

# The Much Needed EU Pivoting to East Asia\*

PATRICK A. MESSERLIN\*\*

ECIPE, Belgium and Seoul National University, Korea

*The EU macroeconomic and budgetary policies will be politically sustainable only if the EU increases its anemic growth by making the necessary domestic regulatory reforms. In the absence of a Doha deal, preferential trade agreements (PTAs) are the only instrument left for buttressing EU domestic reforms and boosting EU growth. But PTAs could achieve such goals only if the PTA partners of the EU are big economies, well regulated and well connected to the rest of the world. Japan and Taiwan are the only economies in the world (except the US) meeting these three conditions--hence the need for a EU resolute pivoting to East Asia based on concluding ambitious PTAs with these two economies as quickly as possible.*

*Another consequence of the Doha failure is to induce other large economies to create "mega" PTAs--the Trans Pacific Partnership (TPP) led by the US and the China-Japan-Korea (CJK) agreement. For the EU, the only way to insure its firms against the risks of discriminations from these mega-PTAs is also to conclude a PTA with Japan (insuring against the TPP) and with Taiwan (insuring against the CJK).*

*Finally, managing a resolute EU pivoting to East Asia raises a series of problems. Those involving a few major EU trading partners--the US, China, Korea, Brazil and India--are examined.*

**Keywords:** World Trade System, EU Trade Policy, Preferential Trade Agreements, Trans-Pacific Partnership, Trade, Growth and Domestic Regulatory Reforms

## I. INTRODUCTION

November 29<sup>th</sup>, 2012, the Council of Ministers of the European Union (EU) gave a mandate to the Commission for negotiating a preferential trade agreement (PTA) with Japan. Of course, launching negotiations is

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\*\* ECIPE, Belgium and Visiting Professor at GSIS, Seoul National University, Korea;  
E-mail: patrick.messerlin@free.fr

not concluding them. But, this decision contrasts so much with two very difficult years of preparatory discussions, and it has been taken so much more rapidly than expected that it may indicate a key turning point in the EU trade policy. In this context, this paper has two main goals.

First, it summarizes the economic arguments justifying such a choice. Marshalling these arguments will be necessary during the coming years of negotiations if the few but powerful vested interests which have been fiercely opposed to the mandate will try to torpedo the negotiations--at the detriment of the interests of the many other EU producers of goods and services which have shown up for supporting the mandate.

Second, the paper puts the Japan-EU relations in the much broader perspective of the trade and economic relations between the EU and all the East Asian economies. It is urgent for the EU to fully recognize the central role of East Asia in the world economy, hence to undertake a global "pivoting" to East Asia by starting to work on a PTA with Taiwan, by taking great care of not jeopardizing the existing PTA with Korea, and by preparing, in the longer term, a PTA with China if the Doha Round continues to remain stuck.

The current failure of the Doha Round leaves the PTAs as the only instrument for the EU to boost its growth. More growth is absolutely necessary for making sustainable the current monetary and fiscal policies implemented in the EU Member States (EUMS), including Germany. The euro-crisis seems to calm down, but it is far from being over, with the "debt walls" that budgetary cuts are leaving in many EUMS being higher than those predicted a year ago. The much hailed institutional change (Banking Union) will take years before having a noticeable impact. Less visible, but much more pernicious and damaging, is the attrition of competition generated in many sectors by the past several years of crisis--in the EU Member States as well as in the rest of the world. Far to be conducive to growth, such an attrition of competition favors rents for the most powerful, increasingly entrenched vested interests, hence a sure recipe for increased inequalities and ultimately serious political turmoil.

Relying on PTAs raises two questions to the EU. First, which are the PTAs likely to provide the biggest and fastest boost to EU growth? Second, PTAs have an intrinsic flaw: they favor trade among the signatories at the detriment of trade between the signatories and the rest of the world. Such a flaw raises the following question: which are the PTAs ensuring EU firms best against the discriminatory effects of the PTAs concluded among non-EU economies? The paper shows that, remarkably, these two questions end up with the same set of preferable PTAs for the EU--those with Japan and Taiwan--since the Korea-EU PTA is already in force.

