

EU External Trade Policy

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Forthcoming in El-Agraa, Ali M. (ed.) The European Union: Economics & Policies, 8th edition, Cambridge University Press, 2007

The external trade policy of the EU impinges on nearly one fifth of world trade. Hence, an understanding of the principles and practice of the Union's trade policy, the Common Commercial Policy (CCP), is of vital importance to any student of the global trade environment. Ongoing research on the CCP has addressed both broad themes and detailed aspects of the Union's trade policy (Gavin, 2001; Memedovic *et al.*, 1999; OECD, 2000b; Messerlin, 2001; Meunier, 2005). The *Trade Policy Review of the EU*, the biennial publication by the World Trade Organisation (WTO), provides insight into how trade specialists view the EU and, no less important, how the EU sees its own role. A number of features of the EU's CCP make it particularly worthy of study.¹

First, while commercial policy originally focused on tariffs and other border measures as they affected trade in goods, the scope of the policy today is much more diverse. Policies affecting trade in services and the conditions influencing foreign investment have become increasingly important. As tariffs were reduced in

successive rounds of multilateral trade negotiations to near insignificance, other policy areas which fall under the general heading of regulatory issues have become increasingly relevant to international trade: intellectual property, technical standards and regulations, competition policy, labour standards and environmental policy, to mention but the most prominent. Many of these regulatory issues reach deep into the heart of domestic policy concerns, with the result that trade policy has become increasingly politicised and controversial in recent years.

Second, EU commercial policy has developed a highly complex set of trade relations with third countries, reflecting in part the way the granting of trade preferences was virtually the sole instrument of EU foreign policy in the past. The resulting hierarchy of preferential trading schemes has been determined by a mixture of trade, strategic and foreign policy concerns in which the conflicting interests of member states, as well as hard bargaining between the Union institutions and the member states, have played an important role. The 1990s saw a significant extension of EU regionalism. Following the launch of the Doha Round of multilateral trade talks in 2001, the EU announced a moratorium on further expansion of its regional trade arrangements, but this has not prevented continuing negotiations on creating such arrangements with a number of its trading partners.

Third, EU commercial policy is shaped by the Union's obligations (and reciprocal rights) under the WTO, which came into being in 1995. The purpose of the WTO is to establish and monitor the rules for trade policy-making in its members

* The authors are grateful to Dermot McAleese for his permission to build on his chapter in earlier editions of this book and for his helpful comments on this chapter, and to Hansueli Bacher for valuable research assistance.

and to encourage the liberalisation of trade through successive rounds of trade negotiations to reduce tariffs and other barriers to trade in goods and services. One of its core principles is that of Most-Favoured-Nation (MFN) treatment, which means that members undertake not to discriminate in their treatment of imports originating in different members (see Chapter 1). The EU played a major role in the Uruguay Round Agreement conducted under the auspices of the General Agreement on Tariffs and Trade (GATT) which established the WTO. It was among the strongest proponents of the further comprehensive round of trade negotiations which was initiated in Doha, Qatar in November 2001. The suspension of the Doha Round in 2006, however, has revived the tension between the EU's commitment to multilateral trade liberalisation through the WTO and its ongoing concern with regional and bilateral agreements outside that organisation.

This chapter investigates these themes in five separate sections. The first describes the pattern of trade between the EU and the outside world. The second presents an overview of the principles and policy instruments of the CCP. The third considers EU trade policy specifically towards its main trading partners. The fourth contains an analysis of trade policy issues which are coming to the forefront in ongoing trade negotiations. The concluding section considers the future development of the CCP.

24.1 EU trade and specialisation patterns

24.1.1 The structure of EU trade

The EU constitutes the largest trading bloc in the world. Excluding intra-EU trade, exports of the Union accounted for 18.1% of world merchandise exports in 2004. The United States and Japanese shares were 12.3% and 8.5% respectively (Table 24.1; see Chapter 5 for a historical perspective).

Table 24.1 The EU in world merchandise trade, 2004

Exports from	Value	
	(\$bn)	%
European Union (excluding intra-EU trade)	1203	18.1
United States	819	12.3
Japan	566	8.5
Other	4054	61.1
Total World (excluding intra-EU trade)	6642	100.0

Source: WTO *International Trade Statistics* (Table I.6), December 2005.

External trade has tended to grow about twice as fast as GDP in most parts of the world and the EU is no exception. Over the period 1995-2005, EU25 trade volumes increased by more than 6% annually in real terms, compared with 2.3% GDP growth. A useful aggregate measure of trade dependence is the ratio of exports plus imports of goods and services to GDP. For the EU25 this stood at 26.1% in 2004, a level similar to those of the US (25.1%) and Japan (27.0%).

About 46% of extra-EU trade is directed towards *developed countries*. Within the developed countries group, the United States is the largest trading partner, followed by Switzerland and Japan (Table 24.2). If intra-EU trade is added to extra-EU trade with developed countries, we find that more than four fifths of the Union's trade is with countries of broadly similar income levels. This is a familiar empirical phenomenon world-wide, but it runs counter to the expectation that trade flows

should be greatest between countries that are most different in economic structure. It has given rise to new approaches to the theoretical modelling of the causes of trade (Krugman, 1994).

Table 24.2 EU merchandise trade by area, 2004

	Imports		Exports	
	\$bn	%	\$bn	%
Developed countries ^a	529.7	14.0	625.2	16.8
<i>of which:</i>				
United States	195.0	5.1	288.5	7.8
Switzerland	77.6	2.0	93.2	2.5
Japan	91.7	2.4	52.6	1.4
Developing countries ^b	601.3	15.9	461.2	12.4
Commonwealth of Independent States	112.4	3.0	80.8	2.2
Other	37.2	1.0	36.6	1.0
Extra-EU	1280.6	33.8	1203.8	32.4
Intra-EU	2510.4	66.2	2510.4	67.6
Total EU	3791.0	100.0	3714.2	100.0

Notes:

^a Europe, North America and Japan.

^b Africa, South and Central America, Middle East and Asia (excluding Japan).

Source: Computed from Tables A12 and A18 in WTO *International Trade Statistics*, 2005.

Developing countries account for 43% of extra-EU trade but for only 14% of total EU trade. Most developing countries rely far more on the EU as an export market than the EU does on them. For example, in 2004, 22% of India's exports went to the EU, but only 1.8% of EU exports went to India, and India's exports accounted for only 1.7% of total EU imports. African countries in general are even

more dependent on the EU market. The asymmetry in bargaining positions is modified somewhat by the strategic importance of some developing country primary product exports, oil being an obvious case in point. The most dynamic element in EU-developing country trade, though, has been the growth in manufactured goods trade with south-east Asian countries. This repeats the general pattern: as countries become more industrialised (i.e., more similar) they trade more with one another.

The commodity structure of EU trade varies greatly by geographical area (Table 24.3). Trade with developed countries consists predominantly of trade in *manufactured goods*. In 2004, these goods accounted for 88% of the Union's exports to developed countries and 81% of its imports from them. Trade with developing countries has a different composition. Primary products figure more prominently in their exports to the EU. Agricultural products comprise 12% of the total and fuels and other products a further 21%. However, the share of manufactured goods in total imports from the developing countries has grown dramatically in recent decades (up from 18% in 1980 to 67% in 2004).

Table 24.3 Commodity composition of EU trade with major trading groups 2004 (% shares)

	Manufactures		Agricultural products		Fuels and other products	
	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.
Developed countries ^a	87.5	81.2	6.5	5.9	6.0	12.9
Developing countries ^b	88.8	67.3	6.5	11.7	4.7	21.0
Commonwealth of Independent States	88.6	19.4	9.6	4.7	1.8	75.9

^a Europe (excluding intra-EU trade), North America and Japan

^b South and Central America, Africa, Middle East and Asia (except Japan)

Source: Computed from Table A18 and A22 in WTO *International Trade Statistics*, 2005.

