Open trade is a two-way street

The European Union will have to accept that one-sided trade liberalisation cannot continue, argues Hosuk Lee-Makiyama

The decision by the European Union's trade ministers to open free-trade negotiations with Japan finally arrived on Thursday (29 November), after years of deliberation. Karel De Gucht, the European commissioner for trade, is unapologetically focusing on free-trade agreements with the world's largest trading nations – not out of bravery or foolhardiness, but out of necessity. The commercial attractiveness of the EU's single market has always been the mainstay of Europe's soft power, which is inarguably in decline. Europe's share of global economic output will be halved in 15 years, and the EU is racing to secure free-trade agreements while it still has leverage.

But the EU, despite being in trance to the mantra of growth and jobs, has so far struck free-trade agreements with countries that account for only 5% of its trade. Just three other countries in the same weight class – namely, the US, China and Japan (each with a gross domestic product of more than $5 trillion, or €3.8 trillion) – would have a meaningful impact on European recovery.

But large-scale trade liberalisation comes at a cost. The EU has so far been content to negotiate trade agreements with countries whose economies are far smaller than its own, such as South Korea and Peru – countries that have accepted EU rules and standards on a wholesale basis, while not requiring a single piece of EU legislation to be reformed.

Such one-sided liberalisation simply will not be possible when European negotiators lock horns over product standards with China's Mofcom, the US Food and Drug Administration or Japan's ministry of economy, trade and industry. Also, the EU's protectionist concern for the European car industry – the sector that accounts for the EU's largest trade surplus with the world – gives rise to bemusement. The EU even has a hefty surplus of half a billion euros on trade in cars with Japan. For policymakers, at least some of the attraction of a deal with the US comes from a sense of relief that Fiat and PSA would not complain about being exposed to more competition.

Moreover, the first priority for Chinese, Japanese or US businesses may not be to open up zero-growth EU markets. For the US, the Trans-Pacific Partnership (TPP) is strategically more important than the 'transatlantic high-level working group on jobs and growth' with the EU.

Japan, which is in pre-election jitters, is focused on its Asian neighbours, and public support for TPP has also reached critical mass. In response, the new Chinese Politburo – the first in which economists outnumber engineers – has invited South Korea and Japan to enter into a three-party trade agreement, turning a blind eye to recent territorial disputes.

The China-Japan-Korea (CJK) agreement would merge into a free-trade area with ASEAN, India, Australia and New Zealand – by any estimates, both the CJK and TPP agreements would reduce European exports to an extent that cannot be compensated for by Europe's own free-trade agreements. The infamous pivot to the East is turning the EU's once offensive trade strategy into a fierce defensive battle to maintain its market share.

Yet, the EU's member states have failed to respond to the offer by China's outgoing premier, Wen Jiabao, to settle all their disagreements in a free-trade agreement. That agreement is admittedly controversial for both sides.

However, qualms about Japan's ability to deregulate its markets were not the only cause of a recent face-off over a mandate on Japan.

Some European leaders have misgivings as to whether EU trade policy represents their short-term political interests. But turning to mercantilism and openness only when it benefits Europe – a classic case of 'do as we say and not as we do' – undermines Europe's own long-term interests by legitimising the same behaviour against Europe.

Economic facts do not cease to exist because they are ignored. The EU would do far better to grasp globalisation as it really is, rather than to remain in the past, however satisfying and reassuring the past was.

Hosuk Lee-Makiyama is the director of the European Centre for International Political Economy (ECIPE) in Brussels.

A genuine monetary union?

Two major blindspots mar the European Commission's roadmap towards a better monetary union, Guntram Wolff argues

José Manuel Barroso, the president of the European Commission, last week proposed a roadmap setting out how to transform Europe's current set-up into a better-functioning monetary union. The paper has two major weaknesses, but it makes three very good and ambitious points.

First, on the positive side, the communication stresses the need to move ahead with a common bank-resolution authority and acknowledges that a purely national system of resolution would not be effective. This is a major and very important change in the Commission's policy stance: until very recently, the Commission's view was that national resolution would suffice. A banking union without a common resolution authority would not be a genuine banking union. Without a common form of resolution, there can be no form of risk-sharing. And without risk-sharing, one of the main aims of the banking union – to break the vicious circle between bank debt and sovereign debt – cannot be achieved. The single financial market would remain fragmented.

Second, the Commission's communication elaborates on what to do with the current debt overhang in the eurozone. Its solution – a redemption fund coupled with 'eurobills' (short-term debt backed by all 17 members of the eurozone) – is very controversial, but the Commission deserves credit for highlighting that there is a debt problem.

It is high time that Europe thought more deeply about how to organise the large process of deleveraging its debt. It is unlikely that prolonged high levels of savings would alone be enough to do the trick.

Third, the communication rightly accepts the need for a common eurozone budget. A eurozone budget would serve as a stabilising factor in the event of both ordinary shocks and asymmetric shocks. The communication also clearly states that the budget must be designed to ensure that there are no permanent transfers and that it fosters structural change. The Commission fails, though, to point out that a common budget is only needed when there are extremely deep recessions.

Two important issues are entirely missing from the communication, however.

First, the section on bank resolution appears strangely incomplete. Centralising resolution powers entails a major transfer of sovereignty, which in turn requires very deep reforms and clear thinking about democratic accountability. Contrary to the Commission's claims, changes to the EU treaty therefore appear indispensable.

It is also possible that we would end up with a new resolution authority inadequately equipped to wind up banks in a way that minimises the cost to the taxpayer. The Commission should therefore re-think its approach to bank regulation. Is the implementation of a single rulebook enough to prevent major risks to taxpayers? Finally, contributions from the financial industry would be an excellent way of reducing costs to the ordinary taxpayer. At the same time, though, general tax resources will need to be called on in extreme cases.

A second criticism concerns the Commission's analysis of the macroeconomic situation. The Commission sets out relatively detailed timetables for a banking and fiscal union, but it suggests no specific steps to restore growth in Europe quickly.

There is obviously a major structural component to Europe's weak growth. That structural element needs to be addressed urgently. However, remedial, structural action would produce growth in perhaps three years' time, and so the outlook for the next two years would remain bleak. This holds true particularly for the countries of southern Europe.

What does the Commission consider to be the truly important macroeconomic policies that Europe should enact now in order to overcome its dramatic decline in growth? The Commission will have to take a position on Europe's macroeconomic policy. Long-term reforms are no substitute for this, because anaemic growth in Europe will undermine them.

Guntram Wolff is the deputy director of the economic think-tank Bruegel.