## II. WHICH PTAS NEGOTIATE?: THE GROWTH ARGUMENT

A PTA should be judged on its capacity to stimulate EU growth as much and as fast as possible, and on its ability to foster and buttress the much needed EU domestic reform agenda. PTAs unable to contribute to these goals will not attract the attention of the EU top policy-makers (heads of state or government, key ministers), hence are doomed to be captured by narrow vested interests and to deliver (very) limited results while fuelling bitter political domestic fights.<sup>1</sup>

What follows shows that the ability of any potential EU-PTA partner to boost EU growth and reforms depends on three main conditions:

- the larger the partner's economy compared to the massive EU economy is,
  - the better the partner's "regulatory quality" compared to the one existing in the EU is,
  - the better the EU potential partner's "hub quality" (that is, its set of PTAs with non-EU countries) is,
- the more attractive for the EU the potential partner is.

By opening simultaneously and non-discriminatorily all the world economies, a successful Doha Round would have ensured EU firms to always find the economies which would be best meeting these three key conditions at any point of time. By contrast, a liberalization based on sequential negotiations of PTAs require to find out--before entering into negotiations--which will be the most promising countries for the next decade or two.

### 1. Economic Size

The size criterion relies on a simple argument (going back to the John Stuart Mill paradox): 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. Changes in relative prices is the mechanism through which European consumers can get cheaper and more diverse products and services.

This size criterion has a crucial time dimension because the EU is in such an urgent need to boost its growth. Negotiating with a partner too

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<sup>1</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.

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 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.

**TABLE 1. LOOKING FOR THE BEST PTA PARTNERS FOR THE EU**

	EU market expansion (% EU GDP)		Regulatory quality		"Hub" quality
	2010	2030	(a)	(b)	
	1	2	3	4	
<b>A: PTA implemented in 2013</b>					
EU	100.0	100.0	5 to 100	2 to 83	Korea
Korea	6.3	6.7	8	22	EU, US, ASEAN, China
<b>B: The PTAs listed by the 2006 "Global Europe" Communication</b>					
Canada	9.7	10.3	13	10	USA
Indonesia	4.4	20.3	129	44	ASEAN
India	10.7	49.7	132	51	
Brazil	12.9	23.5	126	58	Argentina
Russia	9.1	20.2	120	63	
<b>C: The best PTA partners for boosting EU growth</b>					
Japan	33.9	36.1	20	6	ASEAN
Taiwan	2.7	7.6	25	13	China, NZ, Singapore
Chiwan	5.1	14.6	(na)	(na)	-
China	36.2	168.6	91	27	Taiwan, ASEAN

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

Table 1 lists the countries with which the EU is negotiating PTAs since the 2006 "Global Europe" Communication and the other major East Asian economies--including "Chiwan", an entity created by the Korean press for capturing the combined operations of the Taiwanese firms in Mainland and Taiwan.<sup>2</sup> Columns 1 and 2 assess the pro-growth potential for the EU of these various PTAs by calculating for every PTA an "EU market expansion" indicator 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

<sup>2</sup> Taiwan is generally seen as a middle-sized economy. 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 (for details see Messerlin (2012a)).

the EU pro-growth agenda. In order to take into account the time dimension, Table 1 calculates these indicators also for 2030 (the 2030 GDPs have been calculated by using the growth rates estimated by Buiter and Rahbari [2011] for the main economic regions of the world).

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 at least the same market expansion opportunities (scale and scope economies) to the EU firms and consumers than the combined three PTAs with Brazil, India and Russia.
- in 2030, only India could be expected to offer better growth opportunities than Japan, whereas Brazil and Russia remain significantly less attractive than Japan.<sup>3</sup> These results reflect in a large part the fact that the relative growth of Brazil and Russia compared to the world economy is not attractive (these two countries are not expected to increase substantially their shares in the world economy).
- China appears as the most attractive EU partner in economic size terms. Interestingly, these results are consistent with estimates based on a computable general equilibrium model which show the China-EU and Japan-EU as the two PTAs generating the highest welfare (real GDP) gains for the EU [Kawasaki 2011].

## 2. Regulatory Quality

The criterion for regulatory quality relies also on a very simple argument: 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 one of the most powerful instruments to change the relative prices of goods and services.

Regulatory quality is a particularly important criterion for the forthcoming PTAs which 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

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<sup>3</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. It should be also stressed that the fact that these estimates favor the emerging economies has no impact on the urgency of the EU pivoting since this urgency is driven by EU domestic concerns--the urgent need of more growth in the EU.

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 crucial incentive for the many EUMS so reluctant to review their regulations.