The EU's *extra-EU merchandise trade* is traditionally close to balance. A small deficit was recorded in 2004, corresponding to 0.6% of EU GDP. So far, the Union's trade balance has not rated much comment; this contrasts with the debates surrounding the United States deficit (6.1% of GDP) and the Japanese surplus (2.4% of GDP). Nevertheless, some bilateral trade imbalances have been perceived as troublesome, in particular the persistent deficit with Japan. The trade balance's economic importance derives from its being both a lead indicator and the largest component in the *balance of payments on current account*. This balance includes services trade and other current transactions. Trade in *commercial services*, comprising travel, transport, royalties and business services corresponds to some 26% of the EU's total trade with third countries.

In trying to work out the effect of a customs union such as the EU on partner and third countries, customs union theory focuses on the share of intra-union versus extra-union trade. The growth of intra-union trade could be due to either trade creation (a good thing) or trade diversion (a bad thing). As a general rule, the greater the absolute growth of extra-union trade, the less the danger of trade diversion. In the EU's case, two facts stand out. First, the share of *intra-EU trade* in total trade has risen markedly from 42% in 1961 to 67% in 2004. As integration among EU members outpaced liberalisation with the rest of the world, this relative expansion of intra-EU trade is in line with the predictions of theory (see Chapter 6). Second, the increase in the intra-EU trade share was accompanied by a rapid absolute growth of *extra-EU trade*. This indicates a preponderance of trade creation over trade

diversion. Further analysis suggests that, with the important exception of agricultural trade, the rise in intra-EU trade has not been at the expense of non-EU countries (Sapir, 1996).

24.1.2 Intra-industry vs. inter-industry trade

Much academic interest has focused on the composition of international exchanges in terms of intra- and inter-industry trade. *Intra-industry trade* (IIT) refers to the mutual exchange among countries of similar goods. This type of trade runs against the predictions of neo-classical trade theory, according to which countries would export one set of products - those in which they have a comparative advantage - while importing an entirely different set of products - those for which the comparative advantage is held by other countries. IIT is based not on country-specific advantages, but on determinants such as consumers' taste for variety, increasing returns in production and the international dispersion of various stages in the production process of advanced industrial goods. IIT therefore typically dominates trade among diversified high-income economies.

Trade within the EU exhibits generally high shares of IIT. Brülhart and Elliott (1998) have shown that, on average, the share of IIT trade among EU countries rose from 48 to 64% over the 1961-92 period. Given that the definition of an 'industry' in that study is very narrow (SITC 5-digit), this is strong evidence that intra-EU trade is driven by forces other than the type of comparative advantage once emphasised in the textbooks.

According to computations by the OECD (2000b) for the 1970-98 period, the IIT share of extra-EU trade has also been growing continuously. Countries with the

largest and most diversified industrial bases (Germany, France and the United Kingdom) typically have the highest levels of IIT with third countries. Greece, Portugal and most of the 2004 and 2007 accession countries have lower IIT levels – their extra-EU trade relations are still largely *inter-industry*. The proportion of IIT in the EU's trade with developed countries such as the United States is high, as one would expect, and with developing countries it is low. IIT with Japan, however, is surprisingly low, a fact often interpreted as a symptom of the impenetrability of the Japanese market to manufactured exports from the west. Low IIT levels could imply that further trade liberalisation with these countries might involve substantial structural adjustment costs for both parties (see Brühlhart, 1998). This may explain in part the insistence on a certain minimum level of economic development being achieved by applicant countries before accession to full membership of the Union was agreed.

24.1.3 External trade and economic specialisation: high-tech industries and low-skill workers

Changes in the EU's trade structure and trade policy regime have stimulated corresponding changes in the pattern of specialisation of member states. The share of agricultural employment in EU15 total employment has fallen from 12% in 1970 to 4% in 2004 (see Chapter 20). There has been a sustained expansion of the services sector, and a fall in the share of manufacturing jobs from 33% to 19% in the same time period. Some industrial sectors were particularly hard hit. For example, since 1984, EU15 employment has shrunk significantly in iron and steel (down 50% or

257,000 jobs by 2004) and in clothing and textiles (down 33% or 1,510,000 jobs by 2004).

Of course, specialisation pressures induced by external trade are not the only forces that shaped the observed changes in the EU's production structure. Even if the EU had existed in autarky, changes in technology, incomes, tastes and demography would have led to structural adjustment. For this reason, it is difficult to isolate and quantify the impact of external trade liberalisation on observed specialisation trends. However, some insights into the processes at work have been yielded by recent empirical analysis. We concentrate here on two sectors for which the role of extra-EU trade has been subject to particularly intensive debate and substantial research: *high-technology* industries and *low-skill intensive* industries. Both have been identified as losers from the EU's trade liberalisation; the former due to presumed insufficient R&D efforts in the EU, the latter due to the inexorable law of comparative advantage.

Trade performance in *high-tech products* has been a source of concern to the EU for many years. The concern focuses on Europe's perceived poor performance in high-tech sectors relative to the US and East Asian 'Tiger' economies, most importantly Japan. One way of measuring this is by the *technology balance of payments*, i.e., the difference between exports of technology (such as international licensing contracts and technical assistance) and imports (such as purchases of foreign patents, know-how and R&D). According to OECD estimates for 2001, the EU15 had a deficit in technology of \$4.6 billion in contrast with an American surplus of \$22.3 billion and a Japanese surplus of \$5.7 billion. Another type of indicator examines patterns in high-tech merchandise trade, such as the share of high-tech

exports in total manufacturing exports, which, according to World Bank statistics for 2003, shows the EU (20%) falling well behind Japan (27%) and the United States (29%). Other trade statistics provide less conclusive results. Table 24.4 shows that the EU has negative trade balances in some key high-tech sectors such as office and telecom equipment but enjoys a surplus in others such as machinery and cars. Indeed, according to the OECD (2002c), over the 1994-2000 period the EU has increased its share of the world export market in four of the five highly technology-intensive sectors analysed (aerospace, electronic goods, computers and precision instruments) and lost market share in only one (pharmaceuticals). It would therefore be wrong to claim that Europe is generally falling behind in terms of competitiveness in high-tech sectors.

Table 24.4 Extra-EU trade in selected technology-intensive products, 1980 and 2004 (\$ billion)

		Exports	Imports	Trade balance	Change in balance 1980-2004
Chemicals	1980	35.7	17.2	+18.5	
	2004	190.9	109.3	+133.6	+115.1
Machinery and transport equipment	1980	115.9	58.0	+57.9	
	2004	541.3	438.8	+102.5	+44.6
Electrical machinery	1980	11.9	5.7	+6.2	
	2004	57.6	55.2	+2.6	-3.6
Office and telecom Equipment	1980	11.3	17.2	-5.9	
	2004	100.6	180.5	-79.9	-74.0
Automotive products	1980	27.5	8.2	+19.3	
	2004	125.9	52.5	+73.4	+54.1

Source: Computed from Table A18 in WTO *International Trade Statistics*, 2005.

The problem of high-tech industries relates to strategic positioning of the EU economy. Low-skill intensive industries give rise to a different type of concern. In the latter case, it is generally accepted that the EU will lose market share to third countries. What is at issue is the pace of change and its effects on the incomes of *low-skill workers*, particularly against the backdrop of the EU's high *unemployment* (see Chapters 5 and 23). Some argue that the law of comparative advantage has been working to the detriment of European blue-collar workers and, in an unholy combination with institutional labour-market rigidities, has fuelled unemployment.

Trade economists have conducted numerous analyses with the aim of isolating trade-related determinants of structural change. Two concepts of structural change have been used: changes in wage differentials across industries and changes in unemployment rates. The starting hypothesis is that the liberalisation of trade *vis-à-vis* unskilled labour-abundant developing countries has depressed demand for unskilled labour in industrialised countries. Trade liberalisation therefore either a) contributes to the widening gap between skilled and unskilled wages, as in the United States and the UK, or b) to rising unemployment of unskilled workers, where union power and restrictive labour-market legislation impede United States-style flexibility of wages. In the EU case, attention primarily focuses on whether increased imports from low-wage countries have exacerbated the unemployment problem.

