What Future for EU in the Global Trading System?

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In the fifty years since its inception, the European Community, as it was originally called, has played, together with the US, a major role in both expanding global trade and shaping the global trading system[1].

More recently, the "great rebalancing" of the world economy towards Asian emerging countries, as well as the turbulence resulting from the 2008 crisis have reshuffled the deck and redrawn the gameboard. Overall, trade keeps opening but trade policies have changed their focus. Geography wise, the US has "pivoted" eastward. Once a proponent of balanced multilateralism, America is moving a large number of its eggs into the Asian basket. Others have also moved to more bilateral trade deals. When it comes to the issues at stake; trade policies now pay more attention to "behind the border" trade obstacles, or "non-tariff measures".

These changes have not negatively affected the EU's trade performance: since 2000, its share in world exports has shrunk by 10%, much less than both the US and Japan (- 40%).

Looking ahead, what course should we expect for the EU in the global trading system?

If we take a medium/long term horizon of roughly two decades, my take is the following: the EU will be more dependent on a growing world trade, which raises policy challenges that need to be addressed within this time-frame.

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EU MORE DEPENDENT ON A GROWING WORLD TRADE

1. Whether we like it or not, the growth of the European economies will be more dependent on foreign markets. This reality stems from consensus forecasts for the medium and long term: world growth around 3.5% per year (average between 2% for OECD countries and 5% for others, each group weighted for half of the output). The EU around 1.5% per year: a substantial growth

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[1] Since the treaty of Rome in 1957, the EU trade policy is governed by the principle of openness: “The Union shall contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and on foreign direct investment, and the lowering of customs and other barriers", article 188b, Treaty of Lisbon.

differential, which explains why roughly 90% of growth will occur outside Europe. European external trade, currently accounting for 40% of EU trade, will grow faster than the intra-EU trade (currently 60%), and will represent 50% of EU trade.

2. Word trade will keep growing, although probably at a slower pace than in the recent period of acceleration of globalisation. The trade/GDP ratio[2], which shot up at a time when production systems began rapidly multilocalising along global value chains, is now decreasing as the process of multilocalisation begins to plateau. But I believe this is a small fluke within a long term trend that will keep prevailing. Technology in the digital age will keep slashing the cost of distance, thus fostering international division of labour. This is all the more true when a large proportion of trade volume takes place within a small number of firms, a handful of trade and techno giants. In the words of Richard Baldwin, "international commerce involves richer, more complex and more interconnected exchanges."[3]

3. Within this growth trend the composition of global trade is likely to change under the influence of several factors which will impact EU trade performance:

- Servicification: growth of service trade is likely to be higher than of goods trade, while the line between goods and services will grow ever-fuzzier. It is a positive trend for the EU, provided that the Single Market is completed.
- Decarbonisation: climate change mitigation should lead to a desirable (and following COP21, expected) change in relative prices penalising fossil fuel inputs, hence changing production patterns and redistributing comparative advantages
- Middle class growth: the next three billion joining the middle class by 2030 (two in Asia, one in Africa and Latin America) will heavily impact the geography of consumer demand, hence moving production closer to areas of growing consumption.
- Greater consumers attention to sustainability issues, leading to higher environmental or social standards, thus rebalancing the relative weight of obstacles to trade: less protection of producers (as the import content of exports keeps growing[4]) and more precaution for consumers (as the sensitivity to sustainability, safety, quality increases with living standards, and civil society increases its engagement in the public debate about trade);

[2] The same probably applies to trade measured in value addition which is a more accurate way of assessing the economic impact of trade.
[3] "Multilateralising 21st Century Regionalism", Richard Baldwin, Global Forum on trade reconciling regionalism and multilateralism in a post-Bali world, OECD Conference Centre, Paris 11-12 February, 2014, p39.
[4] At an annual rate of around 10%: 15% in the 90s, 25% in 2015, probably 40% in 2035 (world average), TiVA OECD/WTO Database

- Fewer border-generated costs ("e border" following the 2013 WTO trade facilitation agreement);
- Safer investment regimes: given the likely impressive increase in foreign direct investment from emerging countries, as well as the huge investment needs that remain in those countries, one should expect more transparency, predictability and stability in investment rules. Whether investor to state disputes will remain subject to bilateral extrajudicial procedures, or whether a multilateral regime will replace them remains an open question.

- Geographical distribution: as regional shares of GDP change, so do trade flows: less for Europe, US and Japan; more for Asia and, later, Africa.

4. This central (positive) scenario for the EU's global trade environment may be impacted by the occurrence of risks which could destabilise the world economy

Such risks are already quite well identified: interstate conflicts generated by geopolitical tensions, terrorism leading to tougher security requirements that hamper trade flows; social disruptions stemming from a further technology-driven rise in inequalities.

Other risks are more trade-specific: protectionist measures in the form of export restrictions, local content requirements, investment discrimination or more-or-less disguised subsidies to domestic producers; there are also constraints on trade finance following stricter regulatory prudential standards of anticrime/corruption/drug trafficking/terrorism , the so-called "KYC"[5] precautions.

The more important factor and less noticed so far, is the growing importance of precaution, the scope of which is shaped by cultural, philosophical or ideological features: data privacy, genetically modified food, animal welfare standards, and more generally moral or ethical attitudes towards life at a time when biotechnology will fundamentally call into question our previous attitudes.