Columns 3 and 4 of Table 1 rely on two simple average indicators on regulatory quality. For the EU, they provide the highest (i.e., worst regulated EUMS) and lowest (i.e., best regulated EUMS) ranks among the 27 EUMS. Though these indicators rely on very different (admittedly crude) methodologies, they provide quite 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 ranks of 20 (on the basis of the Doing Business indicator, or DB) and 24 EUMS (on the basis of the World Economic Forum indicator, or WEF) while Taiwan's rank is better than the ranks of 18 (on DB basis) and 20 (on WEF basis) EUMS.
- the largest countries with whom the EU is currently negotiating PTAs exhibit low regulatory quality, an additional reason for them to fail to boost EU growth.
- China's indicators are much behind in terms of regulatory quality (on DB basis), but they are better than those of the large partners involved in the ongoing EU PTA negotiations.
- the vastly diverse regulatory quality among the EUMS themselves 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 (on DB basis) and 48 (on WEF basis), and joining late the EU has not been necessarily an handicap.

Interestingly, the crucial role of regulatory quality can occur as soon as negotiations start, as illustrated by the discussions between Japan and the EU in 2010~2012 (the so-called "scoping exercise"). These discussions have already brought significant results since they have compelled the two sides to start to review their own domestic policies. First, Japan has agreed during the scoping exercise to a long list of changes in its regulations for making them more open and/or transparent.

Second, less noticed but as important is what happened on the EU side. The EU insistence during the scoping exercise to present its public procurement markets as open and those of Japan as closed has generated an healthy exercise in reality check. There is now robust evidence that goes in the opposite direction of the EU claim.

- Table 2 summarizes the basis of the EU insistence, but also shows its first limits. A study done by the Commission [Commission 2012] suggests 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) on a *de jure* basis. But this is far to be the complete story. The same study notes that the EU does not apply its *de jure* commitments, but reduces them by using “selective derogations”--cutting the *de facto* openness of the EU public procurements markets to 70 percent (instead of 85 percent on a *de jure* basis) in Japan’s case. And, the same study recognizes that Japan does not use protectionist measures in many public procurement markets it did not open *de jure*. As a result, the *de facto* openness of the Japanese public procurements markets for EU firms is 72 percent (instead of 28 percent on a *de jure* basis), that is, similar to EU’s.

TABLE 2. REALITY CHECK IN PUBLIC PROCUREMENT MARKETS, THE EU VS. JAPAN

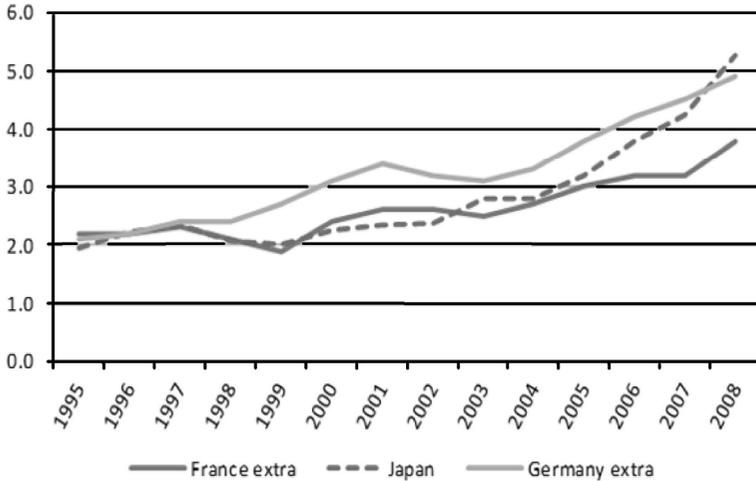
	EU	Japan
de jure openness	85	28
minus specific derogations	15	-
plus effective openness	-	44
de facto openness	70	72

*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(2012) 124 final. Messerlin (2012c).

- These results are much reinforced by an analysis based on a much more robust and encompassing source, namely the National Accounts (Messerlin and Miroudot 2012). For illustration sake, 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 in the recent years. In addition, National Accounts show that the EU Internal Market is far to be a reality, and that it is still subjected to many protectionist barriers. In short, the scoping exercise has shown the necessity of domestic reforms in the EU.

FIGURE 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.

This example illustrates how the negotiating process should be used in the years to come. Far to be a mere confrontation of the two parties, it should be the opportunity for both sides to think about their own weaknesses, and to use the negotiations as a way to reform their own economies. In other words, negotiations are a crucial way to improve regulatory quality in both negotiating parties.

