

TRANS-PACIFIC PARTNERSHIP: A challenge to Europe

By Matthias Bauer, Fredrik Erixon, Martina Ferracane and Hosuk Lee-Makiyama

‘It is a bad idea. It won’t happen. If it does happen, it will not last.’ It is not easy to give a ‘European view’ on the Trans-Pacific Partnership (TPP), but if there has been one, its revealing character has surely been the denial of the merits and feasibility of the whole enterprise. When the TPP was launched, towards the end of the Bush Administration in the US, trade observers in Europe considered it a doomed initiative that would neither bring significant gains nor be feasible. It was seen as yet another example of the failing philosophy of ‘competitive economic liberalisation’ – the idea, associated above all with Robert Zoellick, that preferential agreements could help to push a multilateral agreement – or as wilful neglect of multilateralism by the Bush Administration.

When the Obama Administration embraced the TPP initiative and gave it its own hallmark, it was seen as an attempt to boost the US pivot to Asia, at best as the weak economic leg of a larger geopolitical strategy, or – less impressively – as an effort of public diplomacy to breathe some economic rhetoric into an enterprise that in reality was about security alone.

Yet since the start of the TPP negotiations, new countries have joined the TPP – adding more economic clout to the initiative. The scope of the negotiations has also changed somewhat, taking it into some novel fields of trade policy. Negotiations have advanced to a point where a conclusion is anticipated by involved countries in the near future. Yet such developments have not

EXECUTIVE SUMMARY

What if the Trans-Pacific Partnership (TPP) is not a doomed initiative – and what if it will actually make inroads into modern trade problems? The Asia-Pacific region is now the world’s centre of economic gravity holding an increasing share of world production and promising a rapid turn into the world’s fastest growing consumer market. TPP will change the competitive relation between European and American firms as far as access to this market is concerned.

The negotiations now include Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US, and Vietnam. Influential actors, including South Korea, Philippines, Taiwan, Thailand, (and even China) have formally or informally shown

their interest in joining the negotiations. There is no reason to doubt that TPP is the new agenda-setting pillar in the Asia-Pacific region and beyond representing 60% of world trade – the same level as GATT during the 1980s.

In the short term, TPP will be the first ‘competing’ economic integration that is large enough to have a considerable negative impact on Europe. In the long-term, the negative effects will come from dynamic impact, e.g. on investment, productivity and competitiveness. It also presents a ‘deadly threat to European exporters of agricultural products in TPP countries’.

Europe negotiates bilaterally with some TPP countries, but it has no strategy equivalent to the TPP. The ongoing bi-

lateral negotiations with Canada, Japan, Malaysia and Vietnam have been facing difficulties due to the priority given to TPP. The trans-Pacific negotiations even add pressure on the EU’s relations with countries such as Mexico and Chile, with whom FTAs are already in place. Australia and New Zealand are not being addressed at all.

Europe’s trade agenda cannot be underpinned by TTIP and plurilateral initiatives alone. These problems presented by the new regional economic architecture emerging in Asia-Pacific, where TPP is an inherent part, present a strategic imperative to conclude the Global Europe agenda more rapidly and comprehensively than before.

changed European sentiments over the TPP. There is still a preference among many political leaders in Europe to deny the TPP the chances of success or to view it in pejorative terms; in the recent words of Pascal Lamy, for instance, as the TPP is ‘the last of big old-style trade agreements’.

But the reality is that most current trade negotiations are “old-fashioned” in the sense that they are occupied with sectors that are not at the forefront of economic expansion. Generally, trade policy is far behind the curve of global commerce and the problems that clog the arteries of global economic integration today. Before he departed Geneva, Lamy was still pushing the idea that WTO members should return to negotiations over agriculture and industrial tariffs. Besides from TPP, the US has also opened up the negotiations for a transatlantic deal with Europe, making the shift towards bilateral or regional tracks for trade liberalisation a *fait accompli*.

Yet, what if TPP is not a doomed initiative – and what if it will actually make inroads into modern trade problems? While it has dawned on some trade observers in Europe that there is a distinct chance that TPP actually will succeed, there is hardly advanced thinking on what the actual consequences would be for Europe, let alone how it should inform European governments in their efforts to tie themselves closer to the Asia-Pacific market.

REVIEWING THE EU APPROACH TO THE ASIA-PACIFIC

THE EU TRADE strategy was, by default, multilateral. Its bilateral strategy was not necessarily drafted on the basis of commercial consideration, but firmly anchored in its neighbourhood policy around the Mediterranean and the pre-accession countries on its eastern perimeter.

Commissioner Mandelson’s Global Europe strategy of 2007 changed that by opening up commercially driven bilateral free trade agreements (FTAs), largely trailing US FTAs in Asia-Pacific starting with Korea and the failed regional deal with ASEAN (Association of Southeast Asian Nations). The strategy was also supplemented by some bold ventures with economies yet to sign FTAs with the US: notably India and Mercosur, while carefully exclud-

ing China. This is a strategy of quantity – to conclude a large number of country-to-country bilaterals in Asia-Pacific based on a European model text. By and large, this strategy was sustained until the opening of the Transatlantic Trade and Investment Partnership (TTIP) that pivoted political attention back to the Atlantic.

There are several reasons for Europe to review its approach – and devote more attention to developments in the region. First, the world’s centre of economic gravity is shifting from the Atlantic region to the Asia-Pacific region. According to a McKinsey study, the world’s centre of economic gravity will have moved from close to Iceland in the 1950s to the region of Novosibirsk in 2025.¹ The EU cannot afford to neglect the Asia-Pacific region because it will have systemic effects for Europe’s trade, old and new.