Most available studies cover the United States or the entire OECD, rather than just the EU, and a number of different methodologies are used. Some studies estimate average factor contents of imports and exports, and infer net effects on domestic factor demands. Other studies regress changes in factor demands over various determinants including import penetration. A majority of analyses find that

trade liberalisation accounts for some of the fall in demand for blue-collar workers in developed countries. However, the contribution of trade to the rise in the skill premium is at most 20%; by far the bigger culprit is trade-independent technological change (Slaughter, 1999).

A contrary conclusion was reached by Wood (1994, 1995) who argued that import penetration from the developing countries is a major cause of falling demand for low-skill workers abundant in the OECD. He refined the standard factor-content analysis and found empirical evidence that manufactured imports of OECD countries tend to have higher low-skill abundant contents than similar goods produced locally, and that imports thereby crowd out low-skill jobs in developed countries. Furthermore, he detected a tendency for OECD industry to engage in 'defensive innovation', substituting capital for low-skill labour in order to survive competition from low-wage exporters, and he pointed to the (often ignored) surge in service exports from those countries. He concluded that demand for unskilled labour relative to skilled labour in OECD countries in 1990 fell by about 20% compared to what it would have been had prohibitive barriers been imposed on trade with the developing countries. Neven and Wyplosz (1999) also found evidence of defensive innovation by EU industries in response to competition from developing countries, but the magnitude of their estimated employment and wage effects is very small.

The nature of the trade-employment link is likely to remain a controversial topic for some time. As the EU reduces its external trade barriers under WTO commitments, and as the exporting capacity of developing countries increases, the pressures for trade-induced specialisation will also intensify. Underlying the empirical debate about the significance of trade liberalisation for EU market

adjustment there is a strong *normative* consensus against a return to protectionism. Even though trade liberalisation is acknowledged to produce losers, gainers are still in the majority. The policy response suggested by economic theory is not to re-impose trade barriers to non-EU imports, but to deregulate EU markets while providing social ‘safety nets’, to subsidise employment of low-skill workers (in the short term), and to invest in education (in the long term).

24.2 The Common Commercial Policy (CCP)

24.2.1 EU trade decision-making procedures

The key provisions of the CCP are contained in Articles 131-134 (ex Articles 110-116) of the Treaty of Rome.² Article 131 contains the well-known aspiration:

By establishing a customs union between themselves member states aim to contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and the lowering of customs barriers.

The cornerstone of the CCP is Article 133. It sets out the important rule that:

the CCP shall be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures towards the liberalisation of export policy and in measures to protect trade such as those to be taken in the case of dumping or subsidies.

Article 133 defines CCP coverage only with an illustrative list – mostly tariffs, antidumping or antisubsidy measures, and trade agreements. Trade in goods,

including agriculture, falls unambiguously within the Community's competence. Decision-making concerning trade in goods under Article 133 functions on the basis of qualified majority voting (QMV) in the Council (see Chapter 3). Subject to the Council's approval, the Commission is empowered to conduct negotiations in consultation with a special committee appointed by the Council for this purpose, the Article 133 Committee, and within the framework of such negotiating directives as the Council may issue to it. For example, the Commission negotiates on behalf of the member states in the WTO. In the cut and thrust of negotiations, the Commission may sometimes interpret its mandate in a way with which some member states may disagree, and this has been a source of tension in the past.

Multilateral trade agreements increasingly cover a wider range of topics including services, intellectual property rights, e-commerce and investment where the Community's competence to negotiate and implement trade policies is much less clear. In 1994, the European Court of Justice (ECJ) was asked to rule on the division of competences with respect to services and intellectual property rights. The Court ruled that the Community had exclusive competence with respect to cross-border trade in services but that member states retained joint competence with the Community for trade issues involving commercial presence and factor movements. As a result, the WTO Agreement was signed by representatives of both the EU Council and of the member states. In 1997, the Amsterdam Treaty modified Article 133 to grant powers to the Community to negotiate agreements on services and intellectual property, but only on the basis of unanimity. The Nice Treaty in 2001 further tilted the balance towards exclusive competence by extending majority voting to these areas (with certain exceptions such as agreements that relate to trade in

cultural and audiovisual services, education, social and human health services as well as transport services, which remain outside the scope of Article 133). But other areas of growing significance, such as investment issues or the traditionally contentious area of export policy, remain under the unanimity rule. Unanimity also continues to prevail in the limited instances where unanimity is required for internal decisions, such as taxation matters (see Chapters 3 and 14) – this is called the principle of ‘parallelism’. The absence of QMV in these areas could make the conclusion of future trade negotiations cumbersome where the outcome is presented as a ‘single undertaking’ because, *de facto*, unanimity is required for the entire agenda (OECD, 2000b).

24.2.2 Instruments of the CCP

The principles of the CCP are put into effect by means of *trade policy instruments* and *trade agreements*. First, we survey the principal instruments of EU trade policy, while trade agreements with non-EU countries are discussed in section 24.2.3.

Tariffs

The most visible element of EU trade policy is the *common external tariff* (CET). More than 10,000 individual products are distinguished at the 8-digit level of the Combined Nomenclature (CN) which lists the duty rates applicable to each product. The structure of the EU’s tariff schedule is compared to those of the US and Japan in Table 24.5. These are applied tariff rates, weighted by the volume of imports of the affected goods.³ In all three countries, higher tariffs are imposed on imports of

agricultural products, food, textiles and clothing. The import-weighted average tariff rate was 6.7% in the EU compared to 2.7% in the US and 2.0% in Japan. The revenues from import duties flow into the general EU budget, after a 20% deduction retained to cover the costs of customs administration by the importing country (see Chapter 19).

Table 24.5 Import-weighted average applied MFN tariff rates in selected countries, 2004 (2003 for EU25), %

ISIC code	Industry	EU25	US	Japan
1	Agriculture, forestry, fishing	14.2	4.5	2.4
2	Mining and quarrying	0.1	0.0	0.0
3	Manufacturing	7.0	3.1	2.5
31	Food, beverages and tobacco	22.4	8.2	8.3
32	Textiles and apparel	10.2	10.6	9.6
33	Wood and wood products	6.2	1.3	2.9
34	Paper and paper products	6.3	0.1	0.0
35	Chemicals, petroleum products	5.7	3.3	1.7
36	Non-metallic mineral products	7.5	4.4	1.1
37	Basic metal industries	6.7	1.0	0.6
38	Fabricated metal products	7.6	2.6	0.8
39	Other manufacturing	5.6	1.8	0.2
	Total all products	6.7	2.7	2.0

Note: The tariff averages in this table are calculated by weighting tariff rates on individual goods by the relative importance of the value of each good in EU imports.

Source: TRAINS database (UNCTAD), 2006.

Tariff averages mask substantial variation of tariff levels across individual products. For example, following the Information Technology Agreement signed in 1997, the EU phased out remaining tariffs on most computer and telecom related goods. At the other extreme, ‘sensitive’ imports such as trucks, cars, clothing and footwear continue to attract high tariffs, in excess of 10% *ad valorem*. The peaks are even more pronounced in the agricultural sector. MFN tariffs on meat, dairy products and cereals were 28%, 38% and 39% respectively in 2004, with individual tariffs exceeding 200% in the case of some dairy products.

Non-tariff barriers

In addition to tariffs, the EU has made significant use of various non-tariff measures to limit imports, although their importance has diminished considerably since the late 1980s, as WTO rules have enforced a stricter discipline in their use. Non-tariff barriers (NTBs; see Chapters 6 and 7) include quantitative restrictions, price controls and regulatory barriers. Specific examples include import quotas, voluntary export restraints, discretionary licensing, anti-dumping duties or prohibitions for health or safety reasons.