### 3. Hub Quality

A potential EU-PTA partner with a wide network of good quality PTAs would clearly offer to EU firms new opportunities under the form of better market access to the economies covered by the PTAs already concluded by the potential EU-PTA partner. This is the case whether EU firms would sell their products in the potential EU-PTA partner, or whether they would invest in this potential partner for selling to the third markets opened by the potential partner's PTAs. In short, the "hub quality" of the EU potential partner saves time and money to EU firms for getting better market access to third countries. EU firms do not need to wait for EU negotiations with these third countries (of course, that does not prevent negotiations between the EU and the third countries at a later stage).

Column 5 of Table 1 gives a sense of this hub effect by providing a brief list of the main countries with which the EU trading partners have deep trade and economic relationships under some legal form (PTAs, bilateral investment treaties, etc.). Clearly, Japan, Korea and Taiwan are much more promising in this respect than the current countries with which the EU is currently negotiating--with Korea showing by far the best hub quality.

#### 4. The Growth Argument: Concluding Remarks

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

- the current PTAs under negotiations have very limited pro-growth traction for the EU before the 2030s. The economic size, regulatory quality and hub quality of the countries with which the EU is currently negotiating are too low and/or too distant to boost the EU growth in a significant way.
- 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 in the coming years (it is already done for Korea).
- such a pivoting would allow the EU to speed up the deepening of its trade relations with other East Asian economies, starting with the ASEAN countries with whom Japan and Taiwan (and Korea) have deeper trade agreements than those which exists between the EU and these countries.
- the EU should start to prepare for negotiating a PTA with China in a not so distant future if China improves its regulatory quality and if the Doha Round continues to be stuck.

These conclusions imply a dramatic shift of the current EU PTA strategy. Managing such a shift raises important problems examined in section 3.

### III. WHICH PTAS TO NEGOTIATE?: THE INSURANCE ARGUMENT

The Doha Round stalemate has sent the world trade system into unchartered waters. Highly unlikely until now, PTAs among the largest world economies are to become a reality. Table 3 describes the current situation of the four world largest countries, 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-Japan-Korea (CJK) PTA. But, Korea is changing fast this situation by pursuing bilateral talks with China, a process that has re-energized the China-Japan-Korea (CJK) process.

TABLE 3. PTAS AMONG LARGE COUNTRIES: THE STATE OF THE NEGOTIATIONS (NOVEMBER 2012)

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

*Notes:* Entries in italics indicate that the discussions are at a preliminary stage (joint study, scoping exercise, etc.) as of 31 December 2012. CJK: China-Japan-Korea PTA. JEU: Japan-EU PTA. TPP: TransPacific Partnership.

*Source:* GDP 2010 data from WTO Trade Profiles, WTO website.

## 1. EU Insurance Against the TPP: Japan is Key

The main risk of discriminations against EU firms comes, in the short and medium term, from the TransPacific Partnership (TPP) negotiated under the active US leadership. As of today, the TPP (excluding the US) involves ten countries (Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam, Canada and Mexico). Japan, invited to join the negotiations, would be 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.

The risks of TPP discriminatory impacts on EU economies depend on three key components of trade policy that can 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 are. 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.

Table 4 gives a rough estimate of the magnitude of the discriminatory risks by calculating the sum of the TPP11 GDPs fulfilling the various protection criteria (column 3 provides the definition of these criteria). Table 4 shows many sources of important risks:

- in agriculture, three-fourth of the TPP11 GDP will witness discriminations 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.
- 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 (about 30 percent 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 on imports from the EU 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.
- 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.).

**TABLE 4. ASSESSING THE RISKS OF DISCRIMINATORY IMPACTS OF THE TPP AGAINST EU FIRMS**

Types of Barriers	Magnitude of the risks (a)	Criteria used to classify a TPP country As "highly protected" (b)
1	2	3
<b>Border barriers</b>		
<b>Tariffs</b>		
agriculture		
applied	73.4	TPP11 countries with average tariff higher than 10 percent
bound	75.7	TPP11 countries with average tariff higher than 10 percent
manufacturing		
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 average tariff lines > 25% all traiff lines
Trans-border trade	43.3	TPP11 countries not included in the the 18 top countries (c)
	30.5	TPP11 countries not included in the 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). [f] OECD foreign direct investment restrictiveness indicators (0 means a totally open country, 100 a totally closed).

