Global Europe: Old Mercantilist Wine in New Bottles?

Jim Rollo
University of Sussex

To be Published in a Special Issue on the EU's new trade policy
in Aussenwirtschaft in January 2007
Edited by Simon Evenett

This paper analyses the European Commission's communication Global Europe and attempts to demonstrate that the substance behind the shift in emphasis towards bilateral trade policy is an extension of existing EU bilateral trade policy; that the shift is not convincingly justified by the analysis in the EU Commission papers; that the shift might be best thought of as an attempt to re-energise corporate sector support for trade liberalisation in the face of the suspension of the Doha Development Agenda and a weakening of political support for trade liberalisation.

Keywords: EU European Commission, Bilateral Trade Policy, Trade Liberalisation
JEL-Codes: F13, F15, F42

1 Introduction

Mr. Mandelson's new trade policy (EU COMMISSION 2006a, 2006b) seeks to dress a shift in trade policy from one with a bias towards multilateral liberalisation to one with a bilateral or regional trade policy bias in the clothes of the Lisbon Agenda and give it a focus on the emerging markets of Asia and Latin America.

Bilateralism or regionalism is not new in the policy armoury of the European Union (EU). From its inception the Union, with the Commission as negotiator, has used preferential arrangements as a way of binding potential members, neighbours, and former colonies of its member states more closely to it. Latterly there have been some defensive Free Trade Agreements (FTAs) to protect market access in the face of US preferential arrangements in Latin America. It is important to understand the development of these policies, to see where the new policy comes from, and the way in which it is a seamless extension of existing trends; this forms the subject matter of the next section of the paper.

The section following that reflects on the justifications for the change in policy and the choice of countries with which to initiate agreements. It rather rejects the Commission's justifications for the change in policy and instead suggests that the real impetus is to revive the enthusiasm of the corporate sector for trade liberalisation and to revive the old multilateral trade negotiators' game of using the opening of foreign markets to justify domestic liberalisation. The fourth section considers the implications for the multilateral system which it sees as negative. Conclusions follow.

2 The Development of Bilateralism and Regionalism as a Tool of EU External Economic Policy

From the arrangements with Greece and Turkey which date to 1963 through the FTAs with the Iberians, the EFTAns[1] with the countries of central Europe and now with the Western Balkans, bilateral agreements have been a part of the process of preparation for full EU membership. From the 1990s these agreements included aspects of deep integration mapping onto the EU's own Single Market Programme. With the EFTAns the whole of the single market was part of what became the European Economic Area including the free movement of capital and workers as well as regulatory approximation and mutual recognition. For the countries of central Europe, limited commitments on freedom of movement of capital, competition policy, service sector integration including limited movement of natural persons, were part of the Europe agreements, while Turkey has a customs union (albeit incomplete) with elements of mutual recognition of certification and standards. Starting with the central Europeans, the EU also began to encourage its partners to integrate among themselves and also offered the possibility of cumulation of rules of origin to break down some of the worst aspects of the hub and spoke agreements negotiated with the EU. This approach has been carried over into the Stability Pact agreements with the Western Balkans in a so far unsuccessful attempt to encourage a re-integration among the constituent parts of the former Yugoslavia. One important common feature of all of these agreements is the virtual absence of any access to EU agricultural markets until the trade partners join the EU.

With the African, Caribbean and Pacific countries (ACP), the approach originally was to offer incomplete duty free access (often subject to quantitative restrictions) to the EU market, a form of GSP-plus since there was no reciprocal access for EU goods. Some of the ACP also received very lucrative tariff-free quotas on sensitive agricultural goods, notably bananas, beef and sugar to substitute for loss of market access when their former rulers adopted the Common Agricultural Policy (CAP). This GSP-plus approach

[1] The members of the European Free Trade Association (EFTA).

has also been extended to Least Developed Countries (LDCs) with practically no products excepted in the Everything But Arms (EBA) arrangement, albeit with some adjustment periods for EU sensitive products, notably sugar. But, Bangladesh apart, the LDCs are not large actual or potential traders so the competitive threats are small especially once Sanitary and Phyto-sanitary (SPS) standards are taken into account. A similar set of asymmetrical tariff free arrangements were offered to the countries of the Mediterranean littoral but without any significant agricultural access.

