



EU Trade Policy

Approaching a Crossroads

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International Economics Programme | June 2008 | IEP/JEF BP 08/04

Summary points

- In an important shift, inspired partly by drift in the Doha Round negotiations, the EU announced in 2006 that it would seek new free trade area arrangements with fast-growing economies, particularly in Asia. The plan, which ended a moratorium on the launch of bilateral trade talks, in place since 1996, was billed explicitly as a contribution to the EU's own growth and jobs strategy as well as a market-opening exercise.
- However, the policy has so far been no more effective than multilateral negotiations in producing concrete results. Negotiations with South Korea and ASEAN have made only slow progress, while the state of talks with India remains unclear. The EU spent most of 2007 renegotiating long-standing agreements with African, Caribbean and Pacific (ACP) countries in an effort to satisfy WTO rules.
- Meanwhile, the EU's partnership agreements with China and Russia have expired, and appropriate successor arrangements are still being sought. In both cases, a number of important bilateral problems and strains will need to be dealt with.
- With its various trade negotiations treading water, the EU may need to review its options. One could be a more aggressive pursuit of market access, modelled on the US approach. Alternatively, the EU's traditional preference for multilateral engagement may reassert itself.

Introduction

Does European trade policy lack a strategy?¹ Given the manifest tensions between those who support the priority for multilateral negotiations (currently, in the Doha Round) and those who now put equal or greater emphasis on bilateral and regional trade agreements, this paper attempts a closer analysis of the current state of the Union in trade matters. The truth is that trade policy globally is more or less static, with little or no progress being made. This reflects the problems of adjusting to a new situation in which emerging economies have much increased market power but the trade liberalization process has not yet produced new mechanisms for securing general agreement on how to move ahead, and this affects the EU as much as anyone else.

The multilateral trade scene

The EU has long proclaimed its commitment to multilateral negotiations. But regrettably, since mid-2004 (and arguably since the WTO Ministerial in Cancun in 2003) there has been little or no real progress on the multilateral scene. The reasons for that are complex and connected with the adaptation that all international institutions are having to make to the process of globalization itself and to changes in the relative power of the leading nations in trade and economic terms. In 1995 there was scarcely a reference to ‘the newly emerging economies’, and none at all to the Group of 20 developing countries led by Brazil, India and South Africa, with China in the back seat.

The fact that the Doha Round has also been given the title ‘The Doha Development Agenda’ shows that those who were anxious to launch negotiations in 2001 were aware of these trends. Unfortunately, however, the analysis of these trends has not been followed through with sufficient attention to the role of new economic actors in institutional terms. Nor has enough thought been given to the implications for the ambitious result that both the US and the EU have wanted to achieve from the negotiations, in the light of what would actu-

ally be realistic for the developing-country majority in the World Trade Organization (WTO). It is one thing to consider Brazil and India, and even China; but the mass of African countries, along with others in Central Asia, Southeast Asia and Latin America, have found it difficult to keep up.

Bilateral and regional initiatives

Since any politician likes to have an active policy which shows results, it was no great surprise that Peter Mandelson, the EU Trade Commissioner, published a policy paper in late 2006 called ‘Global Europe: Competing in the World’. His subtitle carefully links trade policy objectives to other policy aims: ‘A contribution to the EU’s growth and jobs strategy’. This also represented a continuation of the policy shift started under Pascal Lamy, who had himself linked the external trade policy objectives of securing better market access around the world, and keeping markets open, with the internal EU policy of providing employment opportunities and support for social welfare.

What struck the observer as new, however, was the stronger emphasis on negotiation of bilateral and regional agreements. While the primacy of the multilateral game and the Doha Round was restated in a somewhat ritual fashion, the policy paper was clearly focused on agreements with certain countries that were showing strong growth and where EU exports could be expected to increase accordingly. Korea and ASEAN countries in Asia, and the Mercosur group in Latin America, were identified as the particular targets of new (or resumed) negotiations, with a nod to India, the Gulf Cooperation Council countries and Russia as second options. (Negotiations were started many years ago, but have never been consummated, with the Mercosur group and with the GCC.) China, despite clearly meeting the growth criteria, was said, rather pointedly, to be an exceptional case and to require its own specific approach.

