are defined as the imports of foreign goods and services used in domestic government procurement markets divided by the total public demand in government procurement markets).

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

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



Source: WIOD, Messerlin and Miroudot 2012.

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

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

right panel) is more open than the larger Spain (1.2 times Korea's GDP size) and even than the notably smaller Netherlands (0.7 times Korea's GDP size).[6]

The implementation issue

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

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

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

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

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

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

Section 2. Meaningful mega-PTAs require better negotiating instruments

The limits of the EU Internal Market are so numerous and widely spread across sectors that they suggest some systemic mistake in the European integration process. If the enthusiasm for European integration did face ups and downs during this period, there was no systematic drag on the whole endeavor which could explain so many limits. And, the current mounting resentment with respect to the EU endeavor in many EUMS is fuelled by the perception that the EU Internal Market did not deliver what was announced, and that it is rather perceived as a source of more constraints and costs than of benefits.

What follows argues that this systemic failure has been the way intra-EU negotiations on norms of goods and on services regulations have been conceived. If correct, this explanation is of great interest for deepening the EU Internal Market, but also for the coming negotiations of all the mega-PTAs, and especially of those between East Asia and the EU. This is because these mega-PTAs deal with the same key issue than the Internal Market—how to negotiate on regulations, be technical norms for industrial and agricultural goods or regulations shaping markets in services. In short, the Internal Market programme was a "21st century" trade agreement.

The key question is: Which is the most efficient instrument for negotiating on regulations? After all, the history of tariff negotiations of the last 150 years has been the history of mastering progressively more efficient techniques for tariff cuts. And it amply shows that inefficient negotiating procedures and instruments (requests and offers on tariff cuts on a product basis, tariff-rate quotas, etc.) are not only unable to bring the expected benefits from market opening, but—much worse—can even deliver distorted, hence costly, liberalizations.

The basic question: the value of regulatory differences in modern economies

There are two radically different ways to look at regulatory differences [Messerlin 2011]. The first view—probably the most widely accepted—is that regulatory differences are "bad" because they impose more costs on foreign producers than on domestic firms in the domestic market. Such "unfair" differences should thus be eliminated or reduced as much as possible by appropriate legal mechanisms. This first view insists on a (somewhat mythical) level plain field. It is entirely focusing on producers.

The second view is that regulatory differences are "good" because they reflect different "varieties" in supplied goods or services. More varieties increase the consumers' welfare because they offer them more choices. This second view is consumer-driven. In such a context, regulators concerned about consumers' welfare should welcome regulatory differences. Accordingly, they should focus their attention on assessing the "equivalence" of competing regulations from the consumers' viewpoint (for instance, safety).

Interestingly, this consumer-driven approach is based on a landmark ruling of the EU Court of Justice (the so-called 1979 "*Cassis de Dijon*" case). This case did echo the wide perception in the EU in the 1960s and 1970s that the major achievement of the EU Internal Market was not prices decreases, but the huge increase in the diversity of products (varieties)—such as Italian low-end cars competing with high-end German cars and middle-end French cars.

Not surprisingly, the producer-driven and consumer-driven approaches are on a collision course. The first approach aims to limit differences, hence choices for the consumers—and competition among producers. The second approach aims to keep as large as possible choices among varieties, hence differences among regulations since varieties and regulations are somewhat inter-active (some regulations favour some varieties which then call from some regulations for further development).

Three basic instruments are available for negotiating on norms: "harmonization", "mutual recognition" and "mutual equivalence". Sometimes, negotiators have recourse to the notion of "regulatory convergence". However, this notion is generally a weak form of harmonization

postponed in an undefined future: harmonization is not possible now, but it is "hoped" that it will occur over time.

What follows tries to assess the respective merits of the three basic instruments in the context of mega-PTAs negotiations. For brevity sake, what follows does not always develop the arguments at the two levels required: the design *per se* of the regulation, and the implementation of the designed regulation—for instance, defining a technical norm and designing the certification process ensuring the respect of the new norm.

Harmonisation: unfounded assumptions

It seems fair to say that harmonization still remains the preferred negotiating instrument for most negotiators dealing with mega-PTAs. However, looking at harmonization as the best negotiating instrument on regulations relies on three unfounded assumptions.

