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THE EU IN THE WORLD TRADING SYSTEM

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ABSTRACT:
EU policy towards external trade has changed dramatically since the 1960s and 1970s, when it was characterized by protection for domestic producers in areas such as agriculture, cars, steel, etc. and by a pyramid of preferences favouring trade partners to varying extents. By the time of the 2015 *Trade for All* statement, the EU was committed to open trade relations in support of European firms' participation in global value chains, reinforced by deep agreements with specific partners (e.g. Korea, Canada, Japan), of which a prime example is the EU-Australia agreement currently being negotiated. The deep agreements, among other things, provide frameworks for dealing with new technologies consistently with the single digital market and EU privacy requirements.

Against this evolving background, the EU has had to deal since January 2017 with US abdication from leadership of the WTO-based multilateral trading system and wilful introduction of new trade barriers against especially China but also including the EU.

This paper sets out the background to the international trade challenges facing the new EU leadership team and analyses the available options and likely outcomes.

Key words: economic integration; globalization; international trade

JEL classifications: **F02 F15; F55**

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Against this evolving background, the EU has had to deal since January 2017 with US abdication from leadership of the WTO-based multilateral trading system and wilful introduction of new trade barriers against especially China but also including the EU. This has happened at a time when the WTO was already experiencing difficulty of introducing new measures, as reflected in the interminable Doha Development Round whose only, relatively minor, achievement - the 2017 Trade Facilitation Agreement - was initially vetoed by India.[1]

This paper sets out the background to the international trade challenges facing the new EU leadership team and analyzes available options and likely outcomes. The first section reviews the challenges facing the EU at the start of the WTO era in 1995 and the second section analyzes the EU response to these challenges, emphasizing the slow but consistent convergence towards policies easing access to imported inputs as opposed to protecting European producers from competing imports. The third section undertakes preliminary assessment of the impact of the Trump Shock on the EU. The final section draws some conclusions.

1. The World in 1995

On 1 January 1995, the World Trade Organization began operation. Under the leadership of the "Quad" – the USA, EU, Japan and Canada – the last GATT round of multilateral trade

[1] On the TFA negotiations, see Neufeld (2014), and on implications for the EU Cachet (2017). Difficulty in incorporating new areas does not mean that the WTO is useless; domestic law codes are not rejected because of difficulty legislating in new areas.

negotiations, the Uruguay Round, Shad been brought to a successful conclusion, but it had been a close-run thing. Negotiations had been near to collapse at the Montréal Ministerial meeting in 1990. The EU's part in the resuscitation of negotiations required commitments to reform its most protectionist policies (the common agricultural policy and new protectionism against imports from East Asia) and to end the one-way preferential treatment granted to former colonies and other preferred trading partners, which was in conflict with the letter and the spirit of GATT trade law based on non-discrimination among members.

Many in the EU were not unhappy to reform the expensive agricultural policy or to dismantle the pyramid of trade preferences that had led more often to disputes among partners concerned about their place in the pecking order than to gratitude for preferential treatment. Nevertheless, reform was a slow process as potential losers resisted change. CAP reform begun by MacSharry in 1992 was not really completed until after the Fischler reforms of 2003-4, when rural subsidies were decoupled from output or farm size; export subsidies to dispose of surpluses had disappeared by 2010 (**Figure 1**). Agricultural protectionism remains for some items (e.g. beef and sugar) but is much reduced. The complex array of quotas on textile and clothing imports from low-wage countries was only terminated with the end of the Multifibre Arrangement in December 2004. By 2006, when the Commission issued its *Global Europe* report, the EU was clearly searching for a more outward-oriented trade strategy.

Meanwhile, the world economy was changing in important and interconnected ways. By the late 1990s, reports were publicizing the complexity of international production processes and the limited meaning of "Made in country x" labels. Initially, the subject of a plethora of names (outsourcing, offshoring, fragmentation, trade in tasks, etc.), the phenomenon is most commonly referred to now as global value chains (GVCs), even though most chains are regional rather than global.[2] Early European examples included the concentration of Maltese industry with a quarter of workers involved in assembling Wrangler jeans during the 1970s (Grech, 1978) or the Ford Fiesta assembled in Spain since the 1970s from European-wide components.