Was this entirely new, and was the change as dramatic as some commentators seemed to think at the

¹ ‘A European Trade Policy which Lacks a Strategy’ is the title of a paper by Beatrice Richez-Baum in the Friedland Papers series published by the Paris Chamber of Trade and Industry: ‘Lettre de prospective, mars 2008’.

time? The answer is, of course, no. The EU had always had a strong track record of bilateral free trade area agreements, stretching back to the 1970s and beyond; but in those days the network was more closely aligned to the broader European area (e.g. agreements between EC and EFTA countries, and with Mediterranean countries in the 1970s). Later in the 1990s came the Central/East European countries and the former Yugoslavia; and, since the establishment of the WTO, agreements with Mexico (2000) as well as with South Africa and Chile (2000 and 2003 respectively). Another area of preferential arrangements was the ACP states (over 70 former colonial countries in Africa, the Caribbean and the Pacific) which were covered by successive Lomé Conventions, and from 2000 by a new agreement signed in Cotonou.

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So what was the new ingredient? In the time of the Santer and Prodi Commissions there had been a self-imposed ban on *new* bilateral free trade agreements in order to underline the main emphasis of the EU’s efforts, the Doha Round. This policy also conveniently allowed the EU to decline to enter into negotiations with Canada and Singapore, both of which had proposed themselves as free trade partners. In this sense, therefore, there was now a clear break with the past.

The fairly clear emphasis on Asia in Mandelson’s policy paper was also a new departure, reflecting the

weight of the new emerging economies and in particular the policy initiatives that China had taken to reinforce its regional relationships. These changes in turn forced Japan and Korea to respond, as well as Australia and New Zealand; the United States, with its long-standing geopolitical interest in the area – e.g. in the context of APEC (Asia-Pacific Economic Cooperation), was not far behind. Europe was in a catch-up game and without a new effort might have been the only major player to be absent.

At a more commercial level, European export interests were about to face discrimination in important markets as preferential access was exchanged between countries within the region and with others. So there was a clear mercantilist motivation to the new policy as well, which happily fitted with the analysis that improved access to these selected growing markets was worth a fresh effort. As a bonus, these agreements could also be linked back to the multilateral scene by adopting the ‘WTO plus’ approach: that is, by having a free trade area agenda which would result not only in ‘the highest possible degree of trade liberalization’² (the ultimate ambition being trade free of duties and other barriers), and more open access for service providers, but also in mutually satisfactory arrangements to align respective regulation of technical barriers and to address investment and competition problems, among others.

This was therefore an ambitious bilateral agenda with a reach going well beyond the classical free trade area which the GATT, despite some efforts, had never been able to define exactly.³ If one looks at the comparative figures for tariff levels, in agriculture and in industrial products, of the prospective partners, as well as the state of openness for services, one rapidly notices problems: it would be typical for the partners to have a bound (i.e. committed) tariff level two or three times higher than that of the EU, sometimes much more, but to have a level of applied tariff rates much lower than that. Would they

2 *Global Europe: Competing in the World. A Contribution to the EU’s Growth and Jobs Strategy*, European Commission, 2006, p. 12; <http://trade.ec.europa.eu/doclib/html/130376.htm>.

3 The WTO rule in Article XXIV (GATT 1994) prescribes duty-free trade on ‘substantially all the trade’ between the partners; but this has never been defined as a percentage of the trade volume covered or excluded, nor does it explain whether it means actual volumes or the broader measure of tariff lines. Since the Uruguay Round it is not permitted to exclude ‘a major sector’ of trade – generally understood to mean agriculture.

be willing to commit to duty-free trade bilaterally when they had in the Doha context recently and repeatedly refused to engage on tariffs in this way? Would they be willing to increase the open access for services by a factor of three to match that of the EU when they had held back from such offers in the WTO?

Actual EU trade policy in 2007

Before looking at how these bilateral discussions have fared, this section considers the Cotonou agreement to illustrate how events in the real world are as strong a factor in policy formation as any of the objectives set by governments. During much of 2007, the EU was in fact heavily occupied with renegotiation of this agreement, an exercise that is not only formidably wide (involving over 75 partners) but that on this occasion involved potentially major changes in the EU–ACP relationship. Why was this the case? Cotonou had been designed *ab initio* as an agreement for eight years, finishing in December 2008, but the urgency for its renewal and the difficulty arose from the WTO situation. Following the Uruguay Round the EU had been obliged to seek a waiver for the Cotonou agreement (which, like its predecessors, was based upon free trade in one direction only); this waiver also expired in 2008, with the consequence that all preferential tariff rates in favour of ACP countries would also expire unless some new, genuinely reciprocal, free trade arrangements could be agreed by then.