Quantitative restrictions on imports are generally not permitted under WTO rules. Quotas were imposed on imports of clothing and textiles under successive Multifibre Agreements (MFAs) and regulated by the WTO Agreement on Textiles and Clothing since 1995. Under this Agreement, the EU eliminated these quotas by 2005 in a phased fashion. Quotas on banana imports designed to protect the market for ACP banana exporters were removed from 2006. Quotas remain in place for imports from non-WTO countries such as textile-related and other basic manufactures from former Soviet Union countries.

As visible trade barriers are dismantled, other ways of restricting imports in 'sensitive' sectors are resorted to. Frequent recourse to *anti-dumping measures* is an example of such practice. Dumping is defined as the selling in export markets below some 'normal' price. The 'normal' price of a good is commonly defined as the price prevailing in the exporter's home market. Such divergences could arise if firms export products at very low prices in order to capture markets abroad and to eliminate competition. The imposition of anti-dumping measures is permitted under

WTO rules, if dumping ‘causes or threatens material injury to an established industry ... or materially retards the establishment of a domestic industry’. Complex pricing policies and adjustment for indirect cost factors leave a degree of arbitrariness in the calculation of dumping margins and ‘material injury’. WTO rules also permit countries to take *countervailing action* against exports which have benefited from subsidies in the exporting country provided such exports cause or threaten to cause material injury to a domestic industry. *Safeguard clauses* under WTO provisions allow signatories to take special measures against import surges or particularly low import prices which cause material injury to domestic industries.

The EU has had frequent resort to anti-dumping measures. In 2001, the EU had the second largest number of product categories with measures in force, after the United States. Over the period 1991 to 2003, the number of EU anti-dumping measures in force fluctuated between 101 and 175 and shows an increasing trend over time (WTO, 2004). Anti-dumping actions take one of two forms: a) anti-dumping duties equivalent to the dumping margin or b) undertakings by exporting countries not to sell to the EU below an agreed price. The most affected product categories are iron and steel products, consumer electronics and chemicals. The EU rarely applies countervailing duties and, in almost all cases, the investigations concern products which are also subject to an anti-dumping investigation.

Regulatory barriers

Products imported into the EU must comply with relevant regulations, where they exist, to meet health, safety and environmental objectives. *Technical regulations* are mandatory rules laid down by the EU or the member states, while *standards* are non-

mandatory rules approved by a recognised body such as a standards institute which provide an assurance of quality to consumers. Compliance is established by means of *conformity assessment procedures*. Regulations may lay down product characteristics or their related process and production methods, or they may deal with the terminology, symbols, packaging and labelling requirements applying to a product or production method. Examples include noise and emission limits for machinery, or labelling requirements such as health warnings on tobacco products or the energy consumption levels of household appliances. Such regulations raise the cost of exporting where a manufacturer has to meet a different set of standards or pay for the cost of demonstrating compliance with the importing country's rules.

The EU's use of regulations and standards must comply with its obligations under the WTO Agreement on Technical Barriers to Trade (TBT Agreement) and, for food safety and animal and plant health measures, the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement). These obligations generally require the EU to use international standards where they exist unless they can be shown to be inappropriate, to avoid discrimination against imported products and to avoid creating unnecessary obstacles to international trade. Between 1995 and 2003 the EU or its member states notified between 76 and 437 new regulations annually under the TBT Agreement, while additional measures were notified to the SPS Committee (WTO, 2004). Some of the more important trade disputes involving the EU have occurred around the use of regulatory import barriers such as its ban on the import of hormone-treated beef, maximum aflatoxin levels in cereals, dried fruit and nuts, and its labeling requirements for genetically-modified foods.

Trade rules for services

Extra-EU services trade received a multilateral legal base through the General Agreement on Trade in Services (GATS), which was negotiated during the Uruguay Round. The scope of this agreement encompasses both the right to do business across countries and also the right to establish local subsidiaries, since it also applies to services provided by foreign affiliates of multinational firms. GATS extends the non-discrimination MFN rule to all service sectors, although members can derogate from this for particular sectors listed in the Annex to the agreement by each signatory (the 'negative list'). *National treatment* (i.e., equivalent treatment to that given to domestic suppliers of a service) is granted to foreign suppliers, but only in the sectors where a member makes an offer to do this by listing it in its schedule of commitments (the 'positive list').

As a result of these qualifications, the GATS provides limited coverage of service sectors, but it contains provisions for continued negotiations. Like other developed countries, the EU is an enthusiastic proponent of freer trade in services. Such is invariably the case for sectors in which countries enjoy a decided comparative advantage. Where such an advantage is less clear, e.g., in the case of audio-visual services, where Europe is a major net importer from the US, free trade is seen as posing a threat to European cultural identity. As already noted, an agreement was reached on telecommunications in 1997, according to which 69 WTO members granted each other (and most other WTO countries) national treatment in all forms of telecommunication services, thus covering over 90% of global telecommunications.

Negotiations on financial and professional services were also completed successfully, but proposals for maritime transport were blocked by the US.

The treatment of public services in the GATS has proved controversial. Whatever the merits of the debate on whether the privatisation or deregulation of public services might lead to an improvement or a deterioration in their quality, most people would agree that this is an issue which should be discussed and decided by citizens rather than through the technocratic processes of multilateral agreements. Fears have been expressed that the GATS could require EU governments to open up the provision of public services to competition. However, the EU has included supplementary specifications in its horizontal commitments which allow subsidies to the public sector and the granting of exclusive rights to public utilities. Even in public service sectors where the EU and its member states have made market access commitments (such as private education and hospital services), they retain the right to regulate these activities with a view to achieving legitimate public objectives.

24.2.3 Regional trade agreements

The EU has developed an elaborate web of preferential trade agreements (see Chapter 1). Initially, these were mainly with neighbouring countries and former colonies, but they now extend to trans-continental agreements without these geographical or historical rationales such as those with Latin American countries. WTO rules allow the formation of regional trade agreements (RTAs) as long as trade barriers on average do not rise after integration, tariffs and NTBs are eliminated within the area on 'substantially all' intra-regional trade, and the project is notified to

the WTO in time for it to determine whether these conditions are satisfied (see Chapter 5, especially the appendix on WTO's Article XXIV).

The EU's penchant for regional trade agreements is apparent from Table 24.6. The most favourable treatment is given to those countries that either fall into the least developed category, or are members of the Cotonou (formerly the Lomé) Agreement, or have completed bilateral trade agreements with the EU. Next come the middle income and poor countries that benefit only from non-contractual discretionary preferences offered by the EU under the terms of its Generalised System of Preferences (GSP). At the bottom of the hierarchy are countries which are members of the WTO but not of the GSP which receive the ironically-named MFN treatment. Until 1998, there were just five countries in this category (Australia, Canada, Japan, New Zealand and the United States) but they have since been joined by Hong Kong, South Korea, Singapore and Taiwan after their graduation from the GSP.

Table 24.6 The EU's network of preferential trade agreements, 2005

<i>Type of trade regime</i>	<i>Name of Agreement</i>	<i>Countries involved</i>
(a) Single market	European Economic Area (EEA)	Iceland, Liechtenstein, Norway
(b) Customs Union		Turkey, Andorra, San Marino
(c) Free Trade Area		Switzerland, Israel, South Africa, Mexico, Chile, Faroe Islands
	Euro-Med Association Agreements	Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria, Tunisia
(d) Partnership and Co-operation Agreements (MFN treatment)		Russia plus members of CIS

(e) Non-reciprocal contractual preferences	First generation Mediterranean Agreements Lomé/Cotonou	African, Caribbean, Pacific countries
(f) Non-reciprocal autonomous preferences	Generalised System of Preferences (GSP)	Other developing countries plus members of CIS and Western Balkan countries
(g) Purely MFN treatment		Australian, Canada, Japan, New Zealand, Taiwan, Hong Kong, Singapore, United States, South Korea

*Note:*1. The Euro-Med Association Agreements are scheduled to establish a free trade area by 2010

2. The WTO waiver that covers preferential aspects of the Cotonou Agreement expires in 2008. The EU's Economic Partnership Agreements will then replace the trade chapters of the Cotonou Agreements.