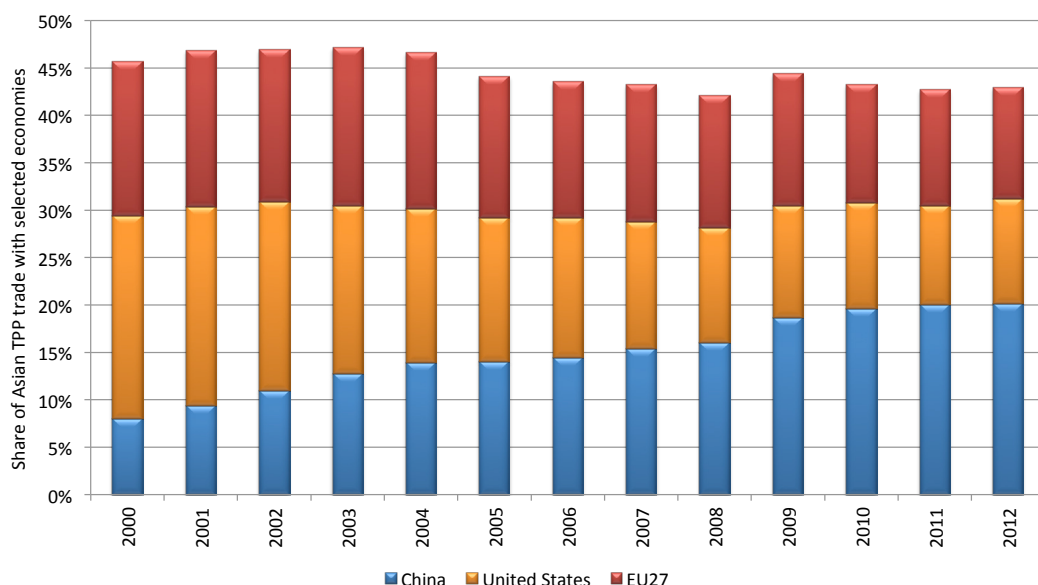
Second, geography is increasingly a central theme in the trade profile of the Asia-Pacific region. While many economies in the region have grown on the back of trade with more liquid markets in the world, greater proximity in trade is now a powerful and growing force in the way these economies integrate with the world. If the natural market trend in trade in the region is pointing in the direction of more intra-regional trade, there are even stronger reasons for Europe to ensure that as few policy restrictions as possible exist in its trade with Asia-Pacific, and that liberalisation takes place as coherently as possible within the region, in absence of full-scale multilateralism. TPP, supplemented by the regional processes of APEC and ASEAN, are bottom-up approaches to that route.

Third, the TPP will change the competitive relation between European and American firms as far as access to the Asia-Pacific market is concerned. It may be an old-fashioned agreement, but the simple fact is that Europe still trades a lot in old-fashioned goods. Comparative policy (dis)advantages still have consequences for market competition – and Europe may soon be faced with such a disadvantage in its trade with Asia-Pacific.

Fourth, while Europe negotiates bilaterally with some

1 Reported by Chris Giles and Kate Allen, Southeastern shift: The new leaders of global economic growth, Financial Times, 4 June 2014

FIGURE 1: SHARE OF TRADE OF ASIAN-TPP COUNTRIES WITH SELECTED ECONOMIES, 2000-2012



Source: Own calculations; COMTRADE 2014

TPP countries, it has no strategy equivalent to the TPP, which could be continually employed to build a larger system for trade policy cooperation in the Asia-Pacific region and to address global commercial problems. The conceptualisation of TPP is one way to exploit the untapped potential of fast growing countries in a complementary way, especially in the light of their different endowments and the different degrees of specialisation of the countries involved in the negotiations. This European lack of initiative is merely an expression of the absence of a much broader vision and a 'grand map' in Europe on what trade relations with the Asia-Pacific region should develop into.

TPP AND THE NEW ECONOMIC CENTRE

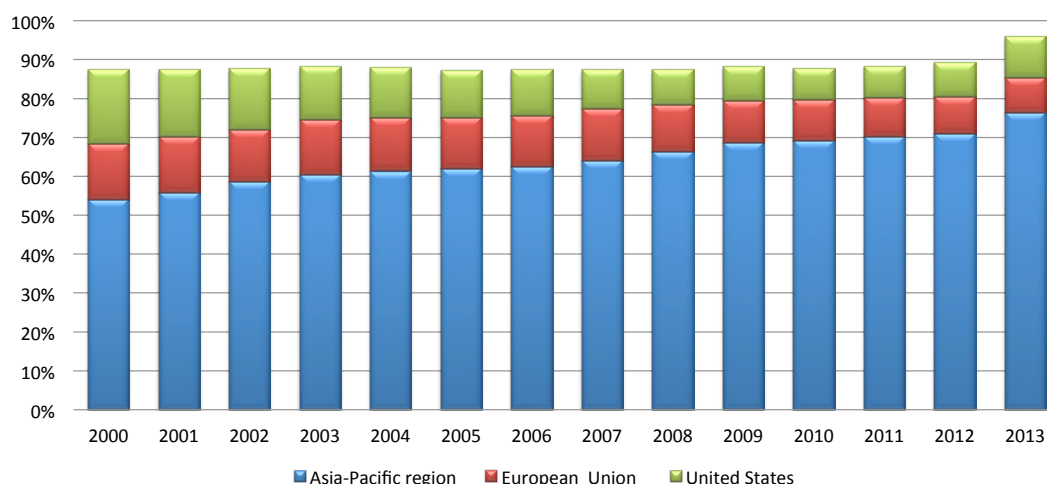
THE EMERGENCE OF Asia as the new economic centre is a long-term constant and key assumption of the Global Europe strategy and its subsequent reaffirmation of Europe's bilateral FTAs and re-engagement with the Asia-Pacific region. Intra-regional trade in the Asia-Pacific region has more than tripled since 2000, while global trade and Asia's trade with economies outside the region have doubled. In the last two decades, the trade pattern of the countries in the region has undergone a process of pro-

found change marked by the extraordinary rise of China and growing intra-regional industrial linkages (which is gradually evolving into economically driven political linkages), especially strong in East and South-East Asia. This has resulted in a staggering increase of the intra-regional trade and investment, with China increasingly gaining weight at the expense of other trading partners outside of the region, mainly the EU and US.

This pattern is also observable in the economic architecture of Asian-TPP countries (Australia, Brunei, Japan, Malaysia, New Zealand, Singapore and Vietnam), whose share of trade with China has increased from less than 8% at the beginning of the century to about 17.5% in 2012 (Figure 1). At the same time, the weight of the EU and US in the Asian-TPP countries' trade has witnessed a notable decline and nearly halved: from 14.5% and 21% respectively in 2000 to roughly 10% in 2012.