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[2] Baldwin (2016) and UNIDO (2019) review the literature on GVCs. The concept was popularized in the late 1990s by reports of how little value-added of the *Made in China* Barbie Doll or iPod actually accrued in China.

The WTO Charter is silent on ecommerce or digitalization. Unsurprisingly so, as the internet was still in its infancy (**Figure 2**). The classic study by Freund and Weinhold (2004) found no statistically significant relationship between internet use and trade up to and including 1995, but from 1997 to 1999 the internet contributed to about a one percentage point increase in annual export growth. Subsequent studies confirmed the timing and positive effect of the internet on international trade (Clarke and Wallsten, 2006; Lin, 2015). One of the effects was to facilitate management of GVCs through better coordination of GVC participants and reliable tracking of supplies, contributing to the rapid expansion of GVCs over the last quarter century.

Many commentators identify three "kingdoms" when it comes to regulation of e-trade (Mitchell and Mishra, 2018). The United States emphasizes commercial freedom with limited intervention, China and Russia are more focused on cybersecurity, and the EU has strong concerns about privacy and individual rights. Such divisions are stylized and may change, e.g. Chinese domestic legislation has evolved from a focus on cybersecurity before 2004 to easing access to the internet since 2014 (Wu, 2018) and this appears to be in recognition of the significance of e-connectivity for trade competitiveness. Meanwhile, US sanctions against Huawei suggest that the USA is becoming more concerned about cybersecurity, even if it risks erecting a digital Iron Curtain (Findlay, 2019).

Another divide is between countries in GVCs, who recognize the importance of connectivity, and countries not in GVCs who are unwilling to cede sovereignty in these areas. Attempts to bring e-commerce and digital trade into the WTO have so far been unsuccessful because of the requirement for consensus and because large members that have only minimal participation in GVCs, such as Brazil, India or Russia, show little interest. One pathway could be to negotiate a plurilateral agreement among like-minded WTO members, as in the 1997 Information Technology Agreement; this is being trialled by some members, including Australia and the EU (WTO, 2019), but is opposed by others for undermining the universality of WTO rules.

2. Developing a Trade Strategy for the 21st Century

The EU has been searching for (and finding) a new external trade strategy. The 2006 *Global Europe* document (European Commission, 2006) foreshadowed and the 2015 *Trade for All* (European Commission, 2015) strategy confirmed abandonment of using trade policy for protection or as foreign policy and adoption of the goal of opening the EU to trade in support of participation in GVCs (**Table 1**).

Faced with the difficulty of progressing reform of world trade law through the WTO, in order to address new issues the EU has embarked on a series of deep trade agreements: South Korea (signed 2010, in force 2015), Canada (signed 2014, applied since September 2017), Japan (signed July 2018), Mexico (agreement in principle, April 2018), Singapore (awaiting signature), Mercosur (negotiations concluded June 2019) and Australia and New Zealand (negotiations both launched in June 2018). The list could have included the United States, but after the 2016 election, President Trump terminated negotiation of the Transatlantic Trade and Investment Partnership (TTIP). The new-generation trade agreements, such as EU-Canada or EU-Japan, cover goods, services, intellectual property, investment, government procurement, access to energy, trade facilitation, competition and regulatory cooperation.[3]

Elsewhere, a twenty-first century phenomenon is the rise of mega-regionals, i.e. deep trade agreements that go beyond a geographical region. The leading example was the TransPacific Partnership (TPP), which promised deep integration among twelve countries but was terminated when the United States failed to ratify the agreement in 2017. However, the remaining eleven went ahead with the CPTPP which came into force in December 2018.[4] The ten ASEAN countries, Australia, China, India, Japan, Korea, and New Zealand are negotiating the Regional Comprehensive Economic Partnership (RCEP). The risk is that a multitude of agreements will create a spaghetti bowl of incompatible rules.