However, the geographical coverage exaggerates the relative importance of trade links with preferred partners in value terms. The shares of extra-EU imports from MFN countries, from countries covered by reciprocal trade agreements and from countries benefiting from unilateral concessions are each about one-third (OECD, 2000b). In fact, the share of imports entering under MFN terms may be as high as 70% given the importance of non-dutiable imports and administrative rules which restrict the use of the preference schemes by the beneficiary countries. An example of the latter are *rules of origin* (ROO) which determine whether a product has undergone sufficient processing to qualify as originating from a preference-receiving country. By making the rules more restrictive, the EU can disqualify many exports from receiving preferential treatment (see Cadot *et al.*, 2005). The EU's Pan-Euro system, introduced in 1997, assures that the same ROO apply to all preferential agreements signed by the EU, which helps lessen the degree of complexity of preferential regimes under the CCP (Estevadeordal and Suominen, 2005).

As world trade becomes more liberalised, the preferential value of RTAs will diminish. In the long term, it is very likely that all WTO members will enjoy relative freedom of access to Europe's market. EU products might, however, suffer from discrimination created by other RTAs. To avert this danger the EU is seeking conformity across the board to WTO rules. As a result, its own RTAs are becoming less discriminatory, more insistent on reciprocity from the partner country and more broadly focused than in the past. They address regulatory issues, right of establishment, foreign investment, competition policy, financial aid and technical co-operation as well as standard tariffs and import barriers *per se*. Thus, opposition to RTAs on the grounds that they breach the non-discrimination principle of GATT has diminished considerably over the years. The suspension of negotiations at WTO level in 2006, however, raises the spectre of at least a temporary increase in the relative importance of discriminatory trade liberalisation.

24.2.4 Estimated welfare effects of the CCP

The EU is generally perceived as having a relatively open and liberal trade policy. This perception is supported by its role as the world's single largest importer; its relatively low tariff levels on manufactured goods; its extensive network of preferential access agreements; and the stance it has taken in pushing for further multilateral trade liberalisation through the WTO. Messerlin (2001) paints a more sceptical picture by taking into account the tariff peaks in agriculture and the role of anti-dumping duties. He calculates that the average tariff-equivalent extra-EU trade barrier across agricultural and industrial sectors amounted to roughly 14% in 1990 and 12% in 2000. Using different data and estimation methods, Bouët (2002) reports

an average tariff equivalent for 1999 of 9% for the EU. Bouët's estimate is somewhat lower than Messerlin's for three main reasons: he uses applied tariffs rather than bound ones, he takes account of anti-dumping duties only on those trade partners to whom they legally applied, and he takes account of the preferential access granted by the EU under regional and bilateral agreements.

Messerlin (2001) estimates that the total cost to the EU of its remaining external trade barriers in 2000 amounted to around 7% of GDP – roughly equivalent to the national income of Spain. Again, Bouët (2002) arrives at a lower estimate, valuing the net welfare loss from the CCP at around 2.5% of EU GDP. Here, the difference is due mainly to the fact that Messerlin's estimate includes not only the traditional deadweight loss from trade restrictions, but also the tariff revenue and producer rents, which he assumed to be largely squandered. Bouët, on the other hand, follows the standard theoretical approach strictly and considers only the deadweight loss. Neither Bouët's estimates nor Messerlin's incorporate the effect of indirect trade barriers such as EU-specific technical regulations and product standards, nor do they incorporate the effects of continuing protection in service sectors. On the other hand, their estimates make the standard assumption in calculations of this kind of full employment, an assumption whose validity may be questioned in the EU at this time.

It is no surprise, therefore, that the estimated benefits from liberalisation of the CCP are also significant. Economists of the GATT (1994), for example, projected EU income in 2005 to be higher by \$164 billion in 1990 prices as a result of the Uruguay Round. When compared to an estimated total world gain of \$510 billion, this implies that the EU obtained fully one third of the global gains. For an 'ambitious' deal concluding the currently frozen Doha Round, Decreux and

Fontagné (2006) predict a total world gain of \$126 billion in 2020, of which \$33 billion would accrue to the EU. Clearly the EU is a major beneficiary of the trend towards global non-discriminatory trade liberalisation.

24.3 Trade relations with the main partners

24.3.1 Developing countries

In spite of their relative economic weakness, developing countries are a key trade partner for the EU (Table 24.4). The present pattern of trade agreements owes as much to history and proximity to the EU as to economic rationale. These trade arrangements are discussed in detail in Chapter 25 and only a very brief summary is provided here. The *Mediterranean* countries, for instance, are bound to the EU by many ties. Fear of excessive immigration from these areas has given the EU an added incentive to assist their economic development through strong trade preferences. Following the 1995 Barcelona Declaration, the EU and 11 Mediterranean countries agreed to form a Euro-Med free trade area by the year 2010. Also contained in this programme are pledges to abolish obstacles to trade in goods and services on a reciprocal basis. Bilateral FTAs incorporating these principles have been already signed with several Mediterranean countries (see Chapter 1).

Prior to the Barcelona programme, the *Lomé Convention* was the EU's most preferential agreement with developing countries. Signed in 1975, and renewed at regular intervals thereafter, it gave a group of African, Caribbean, and Pacific (ACP) countries free access to EU markets for manufactures and a substantial range of primary goods. The Lomé accords encompassed more than tariff reductions. They

included commodity protocols which provided preferential prices to ACP exports of bananas, sugar and beef, the relaxation of NTBs, more flexible application of safeguard clauses, rules of origin and exemption from MFA restrictions. Trade preferences were supplemented by special aid and technical co-operation arrangements.

In spite of this preferential access, the ACP countries' export performance in the EU market has been disappointing. Their market share of EU imports declined from 5.1% in 1970 to 1.5% in 2004 (UNCTAD, 2004). The EU therefore proposed the negotiation of regional economic partnership agreements (REPAs) with groups of the ACPs, establishing free trade areas in place of the non-reciprocal access these countries enjoyed heretofore. This move was also prompted by the criticisms made of the discriminatory nature of the EU's non-reciprocal preferences in the WTO bananas case. It became clear that getting the necessary waiver from WTO rules for these preferences was going to be more difficult in the future. The Cotonou Agreement, which replaced the Lomé Convention in 2000, envisages the negotiation of REPAs over the period 2002-2008 eventually leading to duty-free access for most EU exports to ACP countries as well as for most ACP exports to the EU.

For most non-ACP developing countries the *GSP* dictates the degree of preferential access for their exports to the EU. Initiated in 1971 by UNCTAD, the purpose of the *GSP* was to help developing countries to industrialise through exports to the developed world. The *GSP* provides substantially weaker trade preferences than the Lomé Convention or the Cotonou Agreement. However, under the 'Everything But Arms' initiative adopted in February 2001, the EU has granted duty-free and quota-free access for all products from the 50 least developed countries

under its GSP, with the exception of arms (preferences for Myanmar are currently suspended on human rights grounds). These special arrangements for least developed countries will be maintained for an unlimited period of time and are not subject to the periodic renewal of the standard GSP scheme.

The EU's multiplicity of agreements and special arrangements with developing countries is undergoing considerable re-assessment. This issue is examined in greater depth in Chapter 25 but some general comments can be made here. First, as global trade liberalisation gathers steam and trade barriers crumble, the practical usefulness of trade preferences has diminished. *Preference erosion* is likely to accelerate markedly over the next decade. This will pose special problems for the ACP countries that have enjoyed for many years advantageous access to the EU market. Second, attention is likely to focus more on issues such as the right of establishment in services markets, attraction of foreign investment, rights to tender for public sector contracts in partner countries, and competition law. We will hear less about trade preferences and more about development programmes. Third, developing countries will have to provide reciprocity in future RTAs if they are to be acceptable under WTO rules. This means they will have to reduce their own import barriers as well. For some there will be a serious loss of government revenues as a result and some (small) danger of trade diversion. While some developing country governments tend to see the reduction in tariffs as a 'concession', trade theory suggests the opposite conclusion. Properly managed, the liberalisation of imports can bring considerable benefits to their economies.