The other element in the EU's bilateral policy was the avoidance of trade diversion losses from other countries' FTAs. Hence the EU-Mexico and EU- Chile agreements, in which both sides tried to neutralise potential trade diversion losses from agreements between the US and the Latin American countries. The Mexico agreement exceptionally did not, on the face of it, exclude agricultural trade. Since, however, there was little overlap in production or trade patterns this was not problematic and allowed both parties to claim that the agreement met the 'substantially all trade' provisions of the WTO's rules on the formation of regional trading arrangements.

The negotiations with the countries of Mercosur on a FTA also aimed at avoiding trade diversion losses from the formation of Mercosur and from any potential losses should there be a successful conclusion of a Free Trade Area of the Americas (FTAA). The lack of any substantive progress in negotiations of an FTAA would probably alone explain the similar lack of movement in the EU-Mercosur negotiations which, after all, began before the EU moratorium on negotiating new FTAs was introduced in 1999. It is likely, however, that difficulties arose over the inclusion of agricultural products. Admitting grains, oilseeds, livestock and sugar from Brazil and Argentina in particular would be tantamount to destroying the viability of the CAP and, at best, the gift of huge trade diversion gains to Mercosur. On the other hand why would Mercosur give the EU access to its highly protected industrial markets without reciprocal access to the EU's agricultural markets? It is hard to see the EU-Mercosur negotiations as more than a piece of theatre aimed at reminding the US that Latin America is not a *chasse gardée* for their exporters.

Since the beginning of the century it has been possible to see some convergence of trends in EU bilateral and multilateral trade policy. In particular the approach of introducing elements of deep integration and encouraging regional integration among its partners in bilateral arrangements is now migrating beyond relations with acknowledged candidates for EU membership. The ACP have been forced to consider full bilateral FTAs with the EU after the waiver for the existing asymmetrical agreements was not renewed in the WTO, lose their existing preferences or, at best, revert to GSP. The EU in responding to this need to renegotiate the ACP agreements has suggested both regional arrangements among groups of ACP countries (for example in the Caribbean or East Africa) and including aspects of deep integration.

The EU Neighbourhood Policy aims to sweep up the countries of Eastern Europe (which do have a prospect of eventual EU membership) and of the Mediterranean (which do not) in arrangements that include full reciprocal FTA (again agriculture-light) and crucially 'elements of the single market'. The Mediterranean countries are encouraged to engage in integration among themselves starting with the Agadir group of Egypt, Morocco, Tunisia and now Jordan.

The deep integration provisions are perhaps most important in these agreements because it is these elements that are capable of generating productivity gains which, in turn, can connect increased trade to growth (EVANS et al. 2006: Chapter 1). This also applies to countries with high initial tariffs (e.g. the ACP and Mediterranean countries) where removing tariffs against the EU is likely to generate trade creation (and, therefore unemployment for them in the short run at least) or trade diversion (EVANS et al. 2006: Chapters 3 and 4). This may also be relevant for any EU-India or EU-ASEAN agreement.

The focus on deep integration is also reflected in the changing focus of multilateral trade policy towards Technical Barriers to Trade (TBTs), Sanitary and Phyto-sanitary (SPS), services, intellectual property and investment in the Uruguay Round. It is then perhaps not surprising that an EU that sees deep integration as an important part of its existing programme of bilateral agreements seeks to extend the coverage of these agreements in the face of both the loss of the Singapore Issues from the Doha Development Agenda (DDA) at the Cancun WTO ministerial in 2003 and the suspension of the DDA in mid-2006. Against that background bilateral agreements must appear to be the logical way forward.

A final word on the bureaucratic aspects of this. The renegotiation of the ACP agreements and the introduction of the EU Neighbourhood policy has required a build-up of resources on the design and negotiation of FTAs. This inevitably leads to a shift in the intellectual bias within the Commission towards bilateralism. The suspension of the DDA also potentially leaves scarce staff in the wrong place. Hence the recent reorganisation of DG Trade seems to have led to a diffusion of effort on the WTO while leaving the units dealing with FTAs more clearly focussed. One former senior DG Trade official has been moved to describe it thus ‘it looks to me more like "Doha if and when you can find it, and when all the troops can be assembled in the same battle area; so bilaterals, go for it, and the devil take the hindmost"' (ABBOTT 2006).

