

# EUROPE'S TRADE POLICY BETWEEN THE SEARCH FOR POLITICAL STABILITY AND ECONOMIC GROWTH

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This paper situates the EU's trade policy in the much broader context of the integration of regional and international markets. While the WTO is arguably the best forum to negotiate quantifiable targets and to handle dispute settlement, its primacy in regulatory matters is less obvious. The EU is engaged in the negotiation of numerous preferential trade and investment agreements, with objectives that differ depending on the partner country or region. This article therefore proposes distinguishing between a policy for a “near circle” (countries neighbouring the EU), dominated by a goal of political stability, and a policy for a “broad circle” (countries with a level of development comparable to that of the EU), dominated by a goal of economic growth.

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The European Union (EU) is the world's leading commercial player, in terms of both exports and imports. This supremacy is however crumbling rapidly with the emergence of new trading countries, in Asia in particular. The EU has opened its borders, and is continuing to do so. In 2014, the average Most Favoured Nation (MFN) tariff applied was 5.5%, with a rate reaching 14.8% in agriculture and high rates (over 10%) on a significant number of industrial products (WTO, 2013).<sup>2</sup>

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1. The opinions expressed in this article are the responsibility of the authors alone.
  2. It should be pointed out that this article does not deal with the access of the least developed countries to the European market, nor the preferences accorded to the developing countries.

The WTO has lost its role as a forum for negotiations, but not with regard to disputes. The Doha Round has stalled, perhaps for a long time. The reasons for this are to be found in the major geopolitical swing that is taking place between the United States, Europe and Asia-Pacific, and not in trade relations *per se*. The stall in the Doha process is one of the effects of this ongoing mutation, which is affecting a wide range of diverse issues, including climate change, water supplies and the struggle to promote growth in Africa.<sup>3</sup> Free trade zones of an unprecedented size are being negotiated, such as the Trans-Atlantic Trade and Investment Partnership (TTIP), the Trans-Pacific Partnership (TPP), the EU-Japan agreement, the China-Japan-Korea agreement, and the Taiwan-mainland China agreement. These agreements pose a real systemic risk to the functioning of the international trading system due to their ability to fragment the global economy. These cross negotiations deserve special consideration with regard to the strategy of opening up the European market.

The EU has exclusive competence in trade and investment policy. Before starting negotiations over a preferential trade and investment agreement (PTIA), the Commission must first obtain permission from the Council, which decides on a qualified majority. To ratify an agreement, the European Parliament (simple majority) and the Council (qualified majority) vote on the agreements in their entirety. The unanimity of the Council is required in some cases, particularly for the ratification of provisions relating to intellectual property rights to certain services (audiovisual, education and health).

This article distinguishes between the EU's trade policy towards its neighbours (near circle) and policy towards its trading partners that are at a similar stage of development (broad circle). Indeed, signing a PTIA with countries in the broad circle is a unique way to boost European growth. This differentiation between near circle and broad circle policies will help to situate the EU's trade policy within a perspective of economic diplomacy based on differentiated gains: on the one hand, stability and peace in a regionally

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3. A great deal of research has been devoted to the determinants of the marasm ensnaring the WTO. Messerlin (2012a) presents an overview of the international and domestic reasons.

integrated EU; and on the other, economic growth stimulated by targeted global integration.

## 1. Policy on the near circle: the argument of political stability

The EU's trade policy for its neighbourhood is a key element in its external activity. Based on full membership in the EU or on the conclusion of a comprehensive agreement, this near circle trade policy aims to promote peace and stability on the borders of the EU on the one hand and economic development through the expansion of the common market on the other. The political aspect corresponds to a short-term need, particularly in response to the recent crises on the southern and eastern borders of the EU. The economic criterion is reflected in the spread of European regulations in a space that is thus conducive to the flow of goods, services, people and capital.

The EU is composed of 28 members. The recent accession of Croatia is the result of a gradual process that started well before July 2013. Furthermore, this will encourage the faster economic integration of other Balkan countries so as to reduce trade distortions, mainly in Bosnia and Herzegovina and Serbia (Boulanger, Ferrari, Michalek Vinyes, 2013). Serbia is a candidate for EU membership, along with Iceland,<sup>4</sup> Montenegro, the Former Yugoslav Republic of Macedonia, and Turkey. However, these countries are at different stages of integration, with the customs union between the EU and Turkey having entered into force in 1995<sup>5</sup> while Serbia began accession negotiations only in January 2014. Potential candidates such as Albania, Bosnia-Herzegovina and Kosovo,<sup>6</sup> for which accession negotiations have not yet been opened, are on a path for integration into the common market so as to benefit from a process of stabilization and association.

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4. Iceland, a member of the European Free Trade Association (EFTA), like Liechtenstein, Norway and Sweden, has already entered into a process of integration into the European common market. Unlike the European Neighbourhood Policy, EU-EFTA relations are dictated by economic considerations, as with the broad circle policy with countries at a similar stage of development.