This basic situation was then complicated by several factors. Pro-development players within governments and NGOs naturally took the stand that an end to preferences was unthinkable but that full reciprocity between the EU and the ACP was equally impossible. ACP countries, despite having had long notice of the deadline that the WTO effectively imposed on the EU, claimed that they were being forced to sign up to arrangements without having had time to weigh the full impact on their economies. EU members were

predictably split, with multifarious interests of their own to pursue. Finally, a separate WTO dispute of long standing between the EU and banana-exporting countries intruded into the scene, with Latin and Central American countries undermining the rationale for the special treatment of the ACP by seeking to eliminate completely the preferential trade advantages enjoyed by Caribbean banana suppliers (who would not be competitive on equal terms) and by some African suppliers.

These matters found their own partial and last-minute solutions in mid-December 2007, but the effects of this lengthy and at times highly politicized debate on other negotiating activity – whether the Doha Round, or new bilateral agreements – are now plain to see. There is little significant progress to report. Discussions with what one observer has called ‘the inchoate ASEAN group, mercurial India and a weak Korean government’⁴ proved elusive. In the Korean case very slow progress was made, largely because the US–Korean agreement (signed at the eleventh hour, as the US negotiating authority expired) was put on the back burner following the Democrat takeover of both houses of Congress. In the ASEAN case talks are still on the starting line, with continuing arguments about how countries in the group will negotiate – as a single unit (as the EU would prefer) or each country on its own. And in the Indian case, discussion is bogged down at an early stage.

With the multilateral scene in disarray, and with a US presidential election imminent and a change of EU Commission in 2009, the trade policy world is treading water. It is a common view that the frequency of disputes rises when no multilateral trade liberalization is in prospect, and that it falls when serious negotiations are taking place. In the Doha case, matters have been stalled for so long that one could have expected a steady increase in the number of disputes; but in fact the trend has been downward over recent years.⁵

4 Simon Evenett, ‘Trade Policy’, in *Fragmented Power: Europe and the Global Economy* (Brussels: Bruegel, 2007). (There has, of course, been a change of government in Korea since then.)

5 In the early years (1995–2002) cases referred to WTO averaged 35 a year, with peaks of 40 or more in 1997 and 1998. Since April 2005, the average has been only about 12 per year. The EU itself has launched only five cases since January 2006, but is involved as defendant in others such as the civil aviation subsidies. However, this does not suggest a general rush to litigation as a substitute for negotiation.

For the EU, relations with Russia (given high oil prices and the energy dependence of many EU member states on Russian supplies), and also with China, have moved to centre stage. The Chinese relationship has proved to be closely linked to proposals for trade remedy reforms, but less important in the end than the traditional reliance on anti-dumping action where necessary. The remaining sections of this paper examine the EU strategy in these areas, briefly and in turn.

The EU–Russia relationship

This has been marked in the past by a number of fits and starts, and the provisions of the out-of-date Partnership Agreement have continued unchanged. A number of serious bilateral problems are complicating the work of repairing and improving this relationship: for instance, Poland's anger that its meat exports, although accepted within the EU, are banned in Russia; and British hostility to a regime which has denied extradition of a Russian accused of murder in London, and which has forced the closure of British Council offices in Russia. On top of that, Russia's resorting to limiting or cutting off gas supplies to any country with which it has a commercial disagreement puts energy supplies to the EU as a whole potentially at risk and diminishes Russia's credibility as a reliable partner in the future. The treatment of Western partners in joint energy ventures has also raised issues about the security of such investments.

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The EU does have some leverage, in that Russia is still negotiating its accession to the WTO and needs EU approval of the final result.⁶ In recent months Russia has been steadily increasing its export taxes on timber – a policy designed to make the Russian pulp and paper industry more profitable (at the expense of the long-term viability of the Swedish and Finnish industries). Reports from Geneva suggest that a final resolution of this and many other current issues may be some distance away. Russian negotiating tactics make it hard to know what is or is not in fact agreed, and the likely outcome is that Russia will blame the EU and US for each and every case of disagreement.

China and the EU

China (now the third largest trading nation for goods, and fourth for services) has become a much more important partner for the EU since joining the WTO in 2001. As with Russia, the previous bilateral trade agreement has expired and both sides are looking for the most appropriate form for a successor arrangement. In the Mandelson policy paper of 2006 a free trade area seems to be ruled out (much as it is for the United States and Japan, the other major trading nations). It may be, if a preferential agreement is not possible, that a new arrangement would focus more on investment issues, and on regulatory matters in fields such as health and hygiene (product and food safety), prudential requirements in the financial sector and the protection of intellectual property rights.