The global financial crisis and the European sovereign debt crisis have accentuated this trend. When looking at the trade of Asian-TPP countries in the period 2010-2012, intra-Asian-TPP trade and trade with China have grown faster (respectively 16.9% and 18.5%) than trade with the EU and US (respectively 9% and 12.5%). Moreover, Asian-TPP countries have actively sought

FIGURE 2: SHARE OF ASIAN-TPP COUNTRIES' EXPORTS OF INTERMEDIATE GOODS, 2000 – 2013



Source: Own calculations; COMTRADE 2014

opportunities in new markets and regions, such as Latin America and Africa, with an increasing trade with these regions, even though trade flows are still low in absolute terms.

An overview of trade flows in intermediate goods shows the extent of the intra-regional value chains' phenomena involving Asian-TPP countries. Three-quarters of these countries' exports in intermediated goods are directed to countries in the Asia-Pacific region and these exports have jumped by 6% in the last year (see Figure 2). Both the EU and US account for roughly 10% of their exports, down from respectively 14% and 19% in 2000.

The TPP signatories are not losing time in making their way through the new economic centre of the world. Asia will soon be the world's fastest growing consumer market and a large share of future production will be based in the region. For example, Asian Development Bank (ADB) projects that more than half of the world's GDP will be created in Asia by 2050. Although such economic projections are always combined with uncertainty and often a mere linear projection of the current conditions that may not hold true over time. Nonetheless, there is little doubt that Asia will outgrow other regions from suppressed intra-regional demand in China and Japan, augmented by increasing urbanisation and a fast-growing middle-class. This may indeed lead to increased demand for industrial equipment, capital goods and final goods made

in Europe. However, as the value-added in Asian goods and the share of local inputs in Asia's regional value-chain simultaneously increases, Asia's new consumer class will inevitably begin to buy more locally.

In sum, the EU's lost shares in Asia's demand for intermediate goods also means that it is missing out on Asia's expansion into world markets, while TPP will inarguably change the competitive relation between European and American firms. The tipping of the global balance towards trans-Pacific integration (and inevitably in favour of US exporters with their natural presence in the region) is already taking place without TPP being in place. Europe is already competing against natural market integration taking place at firm-to-firm level, as business in Asia seeks supplies in the region and the US. As a result, almost half of US exports are now destined for TPP countries, while the equivalent EU number is closer to 30% – even with exports to the US included.

THE NARRATIVE BEHIND TPP: THREE TRACKS OF TRADE LIBERALISATION

INCREASING INTRA-REGIONAL BUSINESS linkages have paved the way for the emergence of an increasing number of bilateral and regional trade agreements, as well as unilateral liberalisation. The total number of FTAs concluded and negotiated involving at least one country in

the region has grown almost four-fold from 70 in 2002 to 257 in January 2013, most of which are intra-regional. The role of these pre-existing business linkages is also a considerable difference in how the new Asia-Pacific economic order differs from previous forms of regionalisation, in particular compared to the market integration that took place in Europe – namely that trade liberalisation and the creation of the Single Market in the EU was a policy-led market integration started from political initiatives, whereas the new trade liberalisation in Asia-Pacific is primarily an integration induced by business, merely facilitated and enhanced through political agreements.

Therefore, many intra-Asian FTAs stimulate and boost existing integration rather than seek to create new market integration through political force. This is particularly true in regards to agreements that involve China. Despite being a latecomer to the FTA game, China started to actively engage in FTAs post-WTO accession in 2001. Since then, China has made rapid progress to extend its network of FTAs in the neighbourhood. Primarily, FTAs have served as a tool to consolidate its territorial integrity: China has concluded special FTAs with Hong Kong, Macau and Taiwan, under the long-term notion of ‘one China, two systems’. However, China has also used FTAs to secure a stable supply and access to regional markets and inputs, and thereby reassured its ‘peaceful rise as the leader of the region’ –² a category under which China’s bilateral FTAs with Thailand, Pakistan, Singapore and New Zealand, ASEAN (ACFTA) and the on-going negotiations with Australia fall. Moreover, it is negotiating and considering agreements with other key actors in the region, including India and the three-party FTA with Japan and South Korea (known as the CJK agreement, albeit with an uncertain outcome). Nonetheless, given the need for a rapid reorientation of China’s economy into services and higher value-added for sustained growth and social stability (especially with regards to employment), China has no choice but to engage in a major trade negotiation that could reform their economy – or to open up unilaterally.

The emerging architecture in Asia-Pacific regional integration shows two other tracks, which seem to stimulate

mutual progress. These are the Trans-Pacific track which, in addition to the TPP, covers the P4 agreement³ and many bilateral agreements spreading across the Pacific, including US attempts to strengthening its net of FTAs in the region, concluding bilateral FTAs with Australia, Singapore and South Korea. The final TPP agreement – which is the ultimate culmination of this track – is *de facto* a harmonisation of existing FTAs (and other economic cooperation agreements) involving the US or the P4. It also encompasses the Closer Economic Relations (CER) Agreement and evolving Single Economic Market (SEM) between Australia and New Zealand, one of the most ambitious trade agreements and ongoing regulatory convergence processes that is perhaps the only example of ‘beyond the border’ market integration and comprehensive regulatory coherence on goods and services outside the EU.

The similar, but yet differently flavoured ‘Asian track’ includes a cluster of tariff-centric agreements centred on the ASEAN, and the politically sensitive CJK. In particular, the ASEAN Framework on Regional Comprehensive Economic Partnership (RCEP) aims to create a region-wide free trade area by merging ASEAN’s existing FTAs (including China, India, Japan and CER), and CJK (if it ever comes into fruition) into one single comprehensive document with existing yet relatively weak commitments on goods, services, investment, technical cooperation, intellectual property, competition.

CHALLENGES FOR THE EU

THESE THREE TRACKS described above are not mutually exclusive. They are able to peacefully co-exist, and even complement each other. Most countries are participating in two of these processes and New Zealand, Japan, Malaysia, Vietnam and Singapore and Brunei are part of all three – and jointly, they represent a new challenge to the current *status quo* of EU trade strategy in the region.