However, large groupings can be standard-setters. Thus, the TPP and the TTIP contained fairly similar e-commerce chapters. After the United States pulled out of these negotiations, the chapters survived in only slightly modified form in EU agreements with Canada and Japan and in the successor to the TPP (the CPTPP) and potentially in the RCEP; these four agreements cover all of the largest trading nations except the United States. A logical extension of this pattern of convergence is the EU-Australia trade

[3] Negotiations have been protracted because many of the chapters are inherently complex and also because there has been disagreement over what lies in the Commission's competence (e.g. regulation of investment), unlike the simpler trade policy content of the customs union era.

[4] The eleven signatories of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam.

agreement that is currently under negotiation and which will bridge these groups of major trading nations.

As the United States withdrew from its leadership position in promoting the liberal multilateral trading system, the EU has had to acknowledge that it has to become more proactive. This may be not without internal tensions, as several member states have strong illiberal political parties. However, there is widespread recognition in Eastern Europe that a positive economic development since the end of central planning has been their ability to participate in GVCs; this is especially true of Poland, the Czech Republic, Hungary and Slovakia, and most obviously in the car industry (Pomfret and Sourdin, 2017). Similarly, Australia stepped up, with Japan, after United States withdrawal from TPP to ensure the implementation of CPTPP in December 2018.

3. Trade Disputes in the Era of Trump

Trade tensions between the EU and the USA have simmered for decades. US complaints have mostly concerned farm products and sunset industries such as steel, while recent EU concerns have tended to focus on the market power of digital giants. Since the 1980s, there has been a long-running dispute over subsidies for commercial aircraft producers (i.e. Boeing and Airbus). A crucial point has been that, until 2017, the disputes were contained and largely settled within a common commitment to WTO rules.[5]

Driven by obsession with the trade balance (Figure 2), President Trump appears to have a deep antipathy towards the EU and its policies:

> By the way, the European Union is worse than China, just smaller. It treats us horribly. Barriers, tariffs, taxes, and we let them come in. It's worse than China. Many of us come from there. I do. That's what it's got going. That's about it. They treat us really badly.[6]

The US threat of national security tariffs on automobiles and automobile parts from the EU hangs in the air. A WTO ruling in the long-running Airbus-Boeing dispute triggered US tariffs on iconic European products with the possibility of tit-for-tat tariffs when the

[5] A positive early signal of the WTO's potential was that smaller WTO members could bring cases against the USA (Venezuela on petroleum) and the EU (Ecuador on bananas) and the large countries accepted the outcomes. The Trump administration's veto of new appointments to the Appellate Body threatens to destroy the WTO dispute resolution mechanism.

[6] Speech in New Hampshire on 15 August 2019, transcript available at https://www.rev.com/blog/donald-trump-new-hampshire-rally-transcript-august-15-2019

WTO rules on US subsides.[7] President Trump is also incensed by plans of EU countries to levy a digital tax on technology companies,[8] inadequate contributions to NATO, and other failures to cooperate (e.g. on sanctions against Iran and Cuba or in boycotting Huawei).

Thus, in 2019 the EU has been placed in a largely reactive position, as US actions not only against the EU but also against China and with respect to the multilateral trading system are inconsistent and hard to predict (González and Véron, 2019a).[9] The EU has, rightly, rejected the managed trade approach of the US-Japan agriculture for cars agreement.[10] However, the slow-moving strategy of negotiating deep trade agreements can appear inadequate in President Trump's twitter-driven world of "great deals" whose shallowness matches the sound-bite commentary of popular media.

4. Conclusions

The EU approach to trade policy has evolved substantially. While always committed to trade liberalization in principle (albeit starting from very high tariffs in some of the original members in the 1950s) and compliance with GATT/WTO rules, the common tariff of the customs union involved many derogations from unconditional MFN treatment, an illiberal common agricultural policy and, after the crises of the 1970s and emergence of new industrialized countries, product-specific protectionist measures that were against the spirit if not the letter of the GATT. Since 1990 and more purposefully in the twenty-first century, the EU has moved away from protectionist or preferential trade policies to a regime aimed at facilitating trade for both importers and exporters. In areas

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[7] The dispute dates back to the 1980s when, aided by development subsidies from European governments, Airbus challenged Boeing's monopoly in large (over 100 seats) commercial jet aircraft. The EU response is that the US producer receives implicit subsidies, e.g. from military orders that help to cover the large fixed costs of developing new aircraft models. Compared to a world with a single producer, the duopoly has clearly benefited airlines and passengers, and wars of words over subsidies had not transferred into serious sanctions before President Trump.