- Firstly, there would always exist a technical norm unambiguously superior to all its alternatives. This assumption does not fit modern economies characterized by a huge number of varieties for almost every product and by two decades of intensive norm setting, as best illustrated by a recent EU case in the car sector (see Box1). A norm can be better from one point of view, and not from another. What is true for technical norms is even truer for services regulations. Comparing services regulations suggests that very few regulatory features have an unambiguously detrimental impact on the efficient provision of a service.
- Secondly, harmonization would be a science-driven process. In reality, harmonization is a heavily loaded political process where firms try to avoid increased competition and where negotiators are instructed to fight for their national champions. Such a process is largely driven by the negotiating leverage of the countries and firms. Hence, it is far to guarantee the choice of an intrinsically 'best' norm (assuming that such a norm exists) and it is a source of ultimate disillusions for most firms since, when a firm asks for harmonization, it is generally about harmonization based on its own norms. This is because firms imposing their norms as the harmonized ones keep intact their human (technical and legal) capital while the other firms will have to rebuild their human capital (learn how to use the new techniques and the new regulations and certification process).

- Last but not least, harmonised norms would raise relatively negligible implementation problems. In reality, implementation—such as the certification of the conformity of a product to a harmonized norm—raises very severe problems. First, harmonised norms delivering small gains (for the above-mentioned reasons) coupled with a costly (certification) enforcement are not desirable from a welfare point of view. Second, there is a powerful force for a never-ending increase in the harmonization of the certification procedures themselves when this option was not necessarily envisaged initially (as in the EU car sector with EU harmonized norms and EUMS certification procedures). All these unexpected and increasing costs on the producers and consumers are an essential component of the current resentment against the EU endeavour.

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

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

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

In January 2014, the EU Commission announced legal action against Germany. It also asked the Joint Research Council (JRC) to provide impartial scientific advice in what was described as "a confidence-building measure". However, the JRC is a Directorate General of the Commission funded at more than 85 percent by Commission's money. As a result, its March 2014 conclusion that the R1234yf is safe is unlikely to close the ongoing debate.

Indeed, this latest event raises two debates:

* First is a technical and legal battle on the cooling case and, more generally, on the role of norms in a modern economy and society.

* The second debate goes even further and deeper. It deals with the question of the appropriate institutions required by a much needed "culture of evaluation in a world environment". There is a need to think about the "separation of powers" between the evaluating branch and the normative branch of any institution, such as the European Commission. This debate is crucial for future economically-sound trade negotiations that take fully into account global value chains [Hoekman 2014].

Finally, there is a last argument against harmonization in the current context of competing mega-PTAs. It is hard to see how US and EU negotiators could harmonise norms or regulations in the Transatlantic Trade and Investment Partnership (TTIP) context, while EU and Japanese negotiators will do it in the Japan-EU Free Trade Agreement, and Japanese and US negotiators in the Trans-Pacific Partnership (TPP) context. An illustration of such impasses is provided by the car industry. In the Japan-EU trade negotiations, the Japanese car-makers have expressed their willingness to use norms derived from the UN-ECE norms (European norms defined under the UN umbrella). This move makes almost impossible the use of harmonization between the EU and the US and between Japan and the US in the car sector. Hence, it requires having recourse to one of the two other instruments for negotiating the norm issue in the car sector between the US on the one hand, and the EU and Japan on the other hand.

To sum up, harmonization in the mega-PTA context does not look an economically-sound and promising negotiating instrument, except in special cases all the more because it is hard to see all these mammoth economies ready to give up their existing and future regulations.

Mutual recognition: an unstable and disappointing hybrid

In the late 1960s to mid-1980s, the EU tried hard to harmonize EU technical norms and services regulations in the Internal Market context. It was a frustrating failure: only four industrial sectors got their harmonized technical norms, and almost none in services. Shifting from unanimity to qualified majority for adopting harmonized regulations did not solve the problem.

The EU decided thus to shift to a new instrument—"mutual recognition" (MR)—inspired by the key 1979 *Cassis de Dijon* ruling of the European Court of Justice. MR means that each party accepts the norms of its partner for the goods at stake *conditionally* upon the adoption

of a "core" of common provisions or principles ("essential requirements" in the EU legal jargon).[8] MR is thus an hybrid instrument: the core has to be harmonized through negotiations, and only the other provisions are subject to mutual recognition. From 1979 to 2006, MR was the exclusive approach used by the EU for dismantling barriers caused by unjustified regulations and for building the EU Internal Market. It has been also widely used in international agreements.