To begin, the opening up of China is very pressing issue. The Middle Kingdom has eclipsed the US as Europe’s

2 Garcia, Maria, ‘Fears and Strategies: The European Union, China and their Free Trade Agreements in East Asia’, *Journal of Contemporary European Research*, 2010

3 The Pacific Four, or the P4, denotes the signatories of the first Trans-Pacific FTA between New Zealand, Brunei, Singapore and Chile

largest trading partner and is increasing in importance for countries that are central to the EU trade policy formulation, such as Germany. However, EU exports to China are primarily industrial equipment that are needed in China's current stage of development, but there are no assurances that this trade is sustainable when the country becomes consumption driven and reaches middle income levels. The Global Europe strategy was partly based on a bet that Europe's FTA negotiations with India (opened up in 2007) would compensate for passing over China, and even enable the EU to encircle it. As talks with India are into their seventh year (2007 to 2014) and still nowhere near completion and Indian economic growth has come to a halt, this bet has not ended in the EU's favour. The EU remains constrained domestically from approaching the subject of an EU-China FTA, which past and current Chinese leaderships have proposed. With neither a multi-lateral deal nor an EU FTA in sight, China will ultimately be opening up against another set of trade rules than the EU's ones.

In this regard, there is no reason to doubt that TPP is the new agenda-setting pillar in the Asia-Pacific region, while other global FTAs (including TTIP and RCEP) are in some ways reactions to, or derivatives of it: the TPP negotiations now include Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US, and Vietnam, while other influential actors, including South Korea, Philippines, Taiwan, Thailand, (and even China) have formally or informally shown their interest in joining the negotiations or acceding to it. Strategic imperatives of TPP aside, the TPP membership has now reached 37.5% of global GDP or 60% of world trade. Such market access benefits are too big to ignore and make the TPP too big to fail, whatever concessions it may entail. Given that TPP members are already interconnected by the so-called noodle bowl of bilaterals of varying ambitions and commitments, the benefits from simplifying and harmonising these rules under TPP by far exceeds the costs of the concessions.

This evidence strongly supports that regionalisation – *inter alia* TPP – has replaced multilateralism and the Doha round as the forum where new trade rules and disciplines will be conceived in the coming political cycle, and in the short term. In fact, the current coverage of global trade represented by TPP (60%) is the same level as in GATT

during the 1980s between the Tokyo round and the Doha round. Despite the apparent difficulties with a large number of signatories at different levels of development, it is TPP – not TTIP and EU FTAs – that are likely to be concluded first, and TPP language may very soon find its way into other regional, plurilateral and bilateral agreements, including TTIP.

THE COSTS OF NON-ACTION

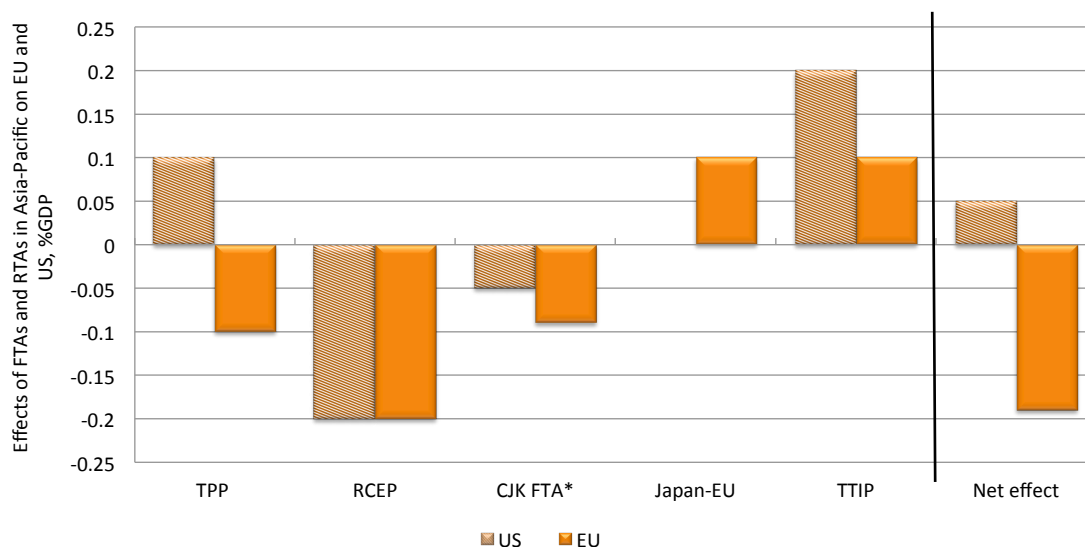
EUROPE'S POLICY RESPONSE to date has been primarily to counter intra-Asian integration and US FTAs to deflect the first-mover advantages they create for US exporters in emerging markets.⁴ To date, only agreements with Korea, Singapore and Canada have been either concluded or nearly finalised. The EU has so far also failed to conclude an agreement outside its neighbourhood with a counterpart unless it has also negotiated with the US first. Moreover, the EU has also failed to negotiate with ASEAN – an endeavour that may have been unfeasible or a political mistake at the outset. Meanwhile, China, India, CER (Australia and New Zealand), Japan and Korea have successfully negotiated FTAs with ASEAN that includes tariffs, services and investment chapters.

Once again, the EU policy response has not been timely, having reacted to TPP only recently with the launch of trade negotiations with Japan and the US; Oceania (Australia and New Zealand) is yet to be addressed at all, and is the blind spot of Europe's map over the Asia-Pacific irrespective of a threat from TPP. Both countries are relatively large in market terms (at \$1.5 trillion GDP). The size of Australia's economy is between Korea and Canada, and the GDP of New Zealand is greater than Vietnam's, another current EU FTA partner. Moreover, they are both substantially embedded in the Asian regional economic architecture. However, EU trade with these two countries together is roughly equivalent to Singapore or the United Arab Emirates.