[8] The idea floated by France, Spain and the UK *inter alia* is that the global profits of a tech company such as Google should be taxed in proportion to the location of users rather than 100% in the company's home country.

[9] Woolcock (2019) also analyzes EU policy choices within the wider context.

[10] In their September 2019 agreement, Prime Minister Abe made market-opening concessions to the USA in return for President Trump's commitment to defer imposition of tariffs on Japanese cars and components.

where the WTO has been slow to respond to new challenges, such as trade facilitation or digitalization, the EU has sought WTO+ agreements with like-minded countries.

Against the backdrop of this long-term evolution, the conjuncture of global events has pushed the EU to the forefront of defenders of the multilateral trading system. The main driver of this change was the 2016 US election and adoption of aggressively unilateral polices by President Trump since January 2017. Among the other leading market-based economies, trade and geographical dependence (Canada and Mexico) or strategic dependence (Japan or South Korea) inhibit too strong opposition to the US President's trade measures.[11] Ironically, given their past history of abysmal relations, the most reliable ally for the EU in defending open multilateral trade is Australia – a common interest reflected in the ongoing negotiation of a deep trade agreement (Pomfret, 2019a). At the same time there has been mounting concern in many trading nations about China's consistency with WTO principles, especially in the role of state-owned enterprises and the use of subsidies.[12]

The incoming European Commission led by Ursula von der Leyen faces a dilemma. Should the Commission negotiate with the United States to moderate trade conflicts and work through the WTO, or should the EU wait for the next US President? Should the EU seek to find common ground with China, especially within the WTO framework, or support the hard line of the USA? Whatever the answers to these questions, the EU's interest lies in maintaining a rules-based multilateral trading system and the incentive is to continue establishing better relations with other countries.

[11] Japanese policy is also related to Prime Minister Abe's focus on personal relations with President Trump and the concentration of foreign and economic policymaking in the Prime Minister's Office rather than the Ministry of Foreign Affairs and economics ministries (Fujiwara, 2019). However, in the same Forum, Aoyama (2019) provides evidence of Japan's free trade leadership in the CPTPP, EU-Japan agreement and RCEP.

[12] More broadly, these concerns apply to all of the BRICs, Brazil, Russia, India and China, none of whom seem wedded to the principles of a liberal global trading system and each appears willing to use their economic weight to ignore those principles or to veto progress at the WTO.