These value-related issues are likely to reveal major differences depending on local specificities or allegiances which might prove difficult to accommodate or even approximate. Levelling the playing field on such topics in order to generate further economies of scale might well raise challenges which will prove to be much more difficult to address than the classical exchange of concessions-based trade deals: levelling protection is a well-known game; levelling precaution is a very different one, not least in political economy terms.[6]

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[5] "Know Your Customer."

[6] Lamy, Pascal, *Looking Ahead: The New World of Trade*, Jan Tumlir Lecture, ECIPE, Brussels, 9 March 2015.

ENSUING EU POLICY CHALLENGES

The aforementioned factors which shape the EU's global trade relationship and their likely interplay define the ensuing policy challenges. As always in trade matters, these policy challenges are both international and domestic.

5. The top priority of EU's trade policy in the future that derives directly from the developments sketched above is an offensive one: it is to open further foreign markets. Because of the growth differential already mentioned. But also because of remaining asymmetries between EU's high degree of trade openness and that of emerging markets, whether one considers traditional obstacles to trade (such as tariffs or public procurement limitations), or behind-the-border measures such as technical or sanitary specifications, or trade distorting subsidies in industry which characterise state capitalism.

As compared to the past, the EU leverage to reach its objectives is likely to erode as the relative importance of its economy shrinks (from around 25% of the world economy in the 2000's to around 15% in the 2030's)., The EU, all things equal, will remain a "fragmented power" where trade policy is indeed integrated. However, other international policies (security/defence, finance, diplomacy) will continue to suffer from its less-than-federal polity.

6. Within this market opening focus, and for the reasons already underlined, more attention will go to levelling the playing field in the area of precaution. Achieving this is less an issue of trade-offs (public opinion reacts negatively to "negotiating" precaution) than establishing proper regulatory convergence on the level and administration of precaution, as differences in both entail costs for producers. The obvious candidate for such a process is the US insofar as EU and US have established the most sophisticated systems of precaution as compared to the rest of the world.[7] Hence the strategic importance of the Transatlantic Trade and Investment Partnership (TTIP) notwithstanding the important backlash of public opinion against it in some member states, starting with Germany, on grounds of "regulatory dumping".

Even if these difficulties are to be overcome (notably in convincing public opinion that levelling precaution is "upward" and not "downward"), it will remain a long haul exercise, if one considers Europe’s painful path towards a single market since the mid-1980s. Assuming such a process of

[7] With the likely exception of Japan.

regulatory convergence is launched successfully, the EU (and US) will then have to cope with its multilateralization, which raises important systemic issues, notably for the WTO.

7. Whatever differences distinguish the past world of trade from the future world of trade, whether to move "multilateral" or "bilateral" to achieve the EU's trade policy objectives will remain an important issue in the future. As was the case in the past, these approaches are all but exclusive. Some are more efficient than others depending on issues or circumstances. Norms and standards are probably best addressed bilaterally, at least for a start, in order to create a benchmark that others can join. Subsidies can be tackled regionally[8] or multilaterally and this topic should become a priority for EU in so far as its strong competition policy seriously disciplines state aids whereas EU firms will keep facing state owned or state supported competitors benefitting from below cost of capital financing.

8. Whereas most trade obstacles the EU will have to target are in the hands of sovereign states, a growing number of standards are decided and implemented by firms who act as *de facto* regulators, in particular in areas like environment or labour. In this sense, the expansion of value chains might help "export" relatively high European standards in such areas, and alleviate EU's negotiating burden, thus partially compensating for the above-mentioned "leverage erosion" to be expected.

9. As far as domestic policies are concerned, in order for the EU to best navigate in the future global trading system, Europeans mostly have to deal with productivity and competitiveness, recovering part of the ground lost in recent decades as compared to the US at the frontier of technology, and structural reforms. These issues, which have to do with further European integration, are dealt with in other chapters of this publication. The one priority I would insist on is achieving, at last, a true single market for goods and services including digital, in order to build a much needed cost efficiency comparative advantage for EU exporters.

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[8] As shown by the recently signed Trans-Pacific Partnership (TPP) between the US and 11 Pacific countries.

In terms of trade, the recent phase of globalisation could be characterised as "wider", whereas the next phase to come will be "deeper". Meaning that the interconnections of production systems via their multi-localisation will necessitate more profound integration in areas that transcend national and regional borders. This new phase of trade opening is likely to prove more bumpy than the previous one, as issues at stake - as shown in this chapter – will have more to do with values or ethics, the interpenetration of which will be both economically necessary and politically difficult.

Globalisation is reaching a stage where Polanyi's famous "re-embedding" issue comes back: markets and society cannot divorce, at the risk of conflict. Market mechanisms, efficient as they are, do not dictate the social contract as legitimacy is what political power is about. Addressing this challenge globally within a large spectrum of differing collective preferences, will be a serious trial.

In this sense, the EU might gain a new edge in globalisation, stemming from its own experience in negotiating deep integration. European integration is, after all, the only explicit attempt to synergize economic and political integration. Recent times have outlined how painful this process can be. In the future world trade, the knowhow accumulated by Europeans might well become an asset. As predicted by Jean Monnet: "The (European) Community is no more than a step towards the organisational forms of tomorrow's world"[9].

[9] Jean Monnet Mémoires Paris Fayard 1976 p.617