This delay to engage with TPP members could be too costly in the short and the long term. Firstly, in the short

4 Lee-Makiyama, Hosuk, Upholding Europe's mandate on trade, ECIPE, Policy Brief No. 11, 2012

FIGURE 5: EFFECT OF SELECTED TRADE AGREEMENTS ON EU AND US GDP, PERCENTAGE



Source: Kawasaki (2012, 2013)

term, all TPP members will benefit from economic expansion and higher economic income, whereas for the EU, TPP will be the first ‘competing’ economic integration that is large enough to have a considerable negative impact on its economy. The estimates by Kawasaki (2011, 2013) demonstrate that the EU’s aggregate income (in terms of purchasing power) falls by 0.1% as a result of the trade diversion created by TPP. The sum of such negative effects from intra-Asian Pacific FTAs is estimated to outweigh the combined potential gains from EU FTAs with Japan and the US (Figure 5).

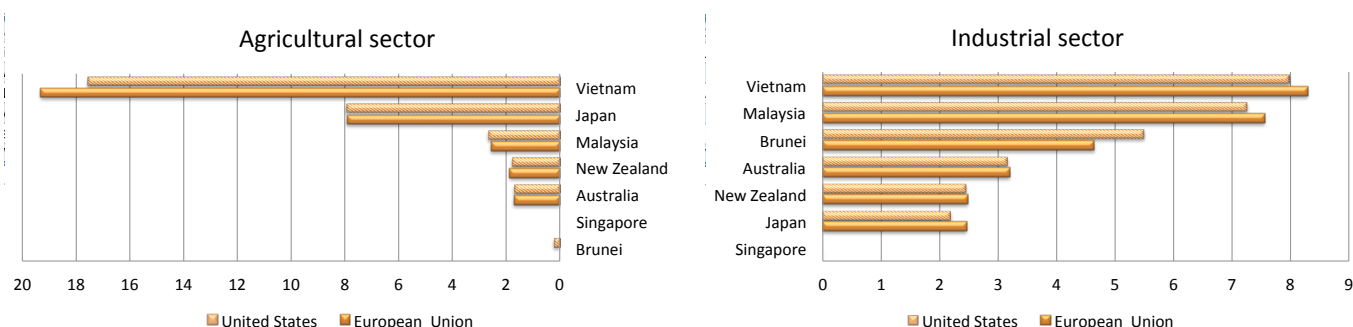
Secondly, the long-term negative effects of TPP for the EU comes from dynamic impact, e.g. on investment, productivity and competitiveness. These effects are even more pervasive and pose a real challenge to the EU. Such dynamic effects may be difficult to determine *ex ante*. Nevertheless, given that Asian economies continue to gain vitality and that TPP is setting the market standards in a number of areas, Europe will inarguably face compliance costs it has not faced before. Global investment patterns are likely to change too. TPP is likely to induce more investment inflows between TPP countries due to increased economic activity and lower transactions costs. This in turn leads to improved utilisation of productivity and factor endowment advantages; as a result, the

importance of the EU as a source for investments will diminish for businesses in TPP countries. Meanwhile European firms aiming to serve the TPP markets will increase their outsourcing of production facilities and distribution entities – with both trends leading to lower investment in Europe.

Lastly, TPP has a significant impact on structural policies and public governance through its disciplines on corporate governance, investment, competition and state-owned enterprises (SOEs) that might substantially improve the business environment for the private sector strengthening competition and innovation capacities – whereas such disciplines are yet to be fully developed in EU bilateral FTAs.

In sum, stronger competition and increased specialisation of intra-TPP-bloc firms will exert stronger competitive pressure on European suppliers and is likely to erode EU firms’ market shares in final and intermediate goods. That said, it is particularly worrisome that no coherent European strategy has emerged so far to steer its trade policy towards addressing developments in the Asia-Pacific region.

FIGURE 6: MFN APPLIED RATES FACED BY EU AND US EXPORTS TO ASIAN-TPP COUNTRIES, PERCENTAGE IN THE LATEST YEAR AVAILABLE



Source: Own calculations; COMTRADE 2013

To balance such negative prospects, it is true that the TPP is neither the first, nor the last, trade agreement without EU involvement. For example, the creation of NAFTA in 1994 did not amount to any serious diversion of trade. On the contrary, EU bilateral trade with Canada, Mexico and the US kept pace with the booming intra-NAFTA trade. This was largely thanks to EU outward FDI into NAFTA that quadrupled during a seven-year period around its creation, mainly due to the excess supply of capital that drove transatlantic mergers, which in turn spurred intra-firm trade between the EU and the US. Whereas capital is still abundant in major European conglomerates, the conditions at the end of the 1990s are impossible to replicate in a post-Euro crisis scenario (in particular for SMEs) while the EU's FDI towards major TPP countries encounters serious constraints compared to NAFTA, as there is less demand for foreign capital in Asia.

AGRICULTURAL POLICY LIMITING EU POLICY SPACE

SOME TIME CONSTRAINTS ON EU trade policy come not from other trade agreements, but internally. For decades, agriculture has represented a caveat to the EU free trade narrative – with the 13% cut in subsidies approved in 2013 for the coming multiannual financial framework starting in 2014. It is more and more evident that the EU needs an export-driven solution in the post-CAP environment – already a reality for sectors such as dairy, pork, wine, sugar, and other competitive products that have graduated to export orientation, higher value-add-

ed, and by focusing on processed food products (PFPs) rather than raw commodities.⁵ The agricultural sectors of some TPP countries prove such reforms bring large benefits in the long term by re-orientation towards R&D, marketing, quality and sustainability. In New Zealand, where the share of farm subsidies is the lowest in the developed world (10 times lower than the EU on partially coupled support,⁶ or up to 40 times less counting all agricultural support), such market developments were spurred by the UK accession to the EU: when a considerable portion of New Zealand exports were diverted away and replaced by European exports to the UK. Future negotiations with the US, Oceania, Latin America and some parts of South East Asia entail putting at least some aspects of CAP on the table, a regime that still accounts for 38% of the EU budget while its distortive effects on competitiveness of European agriculture is well documented. However, throughout the gradual reforms on quotas and subsidies that are taking place (e.g. in meat and dairy production), the EU is also turning towards specialisation and export-orientation towards growth markets overseas. But given that the US is a major exporter of the same goods and has its own integrated supply chain in processed food, TTIP alone cannot offer the market potential that EU agricultural exporters seek, reinforcing the imperative of Asia-Pacific consumer markets.