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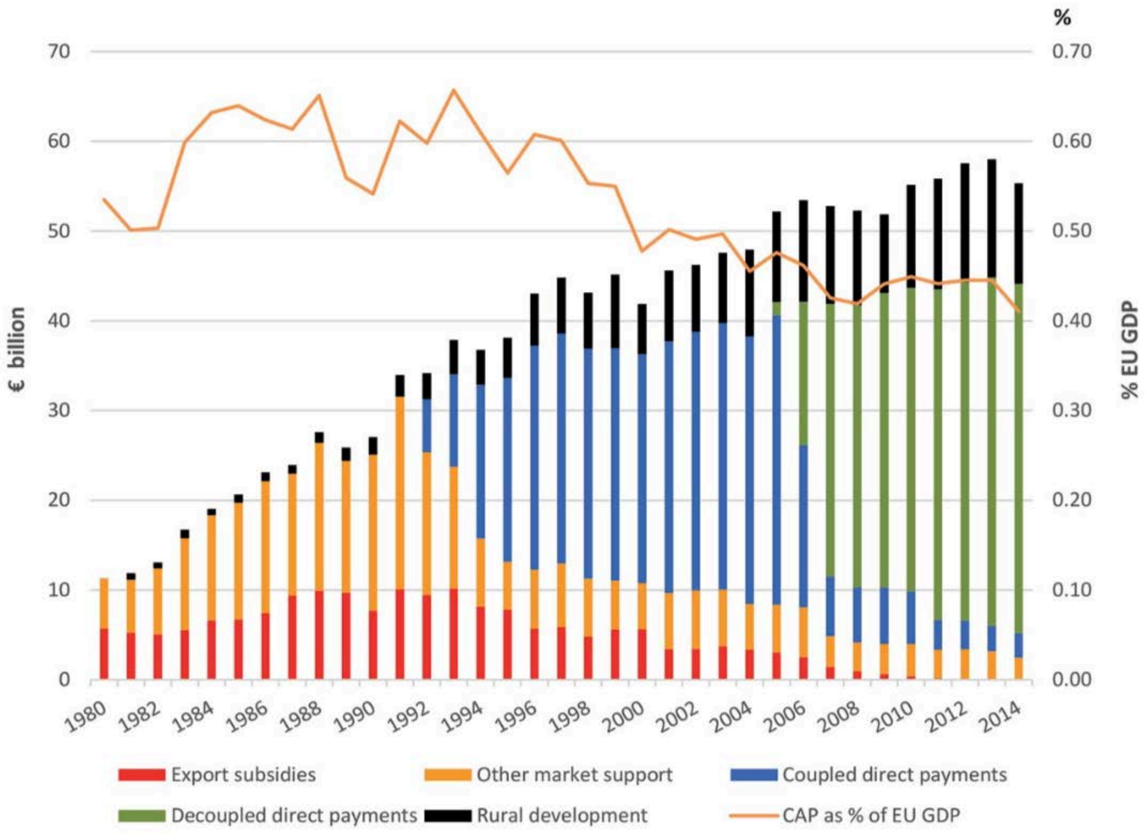
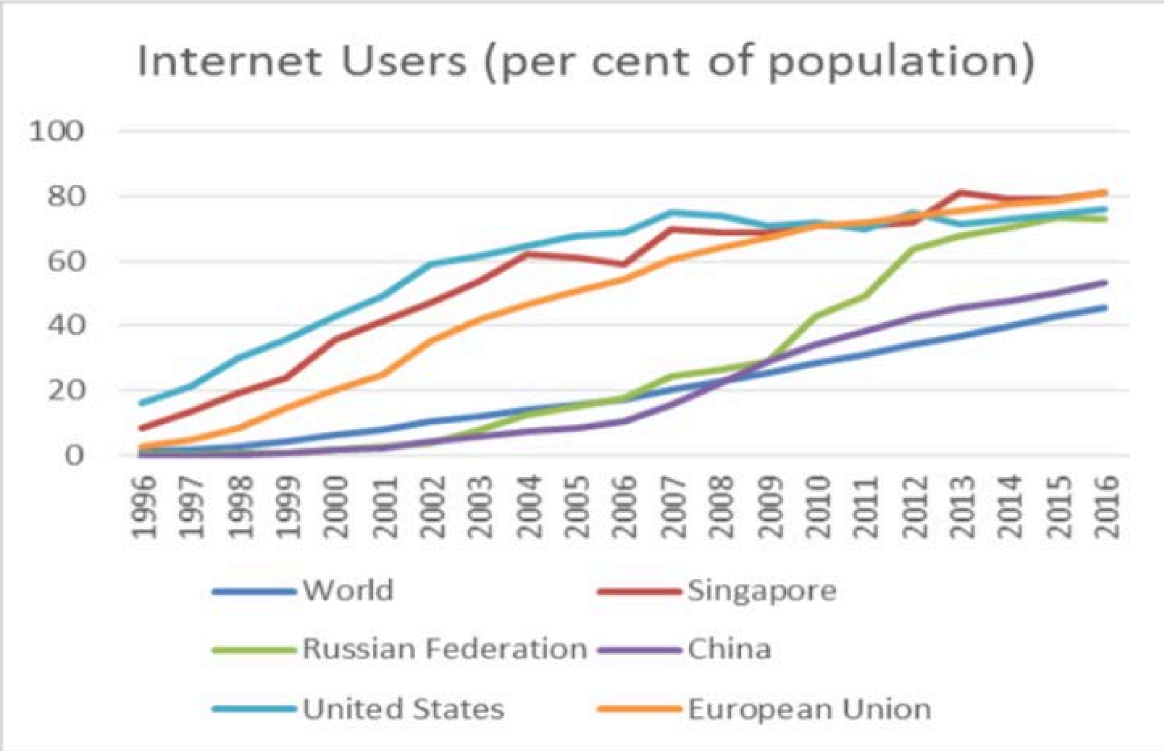
Figure 1: Expenditures on the Common Agricultural Policy, 1980-2014