24.3.2 The United States

The United States is the EU's largest trade partner, accounting for 20% of combined extra-EU imports and exports (see Table 24.2). Although EU trade with industrial countries is in principle governed by the rules of the WTO, this has not prevented controversy arising on many specific issues.

EU economic relations with the United States have been based on strong political and cultural ties as well as common economic interests. Yet, at times, it appears as if the two partners are locked into a state of perpetual crisis. In the past, trade wars have threatened to erupt because of disputes over issues as diverse as steel, hormone-treated beef, aircraft noise, subsidies to Airbus, genetically modified crops and bananas. The EU has complained about unilateralism in United States trade legislation, 'Buy American' restrictions, discriminatory taxes, public procurement and restrictions on non-nationals in the services industries. Some European grievances were vindicated in September 1999, when a WTO Panel confirmed that US export subsidies granted through 'Foreign Sales Corporations' and covering approximately \$250 billion worth of US exports were in violation of WTO rules and had to be abolished by October 2000. After much foot-dragging, and following the imposition of retaliatory tariffs by the EU on US imports, the US finally repealed the legislation in late 2004. The EU launched further WTO proceedings against the US in 2002 for an increase in American protection levels against steel imports. For its part, the United States feared a protectionist 'Fortress Europe' arising from the Single Market programme and continues to accuse the EU of unfairly subsidising high-tech sectors such as aviation. The most acute and enduring cause of friction, however, has been trade in agricultural products, particularly concerning the EU's

refusal to allow imports of hormone-treated beef and its moratorium on approving genetically-modified crops for sale.

Although full-scale trade wars have threatened to break out on many occasions, the strong mutuality of interests between the United States and the EU has, on each occasion thus far, saved them from the brink. Trade relations are characterised by constant levels of minor friction rather than a deeply-set divergence of interests. Indeed, the contentious sectors in transatlantic trade are commonly estimated to account for a mere 1-2% of total trade. There is even talk of eliminating all trade barriers, thereby creating a 'new transatlantic marketplace' of some 700 million affluent consumers. A Transatlantic Free Trade Agreement could yield welfare gains in the range of 1-2% of GDP for Europe and 1.6-2.8% for the United States (Boyd, 1998).

24.3.3 Japan

Trade policy towards Japan has been marked by resistance to what is perceived as excessively rapid import penetration in a narrow range of product markets. It is also marked by internal disunity within the EU. Some member states, such as the United Kingdom and Ireland, have become important hosts to Japanese investment. Naturally, these member states have tended to view sales by Japanese firms more benignly than those with a small presence of Japanese-owned production facilities. Also, countries whose domestic industries compete directly with Japanese goods tend to take a tougher line in the trade policy debate than those for which Japanese sales compete only with other imports. Thus, the high share of Japanese passenger car imports in Ireland (43%) and Denmark (34%) aroused little concern, whereas

Italy and France were highly resistant to any easing on restraints on Japanese imports despite having much lower import shares (5% and 4% respectively in the mid-1990s).

The EU's persistent trade deficit with Japan has been a bone of contention. It has been attributed to the combined effects of the strong competitive performance of Japanese firms, to Japan's high savings rate and, controversially, to Japan's reluctance to open its market to EU exporters. In 2004, 7.2% of total extra-EU imports came from Japan, while the Japanese market absorbed only 4.4% of EU exports. This trade imbalance is made particularly contentious because Japanese exports tend to be highly focused on a small number of sectors (automobiles, consumer electronics).

On the basis of explicit barriers to trade, the Japanese market appears relatively open. Japan has committed itself in the Uruguay Round to a trade-weighted tariff average on industrial goods of 1.7%. This is the second lowest average of all countries (surpassed only by Switzerland). However, there are important implicit barriers to imports. First, access to the Japanese market is restricted by regulatory obstacles such as the arbitrary specification of technical standards for electrical appliances and conditions for participation in the financial services market. Japanese non-acceptance of international standards as well as European certification procedures hampers trade in areas such as the agro-food sector, pharmaceuticals and construction. Second, the existence of tightly connected business groups ('keiretsu'), built upon interconnected manufacturers and distributors, makes it particularly difficult for European firms to sell to Japan.

The EU has exerted pressure on Japan to liberalise access to its market, albeit using a less confrontational strategy than the United States. Consultation is the keyword in EU trade diplomacy with Japan. Annual summit meetings have been held between the Japanese Prime Minister, the President of the European Council and the President of the Commission since 1991, and a permanent dialogue was established in 1993 between METI, the Japanese ministry for economics, trade and industry, and the corresponding Commission Directorate. A 'Regulatory Reform Dialogue' has been maintained since 1995 to reduce the thicket of regulations that hampers trade and foreign investment. In addition, export-enhancing schemes such as assistance for marketing in Japan and special visit and study programmes have been initiated to facilitate access to the Japanese market for European business.

Concern over Japanese import penetration has quietened down in recent years. One reason is that the Japanese economy has proved to be weaker and more vulnerable than was believed a decade ago. Another is that despite the deficit with Japan, the EU enjoys a large overall trade surplus. Hence, to object too strenuously to Japan's surplus might give ammunition to countries which had a deficit with the EU! Third, following the major reforms of its financial sector in the late 1990s, access to Japan's market has become easier for European investors. More European companies now have a stake in good relations with Japan. Fourth, EU manufacturing companies have raised productivity by copying Japanese techniques. 'Just in time' techniques are now commonplace. Fifth, as Europeans have gained in confidence, they are more ready to acknowledge that failure to obtain market share in Japan could partly be due to their poor knowledge of the Japanese market. One piece of evidence on this is what has been called the 'knowledge deficit': the population of

Japan is one-third of the EU but there are five times more Japanese people living in Europe than Europeans in Japan. Finally, Japanese companies are becoming more open and more prepared to engage in co-operative ventures than in the past. The Nissan-Renault merger is an exemplar of this kind of co-operation. Clearly, the EU strategy of encouraging exports to Japan and promoting investment between the two countries is superior to protectionism. One must remember that the EU consumer has gained enormously both from access to Japanese goods and from the efficiency improvements forced on European industry by exposure to Japanese competition.

24.4 Trade policy in a globalising world

On 14 November 2001 the members of the WTO concluded the Fourth Ministerial conference with a decision to launch a new WTO round - the Doha Development Agenda - comprising both further trade liberalisation and new rule-making, underpinned by commitments to provide more effective special and differential treatment to developing countries. The negotiations, initially scheduled to last three years, were suspended in July 2006 without agreement having been reached. The EU had four stated objectives at the time of the launch of the Doha Round: (i) to further liberalise access to markets for goods and particularly services; (ii) to strengthen coverage in the areas of investment, competition, transparency in government procurement, intellectual property and trade facilitation; (iii) to ensure that more assistance is provided to developing countries to help with their integration into the global economy; (iv) to get the WTO to focus more on issues of public concern such as the environment, animal welfare and food safety, ensuring that trade

rules are compatible with the wider interests of society as a whole. A more implicit objective, but which nonetheless carries much weight in the actual negotiating process, is the EU's desire to shape WTO rules on agricultural trade to enable it to maintain support for the European model of agriculture (see Chapter 20). This section examines some of the issues at stake in this comprehensive agenda.