⁵ European Commission, 'Health Check' of the Common Agricultural Policy, accessed at: http://ec.europa.eu/agriculture/healthcheck/index_en.htm; European Commission, Agricultural Policy Perspectives, 12/2013

⁶ Expressed as share of revenues

TABLE 7: LIST OF TPP COUNTRIES

Country	GDP (current US\$ bn)	Trade to GDP ratio (% of GDP)	Trade with EU (€ bn)	Share of EU trade (%)	Trade in services (% of total trade)	FTA negotiations with the EU
Australia	1 560	41%	42	1.2%	18%	None
Brunei ¹	16	108%	1	0%	16%	None
Canada	1 826	62%	59	1.7%	16%	CETA initialled 2014
Chile	277	64%	18	0.5%	15%	Ratified in 2003
Japan	4 901	36%	111	3.2%	17%	Opened in 2013
Malaysia	312	155%	33	1.0%	17%	Opened in 2012
Mexico	1 260	64%	45	1.3%	6%	Ratified in 2000
New Zealand	185	57%	7	0.2%	24%	None
Peru	202	46%	9	0.3%	14%	Ratified in 2013
Singapore	297	374%	47	1.4%	23%	Initialled in 2013
Vietnam	171	30%	27	0.8%	8%	Opened in 2012
US	16 800	162%	484	14.2%	22%	TTIP negotiations opened in 2013

The TPP includes five of the most efficient and important world exporters for many agricultural products (Australia, Canada, Chile, New Zealand and the US) while some TPP countries – notably Japan – must reform and liberalise their food market and agricultural sector to remain in TPP. When these high-value markets are liberalised through TPP, the new market shares will be allocated immediately to the agricultural exporters within the TPP agreement – unless the EU also achieves the same level of market access. This presents a ‘deadly threat to European exporters of agricultural products in TPP countries’ (Messerlin, 2012). Missing out on the political window of opportunity during the TPP ratification process probably means that there will be no willingness for additional liberalisation if that country later opens up negotiations with the EU. Any tariff cut on agriculture and processed foods must be negotiated in parallel and sold as a legislative grand bargain, and not in sequence.

EU FTAS: KEEPING THE INROADS TO THE ASIA-PACIFIC OPEN

As the TPP has effectively become a keystone with unprecedented impact on other FTAs, some parties have even dared to suggest that the EU should accede to the TPP talks. Indeed, such an endeavour would solve the

cumbersome negotiations of today’s parallel negotiations (eleven in total, including plurilaterals) and a TPP accession by the EU (however hypothetical it may be) would indeed solve some structural issues in EU FTAs on a wholesale basis. History also shows that big and improbable trade deals (like TPP or the Uruguay round) are just as likely to happen as small, marginal bilateral deals, as ‘grand bargains’ are able to attract the necessary political clout to overcome the domestic protectionist opposition. However, from the perspectives of both current TPP members as well as the EU – an EU accession to TPP is not a realistic option even when the agreement is opened up for accession to non-original signatories: The concessions for the EU would be simply too steep, and some disciplines are not compatible with Europe’s own FTAs that are based on low-level WTO commitments and texts imposed from EU regulations and directives. This leaves the EU with no choice but to compete with its own new next-generation FTAs in Asia-Pacific, possibly ahead of the TPP.

Before looking at the new partnerships that such a challenge entails, TPP puts pressure on the EU’s relations with countries that already have FTAs. With the exception of the recently concluded EU-Singapore FTA, the EU-Mexico and EU-Chile FTAs are now over a decade old. There are severe complications involved in upgrading

these tariff-centric FTAs, as counterparts have little incentive to upgrade existing EU FTAs on new trade issues before the TPP is signed although their limited scope (given the long phasing periods and non-existent liberalisation of investment and services) has had very little impact on EU exports.⁷ Meanwhile, Chile already has FTAs with all countries that are part of TPP. Despite some misgiving on intellectual property rights, its government is unlikely to withdraw its backing of an agreement. Furthermore, Mexico aligns its efforts for deeper regional integration to Latin America's Pacific border and encourages free trade and further economic integration into the TPP. It is unlikely that Chile or Mexico will express an interest in new trade issues with the EU any time soon – and if they do, TPP will form the outer bounds of what the EU will be offered from these countries.

Concerning the currently negotiated FTAs between the EU and TPP members – i.e. Canada, (CETA), Japan, Malaysia and Vietnam – there have been severe difficulties of parallel EU/TPP negotiations: CETA has long been under wraps due to politically sensitive issues on a range of new trade issues, e.g. public procurement, geographic indications, investments (in particular regarding investor-state dispute settlement) and financial services. Although the final draft is now en route for review and eventual ratification, uncertainty about the process of ratification in the EU continue to prevail.

Japan, as the world's third largest consumer market after the EU and the US, remains the most prized market of the offensive interests of both the EU and the US. These interests sometimes overlap (as in services), complement each other (as in agriculture where they request different products) or directly conflict (as in automobile safety standards and geographic indications where the EU and the US each promotes their own standards that are incompatible with each other).

Finally, the current EU negotiations with ASEAN members are still a priority for the EU. After failing to conclude a comprehensive trade agreement with all of ASEAN in one agreement, the EU pursued a bilateral approach with individual ASEAN economies, starting

with Malaysia, Vietnam and Thailand (where the latter is currently suspended). For both Vietnam and Malaysia, securing extensive country-specific exceptions for their SOEs in both manufacturing and services is particularly important. The EU will find it difficult to make any progress in this chapter, as their SOE concessions are closely coordinated within TPP. SOEs dominate Vietnam, representing 40% of its economy, notably in textiles, which is incidentally a sensitive sector for Europe as well and protected by Europe's deviating rules on rules of origin for clothing. In sum, for all existing negotiations with TPP members, the EU believes its counterparts are the *demandeurs*, but in reality the EU rule-takers are *demandeurs* to the same extent, as the EU is negotiating not to lose their market share in these countries.