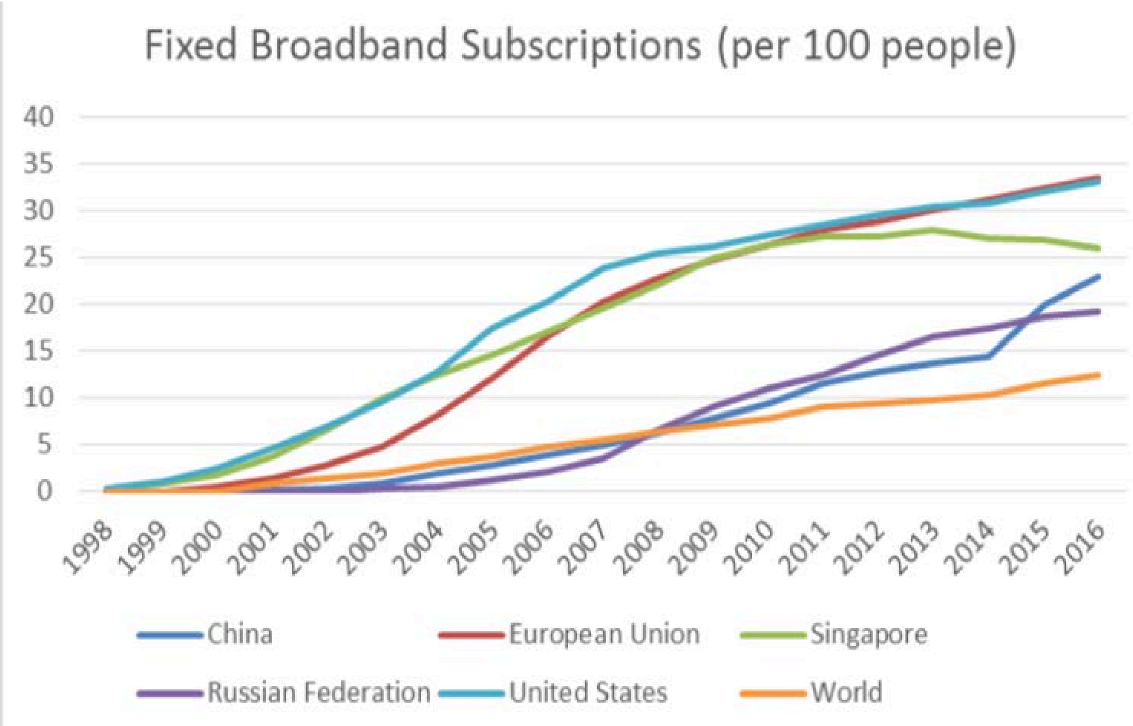


Source: European Commission CAP post-2013: Key graphs & figures – available (2016) at http://ec.europa.eu/agriculture/cap-post-2013/graphs/graph3_en.pdf

Note: Market support since 2010 includes expenditure for wine programmes, producer organisations in the fruit and vegetables sector, school fruit and milk schemes, promotion, beekeeping, etc.

Figure 2: Internet Use 1996-2016 and Broadband Subscriptions, 1998-2016





Source: Bayhaqi et al, 2018 – based on World Bank data.