24.4.1 Trade and Intellectual Property Rights

Intellectual property is an increasingly important part of international trade. Most of the value of new medicines and other high technology products lies in the research, innovation, design and testing involved. People who purchase CDs, videos, books or computer programmes are paying for the creativity and information they contain, not for the materials used to make them. Considerable value can be added even to low-technology goods such as clothing or shoes through design and the use of brand names. These '*knowledge goods*', ranging from computer programmes to pop songs, and '*reputation goods*' such as trademarks or appellations of origin, account for an unquantifiable but undeniably growing share of the value embodied in traded products. The nature of trade policy with respect to such knowledge and reputation goods differs radically from policy aimed at liberalising merchandise trade, since the main concern is not to abolish obstacles to imports (as countries are generally keen to attract knowledge goods), but to safeguard owners' property rights. Negotiations on intellectual property rights therefore do not consist of bargaining on

abolition of barriers, but on agreements to set up minimum standards of ownership protection.

From a theoretical viewpoint, the enforcement of intellectual property rights is a double-edged sword (see Primo Braga, 1995). In the short run, protecting owners of *knowledge goods* (e.g., through patents) violates the rule that public goods, whose marginal usage cost is zero, should be free. Static efficiency considerations therefore advocate a lax implementation of such property rights, to allow maximum dissemination. In the long run, however, the generation of additional knowledge goods is costly: resources have to be invested in research and development, and this will only occur if a future pecuniary return on such an investment can be safely anticipated. A zero price of knowledge goods is therefore socially sub-optimal in a dynamic sense, because it discourages innovation.

Property rights on *reputation goods* also have their advantages and drawbacks in equity terms. Trademark protection on one hand increases the monopoly power of owners, and thereby restricts competition, but on the other hand it can increase consumer welfare by allowing product differentiation and facilitating product information.

Both sides of the theoretical argument have been advanced in multilateral negotiations on intellectual property rights. Since developed countries, including the EU, tend to be the owners and exporters of intellectual property, while developing countries are net importers, the former generally argue in favour of stricter property-right enforcement than the latter. This was particularly evident during the Uruguay Round. These negotiations culminated in the Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement), which, alongside the GATT

and GATS, forms one of the three pillars of the WTO. TRIPS negotiations were championed mainly by the United States and the EU against much initial opposition from developing countries. Divisions surfaced again when it appeared that TRIPS protection would prevent developing countries from gaining access to generic drugs as part of their public health programmes. At Doha in November 2001, WTO ministers issued a declaration emphasising that the TRIPS Agreement should not prevent member states from protecting public health. They confirmed the right of countries to grant compulsory licences (authorisation, under certain conditions, to produce a drug or medicine without the consent of the patent holder) and to resort to parallel imports (where drugs produced by the patent-holder in another country can be imported without the patent-holder's approval) where appropriate. A further waiver was agreed in 2003 to allow countries producing under a compulsory licence to export to eligible importing countries. This was particularly important for the least-developed countries which do not have the indigenous pharmaceutical manufacturing capability to produce their own generic drugs.

Under the TRIPS accord, signatories have to establish minimum standards of intellectual property right protection, implement procedures to enforce these rights and extend the traditional GATT principles of national treatment and MFN practice to intellectual property. It was agreed that 20-year patent protection should be available for all inventions, whether of products or processes, in almost all fields of technology. Copyright on literary works (including computer programmes), sound recordings and films is made available for at least 50 years. Under the agreed transition period, most countries had to take on full TRIPS obligations by 2000,

while the least-developed countries were allowed to postpone application of most provisions until 2006 with the possibility of a further extension.

24.4.2 Trade and competition policy

The relationship between trade and competition policy was first raised by the US which for many years, like the EU, claimed that Japanese corporate groups undermined market access for foreign suppliers by buying largely from each other and maintaining closed distribution chains. More recently, the EU has made the running, arguing that anti-competitive practices by businesses can have a significant impact on access to markets. It has sought rules that would require countries to introduce a national competition policy and to enforce it. It has also highlighted the need for more international co-operation to deal with questions such as international cartels and multi-jurisdictional mergers. This market access agenda is not necessarily shared by developing countries who have been more concerned about possible anti-competitive behaviour by large multinational companies at their expense. They are also unhappy at the prospect of undertaking additional commitments in an area where they have limited capacity and foresee limited gains. Reaching agreement is also made more difficult, as in the case of intellectual property rights, by theoretical disagreements as to what appropriate competition policy should be.

The EU succeeded in getting a WTO Working Group on the interaction between trade and competition policy established at the WTO ministerial meeting in Singapore in December 1996. This Group discusses the relevance of fundamental WTO principles of non-discrimination and transparency for competition policy. There is no question of trying to harmonise domestic competition laws, but even

reaching agreement on a more general framework is proving difficult. The Doha Declaration had set the objective of establishing a multilateral framework on competition policies, but this topic was dropped from the remit of WTO negotiations in 2004. The question being of evident concern to the EU, it is certain to appear again sooner or later on the international policy agenda.

21.4.3 Trade and the environment

Environmental policy moved to a prominent position on the trade agenda during the 1990s (see Chapter 18). Up to then, virtually the only environmental concern to affect trade policy was the protection of endangered species. With the rise of ecological awareness and transfrontier pollution problems such as ozone depletion, acid rain and global warming, trade policy came to be seen as a significant element in a country's overall environmental policy.

The main trade policy issue in this debate relates to the use of import restrictions on goods whose production creates negative transborder environmental externalities. Economic theory suggests that in such circumstances the most efficient remedy is to apply direct environmental policy at the source of the externality (e.g., through pollution taxes, eco-subsidies or regulation; see Chapter 17). However, environmental policies are often difficult to enforce, so this first-best option may not be feasible. In that case, import restrictions may be the only practicable policy tool. The main drawback of import restrictions against polluting countries is that they provide protection to domestic producers of the importable good, and ecological arguments are therefore vulnerable to abuse by domestic protectionist lobbies. For

this reason, trade measures should be temporary and accompanied by efforts to implement environmental policies in the polluting countries.

Even if the externalities are dealt with by environmental policies adopted at the source, new problems can still emerge. Environmental policies affect the competitiveness of open economies. Thus, countries with lax environmental legislation are blamed for 'ecological dumping', and import-competing industries in countries with stringent laws may lobby for protection to ensure a 'level playing field'. As before, the first-best way of ensuring a level playing field is by achieving some degree of co-ordination in environmental policies across countries. This does not necessarily mean that all countries must adopt exactly the same environmental regime, but it provides a powerful rationale for seeking agreement on environmental policies on a multilateral basis. Even if an agreed way of eradicating 'ecological dumping' could be found, it remains questionable if trade restrictions are the most appropriate remedy. Restricting imports can be counterproductive as it promotes the domestic activities which the environmental policy is attempting to restrain.

On another tack, some environmentalists argue that the rising volume of international trade in itself is causing serious damage to the environment. Oil leakage from tankers and pollution from increased road haulage are classical examples. They recommend reduction in trade if necessary by protection as a solution. The standard economic response would be that trade restrictions are inefficient and that policy should instead be aimed at the source of the problem (e.g., taxation of oil shipments and on the use of polluting fuels by lorries). One could agree with this while pointing out that such correct policy action may not be politically feasible. Witness, for

example, the way in which the European Commission's proposals for a carbon tax have been resisted by business interests (see Chapter 18).

We conclude that trade policy is certainly not the best, and can often be an inappropriate, instrument to protect the environment. International dialogue and agreed domestic policy measures are a more efficient alternative. The main platform for such negotiations is the WTO Committee on Trade and Environment, which was established in 1995. Discussions in this committee have so far been a mere stocktaking exercise, and its reports rarely contained specific proposals. The EU, like everybody else, supports the case for multilateral environmental agreements, but the difficulty lies in getting countries to agree.