As for countries that the EU is not yet negotiating with such as Australia and New Zealand, they are indeed smaller but are also more like-minded polities, both politically and economically. Australia and New Zealand are also tied by the Australia-New Zealand Single Economic Market created by the Closer Economic Relations (CER) trade agreement, which is the only market integration that incorporates elements that go beyond the European Single Market, notably for services and labour markets. In addition, Australia and New Zealand rely on a much more decentralised approach to manage both its integration achievements and the proceedings towards even deeper economic integration. While the EU single market architects seek further supra-national harmonisation of standards and regulations, CER is primarily based on mutual recognition. In terms of decision making, the CER partners consult through 'ministerial councils' and rely on existing national courts in order to achieve 'EU-plus' liberalisation while avoiding supranational institutions – a mode of market integration that is more applicable to FTAs than the model of EU single market, especially in Asia which is wary of supranational institutions.

At least in New Zealand's case, some thought is now being given to progressing the trade and economic re-

7 See, *inter alia*, Ex-post assessment of six EU free trade agreements, Copenhagen Economics, 2011

lationship, including the possibility of a bilateral FTA.⁸ However, some elements of the CER approach could possibly even help to overcome the constraints on further harmonisation in the EU, particularly in the sacrosanct areas of national sovereignty. However, a three-party negotiation between EU-CER could potentially strengthen the internal market integration of the EU, especially on services and the recognition of professions where CER provisions are particularly advanced. Besides from TTIP, FTAs with Australia and New Zealand (or both together) have the potential to liberalise their internal market or defend their degree of existing liberalisation. Furthermore, Australia and New Zealand have linked with ASEAN through the Australia-New Zealand-ASEAN agreement (AANZFTA), which is also the most comprehensive agreement that ASEAN ever negotiated with 94% tariff elimination, WTO-plus services chapters (primarily on business mobility and education), and comprehensive investment disciplines.

In the overview of the EU strategy towards major TPP members, the US is itself unique. TTIP and the nature of transatlantic integration are unique indeed by their sheer scale, but so are its problems – the regulatory issues between the EU and the US primarily concerns incompatibility between their regulatory models, and may have less bearing on third countries, including those in Asia-Pacific. The opening of the TTIP negotiations has exposed major doubts from the European public, even amongst traditionally pro-free trade political groups. Given these sensitivities, mutual recognition of regulatory approaches and standards seem too ambitious (or tailored to address the unique incompatibilities between the EU and the US) whereas harmonisation of rules and regulations will be left to the regulatory bodies' talks taking place over a long period after the agreement has been made.

In any case, TTIP will follow TPP (and possibly even the Trade in Services Agreement) in terms of sequencing – i.e. it will not be concluded any time soon, and most likely

once TPP signatories have agreed on its 'own' 21st century standards. TTIP has an exceptional value for Europe, but without the support of numerous EU FTAs in Asia-Pacific, TTIP may not be where the new global trade rules are conceived. In short, TTIP alone is not a panacea that solves Europe's problems in the current bilateral order.

CONCLUSION

CONSIDERING ALL THE developments described, there is no doubt that TPP is the agreement that could make the first and the best claim of being the new agenda-setting pillar, especially given its political impetus and its 60% coverage of global trade. It is the only agreement that could create comparative policy disadvantages for the EU that will occur on top of China's increasing importance in the trading system and Europe's natural loss of market shares in Asia due to its natural and business-driven supply chain integration.

Still, the costs of TPP and competitive liberalisation are constantly underplayed in European capitals. This is in part due to Europe's own experience in time-consuming trade negotiations, and the meagre results in achieving substantive and meaningful liberalisation on 21st century issues. As we have seen, what Brussels sometimes fails to fathom is that Asia-Pacific market integration could follow a different trajectory than its own, and clearly with different imperatives. To begin, basic trade rules such as cutting tariffs and subsidies, or harmonisation of rules of origin still matter in the 21st century. Sectoral trade agreements (notably the Information Technology Agreement, ITA) have shown that a cross-regional zero-tariff regime has remarkable consolidating effects on supply chains, even in the absence of regulatory harmonisation. Research shows that tariff cuts within the TPP alone create a trade diversion that nulls all gains achieved through existing EU FTAs.⁹

But TPP also goes beyond mere tariffs. On the aspects of regulatory divergences, approaches between TPP and traditional bilateral FTAs will be notably different. To

⁸ European Commission, Joint declaration by President Van Rompuy, President Barroso and Prime Minister Key on deepening the partnership between New Zealand and the European Union, Statement/14/83, 25 March 2014; See also: EU to consider free trade deal, says Key, The New Zealand Herald, 26 March 2014, accessed at: http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11226577

⁹ Kawasaki, Kenichi, Determining priority among EPAs: which trading partner has the greatest economic impact? Research Institute of Economic, Trade and Industry (RIETI), 2011

date, the US and the EU FTAs have pushed their own regulatory models and standards (especially in manufacturing sectors such as automobiles, chemicals and pharmaceuticals), rather than actually opening up closed markets. Meanwhile the disciplines in TPP could open up closed markets by comprehensively negotiating services on a negative list basis; the public procurement market is another area where only 4 out of the 12 TPP countries are signatories of the WTO Government Procurement Agreement. Trailing behind TPP will not only impair EU influence on crucial product standards with norm-setting effects, but more importantly by limiting EU FTAs to whatever has already been dealt with and liberalised in TPP, make it less likely to successfully advance the EU's own sectoral priorities.

To conclude, Europe's trade agenda cannot be underpinned by TTIP and plurilateral initiatives alone. Moreover, these problems presented by the new regional economic architecture emerging in Asia-Pacific, where TPP is an inherent part of the landscape, presents a strategic imperative to conclude the Global Europe agenda more rapidly and comprehensively than before: the cost of non-action is that Europe will not be able to advance its own priorities against Japan and the ASEAN countries, possibly even becoming *demandeurs* and rule-takers or missing the window of opportunity altogether when these markets open up, especially for SOEs in ASEAN and agriculture in Japan. Furthermore, the blind spot of Australia and New Zealand should be addressed – and before the bargaining chips from CAP pass their due dates, especially as quick and ambitious deals with these countries could underpin further market integration in the region.

