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Pascal Lamy

What Future for the EU in the Global Trading System?

In the 50 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, along with the turbulence resulting from the 2008 crisis, have reshuffled the deck and redrawn the game board. Overall, the process of global trade opening continues, but trade policies have changed their focus. Geographically, the US has "pivoted" eastwards. 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 ten per cent, much less than both the US and Japan (-40 per cent). Looking ahead, what course should we expect for the EU in the global trading system?

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

EU more dependent on external trade

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 should average around 3.5 per cent per year (two per cent for OECD countries and five per cent for others, each group weighted for half of the output), while EU growth should average around 1.5 per cent per year.[2] Thus, roughly 90 per cent of growth will occur outside Europe.[3] European external trade, currently accounting for 40 per cent of EU trade, will grow faster than intra-EU trade (currently 60 per cent) and will represent 50 per cent of EU trade.[4]

World trade will keep growing, although probably at a slower pace than in the recent period of accelerated globalisation. The trade-to-GDP ratio,[5] 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 continue to prevail. Technology in the digital age will keep slashing the cost of distance, thus fostering the increased 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 technology giants. In the words of Richard Baldwin, "International commerce involves richer, more complex and more interconnected exchanges."[6]

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: The growth of trade in services is likely to be higher than that of trade in goods, 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 the COP21 conference, expected) change in relative prices penalising fossil fuel inputs, hence changing production patterns and redistributing comparative advantages.

1 Since the Treaty of Rome in 1957, the EU trade policy has been 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." See Article 188b, Treaty of Lisbon.

2 IMF, World Economic Outlook, July 2015.

3 European Strategy and Policy Analysis System: Global Trends to 2030: Can the EU meet the challenges ahead?, 2015, p. 27.

4 Ibid.

5 The same probably applies to trade measured in value added, which is a more accurate way of assessing the economic impact of trade.

6 R. Baldwin: Multilateralising 21st Century Regionalism, Global forum on trade – reconciling regionalism and multilateralism in a post-Bali world, OECD Conference Centre, Paris, 11-12 February 2014, p. 39.

Pascal Lamy, President emeritus, Jacques Delors Institute, Paris, France; and Director-General of the World Trade Organization, 2005-13, Geneva, Switzerland.

- Middle class growth: The next three billion people 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 consumer attention to sustainability issues: Implementing higher environmental or social standards will lead to the rebalancing of the relative weight of obstacles to trade. There will be less protection of producers (as the import content of exports keeps growing[7]) and more precaution for consumers (as the sensitivity to sustainability, safety and quality increases with living standards, and as civil society increases its engagement in the public debate about trade).

- Fewer border-generated costs: There will be reduced red tape at borders 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, the US and Japan, and more for Asia and, eventually, Africa.[8]

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, and 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, and investment discrimination or more-or-less disguised subsidies to domestic producers. There are also constraints on trade finance following stricter regulatory prudential standards for anticrime, corruption, drug trafficking and terrorism, the so-called know-your-customer precautions.

The more important but less noticed factor 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, while levelling precaution is a very different one, not least in political economy terms.[9]

Ensuing EU policy challenges

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

The top priority of the EU's trade policy in the future, which derives directly from the developments sketched above, is an offensive one: to further open foreign markets. This is due to the growth differential already mentioned, but also because of remaining asymmetries between the 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), behind-the-border measures (such as technical or sanitary specifications) or the trade-distorting subsidies to industry which characterise state capitalism.

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

7 With annual rates of around 10-15 per cent in the 1990s, 25 per cent in 2015 and probably 40 per cent in 2035 (world average), according to the OECD-WTO TiVA database.

8 See also Mikkel Barslund and Daniel Gros's contribution in this issue.

9 P. Lamy: Looking Ahead: The New World of Trade, Jan Tumlir Lecture, ECIPE, Brussels, 9 March 2015.

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 of 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, since the EU and the US have established the most sophisticated systems of precaution as compared to the rest of the world.[10] Hence, the strategic importance of the Transatlantic Trade and Investment Partnership, 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, especially considering Europe's painful path towards a single market since the mid-1980s. Assuming such a process of regulatory convergence is launched successfully, the EU (and the US) will then have to cope with its multilateralisation, which raises important systemic issues, notably for the WTO.

Whatever differences distinguish the past world of trade from the future world of trade, whether to move "multilaterally" or "bilaterally" 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 the start, in order to create a benchmark that others can join. Subsidies can be tackled regionally[11] or multilaterally, and this topic should become a priority for the EU, in so far as its strong competition policy seriously disciplines state aids among its member states, whereas EU firms will keep facing state-owned or state-supported competitors benefitting from below cost-of-capital financing.

Whereas most of the 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 that act as de facto regulators, in particular in areas like the environment or labour. In this sense, the expansion of value chains might help "export" relatively high European standards in such areas and alleviate the EU's negotiating burden, thus partially compensating for the aforementioned expected "leverage erosion".

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

Conclusions

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 multilocalisation will necessitate more profound integration in areas that transcend national and regional borders. This new phase of trade opening is likely to prove bumpier than the previous one, as the issues now at stake – as shown in this contribution – 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 at which 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 synergise economic and political integration. Recent times have outlined how painful this process can be. In the future of world trade, the know-how accumulated by Europeans might well become an asset. As Jean Monnet predicted 40 years ago, "The [European] Community is no more than a step towards the organisational forms of tomorrow's world."[12]

10 With the likely exception of Japan.

11 As shown by the recently signed Trans-Pacific Partnership between the US and 11 Pacific countries.

12 J. Monnet: Mémoires, Paris 1976, Fayard, p. 617.