5. Andorra and Saint Marin also have a customs union with the EU.

6. "This designation is without prejudice to positions on its status and is in conformity with Resolution 1244 of the United Nations Security Council as well as with the opinion of the International Court of Justice on the Declaration of Independence of Kosovo".

The European Neighbourhood Policy (ENP), which groups the countries bordering the EU, is a tool of economic diplomacy of inestimable influence. The 16 countries in the European Neighbourhood Policy will bring together more than 330 million people in 2030, corresponding to two-thirds of the EU population.<sup>7</sup> The neighbourhood policy is based on the negotiation of PTIA agreements that are called Deep and Comprehensive Free Trade Agreement (DCFTAs). Unlike existing agreements – association with the South, or partnership and cooperation with Eastern Europe – the scope of liberalization covered by a DCFTA goes well beyond simply reducing barriers or opening tariff quotas. It includes trade in services, government procurement, competition, intellectual property rights, and the protection of investments. It tends to integrate the ENP countries into the European single market gradually, as they adopt numerous technical standards and regulations (e.g. sanitary and phytosanitary measures) and develop enhanced cooperation.<sup>8</sup> In order to cope in particular with the high cost of implementing European standards, the European Neighbourhood and Partnership Instrument (ENPI), which covers the 16 ENP countries and Russia, has a budget of about 15 billion euros for the period 2014-2020.

The ENP countries are characterized by 1) an asymmetric trade relationship with the EU, 2) a significant growth potential but requiring prior political stability, and 3) a mediocre regulatory system, aside from a few exceptions such as Georgia, whose Doing Business performance indicator outstrips that of some EU countries. The greater freedom of movement of goods and services should be accompanied by an increase in capital flows between partner countries and by transparency and predictability in the regulatory framework. Likewise, cooperation between countries should allow greater mobility of people. It is worth noting that the latter already exists and should be enhanced by the cooperation

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7. The enlargement policy countries will represent some 20% of the EU's population in 2030, mainly due to the weight of Turkey, which will have a population of between 81 and 93 million by 2030 (UN Population and World Prospects, 2010 projections: <http://www.un.org/en/development/desa/population/>).

8. The Eastern Partnership, the Union for the Mediterranean and Black Sea Synergy are regional forums that help to strengthen cooperation projects that include public and private bodies.

provided for in the DCFTAs. The number of visas issued is a good indicator of mobility (Table 1).

Table 1. Europe's near circle policy

	EU total import.	EU total export.	GDP/capita	Doing Business <sup>1</sup>	Schengen Visas	DCFTA Negotiations
	2011 ln %	2011 ln %	2012 ln €	2014 rank	2012 1000s	As of 01/01/ 2014
EU	6.4 <sup>2</sup>	7.8 <sup>3</sup>	25,500	5-103		
<b>Neighbourhood policy - South</b>						
Algeria	52.1	50.8	4.405	153	280.4	
Egypt	29.1	30.7	2.360	128	120.9	Underway
Israel	34.6	27.7	24.969	35	11.3	
Jordan	20.6	4.7	3.815	119	34.7	Underway
Lebanon	36.1	11.9	8.110	111	85.5	
Morocco	48.3	57.5	2.380	87	322.1	Underway
Palestine	9.2*	1.7*	1.890	138	2.5	
Syria	25.3*	40.5*	2.114*	165	3.3	
Tunisia	57.5	76.4	3.334	51	110.1	Underway
<b>Neighbourhood policy - East</b>						
Armenia	26.0	46.0	2.364	37	35.8	Agreed
Azerbaijan	32.3	59.6	5.820	70	49.9	
Belorussia	18.9	38.9	5.204	63	693.4	
Georgia	29.0	26.5	2.700	8	59.4	Agreed
Moldova	43.5	48.9	1.662	78	48.6	Agreed
Ukraine	31.2	26.3	2.935	112	1 283.0	Underway
<b>Enlargement policy</b>						
<i>Adhesion negotiations in course</i>			Iceland, Montenegro, Macedonia, Serbia, Turkey			
<i>Potential candidate countries</i>			Albania, Bosnia-Herzegovina, Kosovo			

1. The higher a country's rank, the weaker its regulatory performance.

2. Exports from the EU towards the ENP countries as a % of total EU exports

3. Imports of the EU from ENP countries as a % of total EU imports.

\* 2010.

Sources: European Commission (2013), Eurostat, Doing Business.