BIBLIOGRAPHY

Copenhagen Economics, Ex-post assessment of six EU free trade agreements, 2011. Available at: http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147905.pdf

European Commission, 'Health Check' of the Common Agricultural Policy. Available at: http://ec.europa.eu/agriculture/healthcheck/index_en.htm

European Commission, Agricultural Policy Perspectives, 12/2013. Available at: <http://ec.europa.eu/agricul->

[ture/policy-perspectives/policy-briefs/05_en.pdf](http://ec.europa.eu/agriculture/policy-perspectives/policy-briefs/05_en.pdf)

European Commission, Joint declaration by President Van Rompuy, President Barroso and Prime Minister Key on deepening the partnership between New Zealand and the European Union, Statement/14/83, 25 March 2014. Available at: http://europa.eu/rapid/press-release_STATEMENT-14-83_en.htm

Garcia, Maria, 'Fears and Strategies: The European Union, China and their Free Trade Agreements in East Asia', *Journal of Contemporary European Research*. Volume 6, Issue 4, pp. 496-513. Available at: <http://www.jcer.net/ojs/index.php/jcer/article/view/311/344>

Giles, Chris and Allen, Kate, Southeastern shift: The new leaders of global economic growth, *Financial Times*, 4 June 2013. Available at: <http://www.ft.com/intl/cms/s/0/b0bd38b0-ccfc-11e2-9efe-00144feab7de.html#axzz3Ek1hgMhm>

Kawasaki, Kenichi, Rise of the Mega EPAs: A comparison of economic effects, *RIETI Column*, 4 March 2014. Available at: http://www.rieti.go.jp/en/columns/a01_0390.html

Kawasaki, Kenichi, Determining priority among EPAs: which trading partner has the greatest economic impact? *Research Institute of Economic, Trade and Industry (RIETI)*, 2012. Available at: http://www.rieti.go.jp/en/columns/a01_0318.html

Lee-Makiyama, Hosuk, Upholding Europe's mandate on trade, *ECIPE*, Policy Brief No. 11, 2012. Available at: http://www.ecipe.org/media/publication_pdfs/PB201212.pdf

Messerlin, Patrick, The TPP and the EU policy in East Asia, *ECIPE Policy Brief*, no.11/2012. Available at: http://www.ecipe.org/media/publication_pdfs/Messerlin_TPP-EU_EN05212.pdf

Petri, Peter A. and Plummer, Michael G., The TPP and Asia-Pacific Integration: Policy implications, 2012. Available at: <http://www.piie.com/publications/interstitial.cfm?ResearchID=214>

LATEST PUBLICATIONS:

The ECB's Ad hoc Monetary Policy: Will its Lack of Forward Guidance Finally Burst the Eurozone?

[ECIPE Bulletin No. 12/2014](#)

By Matthias Bauer

A FRIENDLY FIRE ON ECONOMIC RECOVERY: A Methodology to Estimate the Costs of Data Regulations

[ECIPE Working Paper No. 02/2014](#)

By Erik van der Marel, Hosuk Lee-Makiyama, Matthias Bauer

Can Plurilateralism Save the Bali Agreement on Trade Facilitation?

[ECIPE Policy Brief No. 08/2014](#)

By Stuart Harbinson

Les Fonds Souverains de Brevets (FSB) :Un nouvel instrument de défense commerciale?

[ECIPE Policy Brief No. 07/2014](#)

By Hosuk Lee-Makiyama, Patrick Messerlin

Sovereign Patent Funds (SPFs): Next-generation trade defence?

[ECIPE Policy Brief No. 06/2014](#)

By Hosuk Lee-Makiyama, Patrick Messerlin

Cities and the Wealth of Nations: How can Helsinki, London, Paris and Stockholm prosper from TTIP?

[ECIPE Occasional Paper No. 06/2014](#)

By Fredrik Erixon, Martina Francesca Ferracane

Demystifying Investor-State Dispute Settlement (ISDS)

[ECIPE Occasional Paper No. 05/2014](#)

By Fredrik Erixon, Roderick Abbott, Martina Francesca Ferracane

The Problematic Politics of China's Economic Reform Plans

[ECIPE Policy Brief No. 05/2014](#)

By Guy de Jonquières

The Impact of Data Localisation on Vietnam's Economy

[ECIPE Bulletin No. 11/2014](#)

By Bert Verschelde

The Impact of Data Localisation on Korea's Economy

[ECIPE Bulletin No. 10/2014](#)

By Bert Verschelde

The Impact of Data Localisation on Indonesia's Economy

[ECIPE Bulletin No. 09/2014](#)

By Bert Verschelde

The Impact of Data Localisation on India's Economy

[ECIPE Bulletin No. 08/2014](#)

By Bert Verschelde

The Impact of Data Localisation on China's Economy

[ECIPE Bulletin No. 07/2014](#)

By Bert Verschelde

The Economic Impact of Marco Civil da Internet in Brazil

[ECIPE Bulletin No. 06/2014](#)

By Bert Verschelde

Negotiating Trade in Services: Lessons From Autonomous Liberalisation

[ECIPE Bulletin No. 05/2014](#)

By Erik van der Marel

The European Centre for International Political Economy (ECIPE) is an independent and non-profit policy research think tank dedicated to trade policy and other international economic policy issues of importance to Europe. ECIPE is rooted in the classical tradition of free trade and an open world economic order. ECIPE's intention is to subject international economic policy, particularly in Europe, to rigorous scrutiny of costs

and benefits, and to present conclusions in a concise, readily accessible form to the European public. We aim to foster a "culture of evaluation" – largely lacking in Europe – so that better public awareness and understanding of complex issues in concrete situations can lead to intelligent discussion and improved policies. That will be ECIPE's contribution to a thriving Europe in a world open to trade and cross-border exchange.

www.ecipe.org

Phone +32 (0)2 289 1350. Fax +32 (0)2 289 1359. info@ecipe.org. Rue Belliard 4-6, 1040 Brussels, Belgium