Figure 3: US Trade Deficit with the EU (from González and Véron, 2019b)

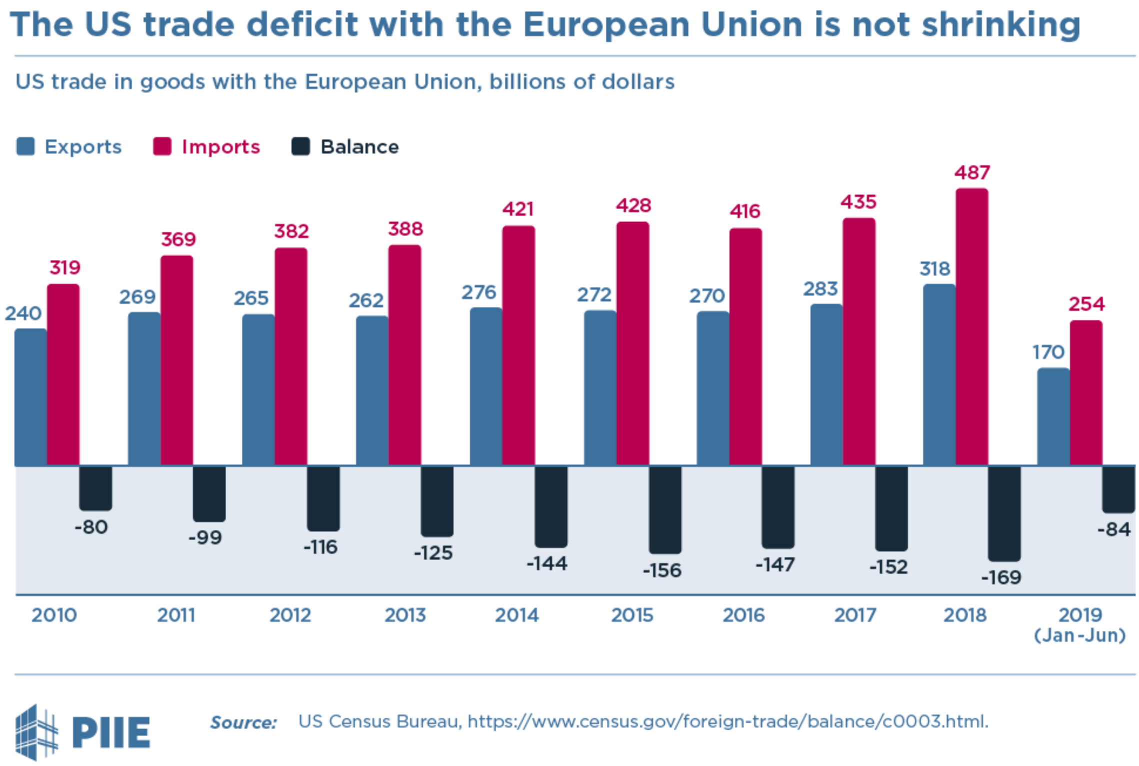


Table 1: *Trade for All: Towards a more responsible trade and investment policy* - adopted by the Commission on 14 October 2015

Box 2.1 Objectives of the updated trade and investment policy strategy

The EU will focus attention on, *inter alia,* achieving the following:

(i) A more effective policy that tackles new economic realities and lives up to its promises by:

- Updating trade policy to take account of the new economic realities such as global value chains, the digital economy and the importance of services.
- Supporting mobility of technicians, experts and service providers.
- Setting up an enhanced partnership with the member States, the European Parliament and stakeholders to better implement trade and investment agreements.
- Including effective SME provisions in future trade agreements.

(ii) A more transparent trade and investment policy by extending the TTIP transparency initiative to all the EU's trade negotiations.

(iii) A trade and investment policy based on values by:

- Responding to the public's expectations on regulations and investment: a clear pledge on safeguarding EU regulatory protection and a strategy to lead the reform of investment policy globally.
- Expanding measures to support sustainable development, fair and ethical trade, and human rights, including by ensuring effective implementation of related FTA provisions and the Generalised Scheme of Preferences.
- Including anti-corruption rules in future trade agreements.

(iv) Progress in negotiations to shape globalization by:

- Re-energizing multilateral negotiations and designing an open approach to bilateral and regional agreements.
- Strengthening EU presence in Asia and setting ambitious objectives with China.
- Requesting a mandate for FTA negotiations with Australia and New Zealand.
- Exploring launching new investment negotiations with Hong Kong, China; the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu (Chinese Taipei); and the Republic of Korea.
- Starting new ASEAN FTA negotiations with the Philippines and Indonesia, as and when appropriate.