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

As a result, MR is subjected to intrinsic forces drifting it over time ever closer to harmonisation. In the EU, this evolution has been accelerated by the accusations of certain EUMS against the 'regulatory dumping' of other EUMS which were allegedly adopting a 'loose' interpretation of the core provisions. These accusations have been dealt with by imposing increasingly tight constraints on certifications procedures. In the rest of the world, MR (MR+) has rarely solved the problem of very costly double certification requirements—but in very special cases such as aircraft bodies (a situation probably more due to the strong duopoly of Airbus and Boeing and their intricate value chains, than to the influence of the regulatory bodies).

"Mutual equivalence": the promising instrument

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

[8] In the EU jargon, MR covers both the regulation *per se* and the certification (implementation) process. In the WTO jargon, MR refers only to regulations, while "MR+" covers the certification process.

To be politically acceptable, ME requires a systematic preliminary step: a joint process of 'mutual evaluation' of the norms and regulations at stake by the two partners. This step can be done only by the regulators of the two parties—not by the trade negotiators. It has two critical features. It is a decisive trust-building process among regulators—hence consumers. And it is an insurance mechanism: when reforming its norm or regulation once a PTA is implemented, a party will be careful not to breach the reasons (safety, health, etc.) which have justified the adoption of the norm or the regulation—hence the ME status (if agreed). In other words, the ME approach has a built-in "anti-race to the bottom" component. If the two parties decide not to decide to use the ME approach, then the norms or regulations under investigation could be still negotiated under mutual recognition or harmonization

suggests some ideas on how to combine trade negotiators and sectoral regulators, as illustrated by Box 2. Such a process offers an unique opportunity to build, restore or improve trust among the signatories—in particular, if it includes systematic reviews of the situation at definite periods of time.

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

Two articles of this Directive are particularly useful for today PTAs negotiations. Article 14 lists provisions in the existing regulations of the partners which represent indisputable barriers to market access (nationality clause, obligation to have an establishment in more than one location, etc.). This list could guide the trade negotiators for picking the goods and services as possible candidates for ME status.

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

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

Concluding remarks

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

indispensable instrument in a context of an international trade increasingly dominated by value added chains [Hoekman 2014].

The success of the ongoing negotiations on mega-PTAs will thus largely depend on their ability to deal with regulations. This is particularly true for the current and future mega-PTAs involving the EU: Japan's tariffs are extremely low, and peaks are rare (except for a few agricultural products); China's tariffs are higher than Japan's, but they are still moderate (often lower than EU's tariffs) and the share of tariff peaks is limited—a consequence of the very demanding Protocol of Accession imposed on China in 2001; the same could be said for Taiwan. Paradoxically, it may be the US tariffs that could raise the most difficult problems, a testimony of the leniency of the GATT-WTO regime to the founding Members. The key for success is thus the negotiators' ability to combine harmonization, mutual recognition and mutual equivalence depending the negotiated topics. For instance, in the case of the Japan-EU PTA, harmonization may emerge as the preferred solution by the Japanese car-makers, but mutual equivalence may prevail for buses or trucks. The main consequence of such detailed complexities is the urgent need to get an active involvement of the regulating bodies, in addition to the traditional negotiating teams. In short, far to mean a decline in the "sovereignty" of the negotiating countries, the current and future negotiations on mega-PTAs require a healthy and robust evaluation of the quality of their own governance by the negotiating countries. They require much "smarter" countries.

Last but not least, what will happen if the negotiators of the mega-PTAs are unable to use the best negotiating instruments—such as tariff cuts (no tariff-quotas) and a dose large enough of mutual equivalence? In such a case, the economic benefits of too limited mega-PTAs may not be large enough to counter-balance their political costs for inducing the top-politicians of the two countries to invest their political capital in a PTA success. One is slowly rediscovering one of the key feature of the WTO multilateral forum: its capacity to "dissolve" bilateral political conflicts into a worldwide negotiation. Any government could pretend to negotiate with friendly countries in the WTO while talking also with its political foes. By contrast, bilateral negotiations re-activate political "ghosts" and prejudices among two countries. And they do so all the more the partner is a large country.

In this context, it will not be astonishing that, after years of too difficult bilateral negotiations, the trade negotiators of the large countries may go back quietly to Geneva. For instance, the

Trade in Services Agreement (TiSA) would be an available forum for negotiations in services. The economic benefits will be increased—not because of the use of the best negotiating instrument (ME), but because the second-best instrument (harmonization or MR) would be used in an enlarged framework—two dozen of countries and probably a wider set of services. At the same time, the political troubles carried by bilaterals will be largely dissolved. In short, the test of the mega-PTAs success is whether the TiSA negotiations will be intense, or not. If they are, it will be a sure sign that mega-PTAs negotiations will have hung fired.

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