This information suggests with no ambiguity that, in order to prevent likely significant discriminatory risks associated to the TPP, the EU should negotiate an ambitious PTA with Japan, as fast as possible

## 2. EU Insurance Against the CJK: Taiwan is Key

The TPP is potentially the most discriminatory PTA against EU firms in the short and medium term because it is the most ambitious endeavor and with the most advanced negotiations. But, it exists an emerging challenger, with the China-Korea-Japan (CJK) agreement. There is little doubt that a fully fledged CJK could generate severe risks of discriminatory impacts against EU exporters in the long run.

In this context, the Taiwan-EU PTA fulfills the insurance objective, and the EU should be well advised to follow 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 Economic Cooperation Framework Agreement (ECFA) (Dreyer et al., 2010) to the extent that it has not yet a PTA with China.<sup>4</sup> As a result, Korea has started bilateral trade negotiations with China in January 2012. In turn, these negotiations have re-energized the CJK agreement which can then play a dual role for Korea: the CJK “Japanese leg” is Korea’s insurance policy against a TPP that would include Japan; the CJK “Chinese leg” is Korea’s insurance policy against the China-Taiwan ECFA.<sup>5</sup>

### 3. The Insurance Principle: Before Not After the Accident

Crucially, the insurance argument provides the same conclusions than the growth argument: from the EU perspective, Japan and Taiwan are the best candidates for PTAs which should be both ambitious and concluded as soon as possible.

That said, it has been sometimes argued that the EU should wait for a successful conclusion of the TPP negotiations before negotiating with Japan. This argument misses two important points which are also valid for the CJK case.

- any insurance works only if contracted 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. And, such a late move of the EU will be seen by Japan and all the major countries as an inglorious surrender.
- anyway, the growth argument does not leave much choice to the EU: the EU quest for more growth is urgent for domestic reasons--the political sustainability of the EUMS monetary and fiscal policies--not for international reasons.

In this context, it is also essential to understand the motives driving the US very strong push for the TPP. There is a wide range of motives: the failure of Doha negotiations, the fact that TPP is a preferential trade

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<sup>4</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>5</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.

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 diplomatic "pivoting" to East Asia.

But, by far, the most important motive is the collision course of China and the US on China's role in the world economic governance. The US does not want China to continue to benefit from the (limited) "special and differential treatment" (as it currently enjoys in the WTO for instance) or any other free-riding situation. In sharp contrast, China is very frustrated by the fact that the 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. China also stresses that the large share of truly poor people in its total population makes it eligible as a developing country. Last but not least, China feels unprepared for playing a leading role in world affairs--echoing the similar difficulties that the US has faced for playing such a role during the first half of the 20th century.

In this context, the US is looking at the TPP as the future multilateral economic institution--a WTO "version 2.0"--imposing (much) stricter disciplines on a (much) wider range of issues than the current WTO. The best chances for the US negotiators to get such a result is first to negotiate the TPP rules and disciplines among the ten (small to middle) countries involved, then to ask Japan to join this group of countries 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."

#### **IV. MANAGING THE EU PIVOTING TO EAST ASIA**

The Council's decision to open the negotiations with Japan is the very first step of the EU pivoting to East Asia. But, the EU is still negotiating or considering to negotiate many other PTAs. How is it possible to make these negotiations compatible with the high priority that the growth and insurance arguments are giving to the negotiations with Japan and Taiwan?

All these negotiations are so complex that they will require a huge amount of resources in terms of time, staff and money from the Commission. It will also be the case for the EUMS since the importance of negotiating partners and the wide scope of the topics to be negotiated will necessarily induce EUMS to "re-invest" in commercial policy in order to follow closely the negotiations--all the more because for many of these topics, the

Commission has no legal competence nor expertise. For the purpose of making clear priorities (and for brevity sake), what follows focuses only on five countries or region: the US, Korea and China, Mercosur and India.

## 1. United States

Clearly, the US fits the key conditions for being an attractive PTA partner of the EU: it is large and well regulated, even though the US has a limited hub quality (reflecting the fact that the existing US PTAs have been largely decided on the basis of political factors).

However, paradoxically, these negotiations could be more difficult than expected because of the high priority given to the TPP by the US and of the US approach in these negotiations. When negotiating regulatory matters in the TPP, the US is in the negotiating mood that the EU used to have a decade ago: export US rules and disciplines in order to shape the TPP as deeply as possible on the basis of US norms and practices--hence the importance of the terms of convergence and harmonization in the TPP talks. This is particularly clear in topics such as intellectual property rights, international investment, and state-owned enterprises.