The benefits expected from integration depend on a significant reduction in non-tariff barriers. Modelling this shows that the aggregate GDP of Egypt, Morocco and Tunisia could increase by more than 10 billion euros in 2020 (2.7% of GDP) due to a DCFTA, compared with the status quo in trade matters. While the increase in European GDP is much less (6 billion), the gains from a stable

and transparent regulatory environment (conducive to investments), and especially the non-monetary gains (political stability), are not taken into account (Boulanger, Kavallari, Rau, Rutten, 2013). Finally, any trade openness leads to winners and losers, which should be targeted by public redistribution and adjustment policies, such as provisions of the CAP related to investments in human and physical capital or measures funded by the European Globalization Adjustment Fund helping people who have lost their jobs as a result of major structural changes in international trade.

In the short term, the economic integration of the near circle is first and foremost a political objective. For the broad circle, the objective is above all economic, and PTIA negotiations need to be guided by the search for growth.

## 2. Policy on the broad circle: the argument of economic growth

Any PTIA signed by the EU must be evaluated according to its ability to stimulate growth in Europe and to promote any reforms needed there. PTIAs that are unable to stimulate growth will not be of interest to Europe's top politicians (Heads of State or Government, Ministers of Finance). They will thus be left to the special interests, leading to only limited results while exacerbating the internal conflicts that any liberalization triggers, even a small-scale one.

This ability to stimulate growth requires that the partner of a PTIA should satisfy three conditions: 1) it must be sufficiently large compared to the huge European economy, 2) it must have a good "regulatory quality" compared to that of Europe, and 3) it must be well connected to the rest of the world. If the Doha round had succeeded in opening all the world's economies simultaneously on a non-discriminatory basis, Europe's businesses would have been able to find countries that meet these three conditions at any time. Liberalization based on a series of PTIA negotiations makes it necessary to determine which countries will be most likely to meet these three criteria, prior to launching negotiations.

The size criterion is based on a simple argument: the larger the size of the partner's markets, the more European firms can increase the economies of scale of their operations and the variety of their

products, and, as a consequence, the more the PTIA in question will help to change the relative prices of goods and services in Europe. This change in relative prices is the mechanism that enables Europe's consumers to find more varied and cheaper products and services. This size criterion has a crucial time dimension, because the EU is facing a pressing need for growth. The EU has little interest today in initiating negotiations with a partner that is too small to have an impact on the EU economy, even if this partner has a huge growth potential in the distant future. Being late in opening negotiations (once the partner has passed its peak size) has a considerable opportunity cost for Europe's growth.

The EU-Korea agreement could be considered a model. This recent agreement (signed in 2010) between two developed economies takes into account almost all the subjects that other PTIA negotiators need to address. In addition, there is good reason to believe that the provisions of the TPP will be close to those of the EU-Korea Economic Partnership Agreement (and Korea-USA). This observation stems from Korea's very peculiar positioning as a dual "platform" in terms of both investment and trade. The expected benefits of this agreement for trade are considerable, on the order of 50 billion euros (Table 2).

The level of average trade protection between the EU and the countries of the broad circle is low (European exports, however, may face weighted average protection on the order of 10% imposed by India and Mercosur). It is possible to approximate a PTIA's growth potential by calculating for each agreement an indicator for the expansion of the European market, defined as the ratio between the GDP of the EU's trading partner and the EU's GDP (Table 2). This ratio provides an order of magnitude of the potential economies of scale and the diversity of goods that the given PTIA will allow European companies, and based on that, its ability to stimulate Europe's growth. This indicator reflects how predominant the TTIP and the EU-Japan agreement are. However, an EU-Taiwan-China agreement would allow the European market to expand by 176% by 2030 (not shown in Table 2, as negotiations have not opened), with Taiwan acting as a "platform" for the Chinese market.

Table 2. Europe's broad circle policy

	Average weighted duty imposed by the EU <sup>1</sup>	Average weighted duty on exports from EU <sup>1</sup>	Doing Business <sup>2</sup>	Expansion of the European market	Expansion of the European market	PTIA Impact on EU GDP <sup>3</sup>	PTIA Impact on EU exports <sup>3</sup>	PTIA Impact on EU <sup>3</sup>
	2011 <i>In %</i>	2011 <i>In %</i>	2014 <i>Rank</i>	2010 <i>% GDP</i>	2030 <i>% GDP</i>	<i>billion euros</i>	<i>billion euros</i>	<i>billion euros</i>
<b>Negotiations concluded – model agreement</b>								
<b>Korea</b>	1.8	2.1	7	6.3	6.7	9.5	25.2	23.6
<b>Negotiations underway</b>								
<b>USA</b>	1.8	1.3	4	94.7	110.9	65.7	29.4	29.0
<b>Japan</b>	3.2	3.7	27	33.9	36.1	42.9	25.2	25.8
<b>Mercosur</b>	4.4	10.5	116*	15.5	28.3	21.5	13.7	14.2
<b>Canada</b>	1.6	2.8	19	9.7	10.3	10.1	14.6	6.0
<b>ASEAN</b>	2.3	2.9	120*	11.4	53.2	4.4	33.7	30.1
<b>India</b>	2.5	9.0	134	10.7	49.7	3.8	11.6	11.8
<b>GCC</b>	0.4	5.8	23*	5.8	11.6	—	—	—

1. Average of duty applied weighted by the flow of imports/exports.

2. The higher a country's rank, the weaker its regulatory performance.

3. Different methodology applied to the examination of each free-trade agreement (FTA); results to be taken with caution (particularly for the breakdown of the agricultural sector).