24.4.4 Trade and labour standards

The social dimension to increased international trade has received increasing attention given the concern that trade and investment flows should benefit people at large and not just international business. This has led to calls for a 'social clause' in WTO rules which would allow trade barriers to be invoked against imports from countries deemed to violate minimum labour standards. Human rights and moral advocates of a social clause see it as a way of promoting and enforcing core labour standards and helping to eradicate exploitative working practices. The difficulty is that trade sanctions will do little for the bulk of the labour force in developing countries which is employed in the informal sector, and could even have the opposite of the desired impact. A less well-founded argument is that lower labour standards, especially in developing countries, give them an 'unfair' competitive advantage which will either lead to 'social dumping' (the ability to sell goods abroad more

cheaply analogous to ‘ecological dumping’), or to the erosion of existing social standards in developed countries (the ‘race to the bottom’ argument) as footloose firms threaten to uproot to take advantage of laxer standards elsewhere. This version of the pauper labour argument is no less a fallacy for being restated in modern guise. Focusing only on labour costs ignores the substantially higher productivity of labour in developed countries. Developed countries are perfectly able to compete in the sectors where they have a comparative advantage.

The 1995 World Summit on Social Development in Copenhagen identified four core labour standards for the first time, and these were later confirmed by the 1998 International Labour Organisation (ILO) Declaration on Fundamental Principles and Rights at Work. The four core standards are freedom of association and collective bargaining, the prevention of child labour, the elimination of forced labour, and the outlawing of discrimination. The EU is strongly committed to the protection of core labour rights, but the debate is about the appropriate role for the WTO in this task. The ILO enforcement mechanism, being limited to ratified conventions, is rather weak. Hence the attraction of using the WTO with its rules-based system and binding dispute settlement mechanism as the means to ensure compliance.

In the first WTO Ministerial Conference in Singapore in December 1996, the EU was among those which suggested that a WTO Working Party be created to look into the links between international trade and working conditions. The proposal was fiercely resisted by the developing countries which saw it as a guise for protectionism and a cover for more restrictive trade measures. The final Declaration confirmed that the ILO was the competent body to ‘set and deal’ with labour standards. At the Seattle Ministerial Conference in 1999, the United States returned

to the Working Party proposal while making clear that its ultimate objective was to incorporate core labour standards into all trade agreements and make them subject to trade sanctions. This was a major reason for the failure of the Seattle Conference. Labour standards therefore do not feature on the agenda of the Doha Round negotiations.

The EU has opposed sanctions as a way of enforcing core labour standards, but it continues to insist on the necessity of showing that trade liberalisation does not lead to a deterioration in working conditions. It has proposed strengthened mechanisms within the ILO to promote respect for core labour standards, a review mechanism between the WTO and the ILO, as part of which a trade angle would be linked to the reviews conducted by the ILO, and support for private sector and voluntary schemes (such as codes of conduct and ethical labelling schemes) (CEC, 2001a; CEC, 2006p). It has also used social incentives under its GSP scheme to promote core labour standards by providing additional trade preferences for countries which comply with these standards and allowing for the withdrawal of preferences where beneficiary countries practice any form of slavery or forced labour.

24.5 Conclusions

An 'open' market is an elusive goal. Despite much liberalisation, the EU continues to maintain strong defences against sensitive imports. Even under an optimistically liberal scenario, it will be some time before Australia and New Zealand will be able to sell agricultural produce or India textile and clothing products into the EU market without let or hindrance. However, this chapter

concludes that the direction of change has leaned, and will continue to lean, towards easier access. The *Fortress Europe*, which some had feared would be erected around the Single Market, has happily not materialised.

The scope for further *negative integration*, in the sense of reduction of tariff and non-tariff trade barriers, is approaching exhaustion, but in its place there will be greater emphasis on *positive integration* (see Chapter 6). That means requiring governments to adapt domestic policies and institutions so as to ensure that the scope for expanded trade is not frustrated by differences in regulation, market institutions, technical standards and taxes. Linkage between trade issues and other policy areas once considered exclusively in the national domain will grow in importance over time.

Regionalism is still a strong focus of EU trade policy but its future direction is unclear. A recent Commission Communication noted that current regional trade agreements were largely driven by the EU's neighbourhood and development policies, but served its trade interests, particularly in Asia, less well. Using market potential and the level of protection against EU export interests as criteria, it identified ASEAN, Korea, Mercosur, India, Russia and the Gulf Co-operation Council as potential new preferential trade partners (CEC, 2006q). Some worry that this pursuit of regionalism, with its discriminatory stance against third countries, might be at the expense of the stability of the multilateral trading system. Whether regionalism is a 'building block' or a 'stumbling block' for an open multilateral system is a hotly-debated topic among economists. Some argue that it risks prompting the construction of rival free trade areas centred on the Americas and Asia with the prospect that trade disputes between these rival blocs could shake the

foundations of the multilateral system. The more positive view is that the EU's regional trade arrangements can act as a laboratory for rule-making in some of the more contentious trade policy areas, as arguably was the case with the internal market programme, and that experience shows that the EU has pursued a policy of 'open' regionalism which is compatible with its multilateral obligations.

The precise form of the EU's future external policy will depend on several factors. *First*, the increasing heterogeneity among EU members is likely to increase the difficulty of reaching consensus on trade policy. This will strengthen the hand of those who call for the transfer of exclusive competence in all aspects of trade policy-making to the Union, but member states will fight hard to retain as much leverage and influence as they can.

Second, the maintenance of strong economic growth remains crucial. Enthusiasm for integration gathers momentum when an economy is doing well. To some extent European integration and external liberalisation are fair weather phenomena. It is also true that the process of liberalisation itself tends to improve the weather! A prime concern at present is the EU's high rate of unemployment (see Chapter 23). Free trade and unemployment are uneasy, even incompatible, bedfellows. The welfare gains from increased imports do not impress the unemployed. It is remarkable how effective the Commission has been in forwarding its trade liberalisation agenda. One reason may be that many EU countries have a significant balance of payments surplus; when exports exceed imports, it becomes difficult to blame unemployment on excessive imports.

Third, public support and understanding of the benefits of an open trade policy can never be taken for granted. Public opinion finds it difficult to accept that trade

rules might be used to require the EU to import food it deems unhealthy, or products which might damage its environment, or that other trade rules might prevent action being taken to promote animal welfare or improved working conditions. What makes these issues difficult to handle in a WTO context is that, although they are open to abuse for protectionist purposes, they are largely driven by consumer rather than producer concerns. The EU has proposed strengthening the 'precautionary principle' in WTO rules which would allow countries to invoke protection even where scientific opinion is divided on the likelihood of a threat to health or the environment. These concerns also explain why the EU has addressed the linkages between trade and the environment and trade and labour standards, despite the opposition from many trade partners. The EU has also highlighted the need for trade policy to contribute to sustainable development. Sustainability impact assessments are now conducted on its WTO proposals and on bilateral trade initiatives. Governments and business leaders must ensure that trade policy-making remains transparent and accessible if public confidence in the process is to be maintained.

Finally, it is important to reiterate that the stakes in the debate on EU trade policy are high, particularly at a time of considerable uncertainty in the world economy and growing international tension. Estimates were given earlier (see Section 24.2.4) of the cost to the EU of its remaining protectionist barriers, but these would pale into insignificance if there were a breakdown in the multilateral system and protectionist barriers began to increase again. The danger that the resurgence of regionalism might lead to a world of competing trade blocs would be much more real if confidence in the multilateral trading system were damaged. The willingness of developing countries to pursue more open trade strategies would undoubtedly be undermined if

it were felt that the industrialised countries, including the EU, no longer had the stomach for free trade. Balancing the conflicting interests of domestic lobbies, not least agriculture, as well as of the member states is an enormous challenge. EU trade policy will continue to fascinate, and to shape our futures, in the years ahead.

¹ Responsibility for trade in goods and increasingly services and the trade-related aspects of regulatory measures rests with the European Communities (EC) rather than the European Union (EU) – see Chapters 2 and 3. For ease of exposition, however, we refer to the “EU’s” Common Commercial Policy throughout this chapter.

² The observant reader will note that there are now only four trade articles in the Treaty where previously there were seven. The remaining three were repealed.

³ Note that weighting the tariff rates on individual goods by the volume of imports of those goods implies a downward bias in the estimation of the average trade-impeding effect of tariffs, because the volume of imports will naturally be lower in goods that are subject to high tariffs. The tariff averages reported here should therefore be interpreted as lower-bound approximations.