Such an approach would be hardly acceptable by the EU which should be inclined to adopt a logic of "mutual recognition" of the norms and regulations, both in the Transatlantic marketplace and in its negotiations with East Asian economies. Such a EU position flows mainly from the fact that the principle of mutual recognition is a core internal principle of EU law--as best illustrated by the 2006 EU Services Directive which is the legal basis of intra-EU liberalization in many services.

Such a fundamental difference in the US and EU approaches is likely to make the negotiations on the Transatlantic Marketplace more difficult than generally expected. US negotiators will be torn apart between a logic of harmonization/convergence in the Pacific area and a logic of mutual recognition in the Atlantic area.

## 2. Korea and China

One of the major problems raised by the PTAs is that they are negotiated sequentially--contrary to an agreement at the Doha Round which, by principle, opens simultaneously all the countries. Any new PTA can thus have negative or positive consequences on the previous and following PTAs. When negotiating in East Asia, the EU and its negotiating partner should thus take special care of possible negative spillovers. For instance, better mutual concessions in the Japan-EU PTA than those in the existing

Korea-EU PTA could hurt EU and Japanese firms having invested in Korea for using the opportunities offered by the Korea-EU PTA. In short, 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.

Of course, there could exist also positive spillovers. Indeed, a systematic effort in generating such positive spillovers should be made when negotiating the Taiwan-EU PTA. Such a PTA raises the following question: what would be China’s reaction to a Taiwan-EU PTA? A few facts should be noted. The “One China” policy has not stopped China itself from doing a PTA with Taiwan (the Economic Cooperation Framework Agreement or ECFA) and, since then, from deepening and widening the ECFA scope. It has not stopped Taiwan to negotiate a PTA with Singapore and New Zealand, and to conclude a bilateral investment treaty with Japan, the world’s third largest economy and a country even more careful in its political consideration to China than the EU. In these conditions, why would the case be different in principle for the EU? It is all the more the case since the EU and Taiwan have every sound economic reason, in a long run perspective, to create positive spillovers beneficial to Mainland and to avoid as much as possible negative discriminatory effects.

In turn, such a long term vision has two immediate consequences. First, the EU and Taiwan should probably give to their PTA the form of a series of partial (by sector or by topic) agreements concluded as time flows rather than the form of one global text. Such an approach would allow a better grasp of the net effects of the Taiwan-EU deal on Mainland economy. It would also allow to begin by the issues which are the most likely to bring benefits to China, hence to build trust among the parties. The difficulty in such a progressive approach is not so much the lack of visibility (the global content of a PTA is quite standard) than the easiness to find balanced concessions on the limited successive subsets of the whole agreement.

Second, the EU should use this process to review its own trade approach to China. So far, it has not hesitated to raise issues that are bad for the Chinese producers, for the EU consumers, and even sometimes for the EU producers themselves. This is best illustrated by the recent antidumping case on ceramics that is far to get the support of EU producers, or by the antidumping case on Chinese solar panels that is in total opposition with the EU goals on climate change--indeed, subsidizing such panels should be praised by the EU climate change community. Putting aside these issues does not mean that the EU should not be firm. Rather, it means that the EU should be firm on those Chinese measures that are detrimental to the interests of the Chinese consumers--be households or firms (firms’ consumption represents a very large share of total consumption in

any country).

### 3. Mercosur and India

The EU has to review its current negotiations with these two countries. Some of these negotiations are going on for many years (13 years for Mercosur) or leave little hope (India). That reflects a lack of interest from the EU negotiating partners which have lost confidence in market opening as a powerful instrument conducive of growth and domestic regulatory reforms.

A complete stop of the current negotiations with Mercosur and India may be not feasible, and could indeed be counter-productive to the extent that it would leave the protectionist interests unchecked. A better solution would be that the EU and its negotiating partner would renounce to the negotiation of a global PTA text but would define a few domains in which the EU negotiating partner keeps some interest, such as mutual recognition for some norms in agricultural or industrial goods or for some regulations in some services, etc. Limited agreements on such topics will be building blocks preparing the way to a re-opening of the negotiations on fully-fledged PTAs.

## V. CONCLUDING REMARKS

This paper argues for an EU pivoting to East Asia which would consist at concluding ambitious 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 Japan and Taiwan 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 have large 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 most 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 com-

bined French and German markets in 1995, to one-third in 2000 and to almost the parity in 2008?

In short, the EU should adopt an “economic diplomacy” proportionate to its declining economic influence. In the EU pivoting to East Asia, failure and success are not an option. The only option is a quick success.

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