\* Indonesia (ASEAN), Brazil (Mercosur), United Arab Emirates (Gulf Cooperation Council).

Sources: European Commission (2012), Messerlin (2012b), Doing Business.

The criterion of regulatory quality is also based on a simple argument: the better the partner's regulations, the more the EU is forced to improve its own regulations to provide European companies with the same regulatory quality that its partner offers its own businesses. High quality regulations have proven to be a powerful tool for changing the relative prices of goods and services. Regulatory quality is especially important for the forthcoming PTIAs, which will be dominated by regulatory issues, such as product standards, regulations shaping the market in services, intellectual property rights, etc. Once again this indicator shows the predominance of the TTIP and the EU-Japan agreement. The specific economic impact of these PTIAs has been assessed, with the effects on GDP, exports and European imports presented in Table 2. The cumulative benefit of the negotiations currently underway will come to 150 billion euros, two-thirds of this simply for the TTIP and EU-Japan agreement. Over the longer term the cumulative gain could rise to 250 billion euros (2% of EU GDP) and generate 2 million jobs in the EU (European Commission, 2012).

Finally, it is necessary to highlight the key role that a PTIA offers the EU in terms of connectivity, or the platform effect. Clearly, a country that already has a network with preferential economic agreements with other countries offers Europe's businesses new opportunities – whether these businesses sell their products in the partner country itself or invest in the partner in order to produce the goods it sells in the countries connected to it. In other words, the connectivity of the EU's partner may allow European companies to benefit immediately from the partner's network of preferential agreements to penetrate these third countries; for example, Korea provides a platform to the United States, Canada, the countries of Southeast Asia, Japan and China (ASEAN +3).

In short, with respect to economic size, regulatory quality and connectivity (three key criteria for a PTIA to be a source of growth), the European Commission's choices in 2006 were unfortunate (Global Europe). None of the countries targeted by the Commission (Brazil, India and Russia) meets the above conditions (and the serious reluctance of these countries to open their economies to international competition further reinforces the unfortunate nature of the Commission's choices). On the other hand, the United States and Japan do meet these conditions, hence the EU's "pivot" towards these countries in 2013.

The TTIP and the EU-Japan agreement offer the best support available to meet the EU's urgent need for growth, because these two countries are large enough, have a sufficiently high regulatory quality, and are well connected enough to have an impact on the European economy. Like Korea, Japan, with its preferential agreements in force or under negotiation, seems to be an essential "platform" for European companies that are seeking access to other Asian economies, without needing to wait for the conclusion of PTIAs between the EU and the latter.

### 3. Will the EU be reactive and creative?

This paper situates the EU's trade policy in the much broader context of the integration of regional and international markets. In addition to the urgent need for political stability on the EU's borders, there is also a manifest need for economic growth. In the short term, the goal for the near circle is above all political, while

the broad circle can meet the goal of economic growth. While the WTO is arguably the best forum to negotiate quantifiable targets (e.g. reductions in tariff protection, discipline in agricultural policy) and handle the settlement of disputes, its primacy in regulatory matters is less obvious. Negotiations over regulations clearly require a certain trust between the prospective parties to the agreement. Today, no country has confidence in its 158 WTO partners.

This brief overview of the targeted opening of the European market and those of its main partners calls for several recommendations.

- The EU's trade policy in its own neighbourhood is a key element of its external activity. It is an invaluable tool for influence and stability. Whether through full membership in the EU or the conclusion of a DCFTA, the trade policy for the near circle is oriented above all at a political objective of stability and peace, as for European construction more generally.
- The integration of the neighbourhood and the application of the Community *acquis* require financial support, such as the European Neighbourhood and Partnership Instrument. While the short-term objective is above all political, these agreements must spread European regulations to third countries while also promoting investment and labour mobility between the partner countries, meaning an increased flow of goods, services, people and capital.
- The trade policy for the broad circle must meet the EU's urgent need for growth. The TTIP and the EU-Japan agreement offer the best support available, for these two countries are large enough and have a sufficient regulatory quality to have an impact on Europe's economy. In the short term, the EU-Japan agreement is nevertheless less controversial than the TTIP (the subject of polemics over issues such as genetically modified organisms, audiovisual matters, and personal data). An EU-Japan preferential agreement would also provide an exceptional trade platform towards Asia and ensure against the discriminatory effects of a possible TPP.

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