A separate but parallel approach is also under way with the decision to establish a high-level economic strategy group, along similar lines to those guiding US–China relations. This is likely to meet at senior political level, with Commissioners and Chinese ministers participating according to the particular agenda on each occasion. What is certain is that bilateral trade imbalances and other problems, such as the

6 The EU has settled tariff and services access issues with Russia on a bilateral basis, but there are still a number of important matters to be negotiated multilaterally in Geneva in the Accession Protocol.

7 For instance, the so-called 'bra war' in 2006 – which was actually a safeguard measure; and cases involving footwear and more recently energy-saving light bulbs and air compressors. In all these cases views within the Commission and in the Council have become polarized.

exchange rate of the Chinese currency and investment questions, will figure prominently in the dialogue.

Finally, in the Chinese context, there are numerous anti-dumping issues. At their simplest, these represent reactions by European producers to (alleged) low-cost competition from China and other countries. What has complicated the scene is that many Chinese firms are exporting 'to order' in response to the demands of European importers and retailers and according to designs and fashions supplied from Europe. Thus two opposing factions have developed: the firms and member states that want protection for producers; and others, especially importers, that want cheap imported goods and in principle back consumers. This has led to a series of well-publicized, difficult decisions in which the Commission investigates facts and takes its view of the need to act, and then that decision, when it is challenged by one or other of the member states, goes on appeal – to be confirmed or rejected by ministers in the Council.⁷

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These factors have also had an impact on another Mandelson initiative: seeking ways to reform the trade remedy procedures in the direction of a more liberal

attitude and a more balanced assessment between the various interests in play. After a long consultation stage with member states, it became clear that the 'old industry' forces, especially in France, Italy and Germany, still attach importance to the anti-dumping laws as an insurance against unfair competition and as a form of safeguard measure after cuts in customs duties and elimination of other barriers. During this process the China card was played, with reflections in public on the different status of various Chinese exporters: those that were the direct result of European investments (wholly owned subsidiary companies); those that were Chinese with or without a European ownership stake and responding to the import demands as described above; and the classic case of a Chinese-owned company that produced for export. Should these companies be treated differently according to the impact of their exports on the European market and on jobs? No conclusive reply was given to such reflections, but the reform proposals have been withdrawn.⁸

Looking ahead

The EU is approaching a crossroads. In one direction the relationships with China and with Russia will have to be repaired and renewed, whatever happens in the wider world. In another, the uncertainty over the future of the Doha Round makes it difficult to predict how trade policy will evolve. If there is no agreement in 2008, then the WTO may come under pressure to promote some further multilateral action: at the least, a review of its capacity to conduct negotiations in a changing world. If there is a compromise this year, to be ratified in 2009 and implemented gradually, that will interact with current regional initiatives.

So what will the mercantilist EU policy of seeking bilateral and regional agreements in Asia and elsewhere achieve? As indicated above, the score card is not very promising; there has been little significant progress to date. Negotiations with Korea and ASEAN are not

8 Other recommended articles: 'Trade Policy: Time for a Rethink' by Simon Evenett, University of St Gallen, and 'Global Europe: Old Mercantilist Wine in New Bottles' by Jim Rollo, University of Sussex. See also the following recent Chatham House Briefing Papers: Jim Rollo, *An EU–Korea Free Trade Area: Playing Catch-Up or Taking the Lead?*; *Prospects for an EU–Gulf Cooperation Council Free Trade Area: The World's First Region-to-Region FTA?* (both 2008); Stephen Thomsen, *Spice Route to Europe? Prospects for an India–EU Free Trade Area* (2007).

moving forward, for different reasons. Those with Mercosur (as always) are probably dependent on an agriculture deal in the WTO. There is considerable obscurity over the degree of progress with India. Some observers think that the EU will follow the US pattern of adopting a more aggressive attitude in pursuit of freer trade (market access), both bilaterally and in the WTO.

But the world of 2008 is not the same as that of the 1990s, given the institutional changes ushered in by the Uruguay Round and the new play of forces in the WTO, with widespread active participation by many developing countries. It is not an easy prediction to make; but the traditional EU preference for multilateral avenues may well reassert itself.

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The support of the Japan Economic Foundation is gratefully acknowledged



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Designed and typeset by SoapBox, www.soapboxcommunications.co.uk

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