3 The Justifications for the EU's New Trade Policy

The EU papers proposing the new trade policy (EU COMMISSION, 2006a, 2006b) give four main justifications for changing track on trade policy. First, trade is good for productivity growth and hence contributes to the Lisbon Agenda goals. Second, while EU trade performance, particularly in goods, is holding up well in the face of competition from the emerging market economies of Asia and Latin America, it is not accessing these fast growing markets with the same success and that is where the future is. The paper selects South Korea, the Association of South East Asian Nations (ASEAN), India, Mercosur and Russia as worthy of special attention. China is mentioned but then dropped as having special characteristics, as is the US. Third, barriers to trade and investment are high in these new markets. Fourth, that other countries are pursuing bilateral agreements.

3.1 Trade and Productivity Growth

The argument in the Commission background paper (EU COMMISSION 2006b) about the contribution of trade to the Lisbon Agenda is quite sensible. In particular it notes that openness to trade increases competition and leads to reallocation of resources to more efficient uses and to higher productivity. It notes that increasing the openness of the internal market is a key driver of Lisbon goals and that external trade can make a similar contribution. Leaving aside the difficulties that have been faced in liberalising services markets in the EU[2], the key point here is that it is imports which provide the competitive impetus. To trigger such gains all the EU has to do is to reduce its own barriers. The background paper (EU COMMISSION 2006b) makes much of the EU's low barriers to external trade so not much adjustment needs to be made to policy, if that is true. It is also worth reflecting that if it is the benefit of import competition that is important, it is equally important that the liberalisation be non-discriminatory. Taking a competitive advantage driven by protection away from EU producers and giving it to foreign producers is a recipe for reducing domestic welfare rather than increasing it. The policy prescription that follows from the analysis is unilateral or multilateral liberalisation, not bilateralism.

The truth however may be that not only are there pockets of significant protection - agriculture notably - which present real political barriers to unilateral or multilateral liberalisation but also that there is increasing political resistance to any trade liberalisation agenda[3] in the EU. Thus a policy of unilateral trade liberalisation is not on the table but neither is a policy of making a better offer in the DDA, which if it included agricultural market access, might have saved the talks in Geneva from collapse. The policy option that is left seems to be bilateral liberalisation - not because of what it will deliver for growth, that has yet to be demonstrated, but because it will be reciprocal and is likely to attract support from the export lobby for ongoing EU trade liberalisation.

The discussion of the benefits of trade liberalisation for the Lisbon Agenda are well based but they are not obviously the ones driving the change in policy or the proposals in the Commission papers would be different.

3.2 Relative Lack of Success in the Emerging Markets

[2] Witness, for example, the debacles over the Services and Take-Over Directives and the elements of the Financial Services Action Plan, that continue protection of member state financial markets.

[3] The resistance to internal services and investment liberalisation and indeed the rejection of the draft EU constitution in France and the Netherlands, are symptoms of such resistance to economic integration.

The Commission papers note that while overall EU trade performance has not been bad over the last decade, with exports accounting for an increasing share of GDP, stable share of manufacturing in exports and balance or small surpluses on the trade and current accounts, the EU's market share in the emerging markets have fallen, in some cases significantly. This latter picture is reinforced by an analysis of goods trade by the "Centre d'études prospectives et d'informations internationals" (CEPII), the Paris based research institute for DG Trade and available from the DG Trade website (GAULIER et al. 2006).

The question, which is not asked, is why this matters. It is taken for granted that, because these markets are the most rapidly growing, the EU's exports should be growing alongside and that the reason they are not is high barriers to trade and investment. That begs the question of why other countries' market shares are growing in these markets. It is clear that other developed countries, notably the US and Japan, are also suffering and that in some cases their market shares have fallen further (GAULIER et al. 2006: Table 2). This has happened in the face of falling barriers to trade in India and Brazil (as a result of unilateral liberalisation) and in China (as a result of WTO accession). An alternative explanation of the declining market share might simply be that the pattern of EU production does not match the pattern of demand in the target countries. Since in the short term there is not any persistent EU global trade or current account deficit, indeed rather the opposite, it is not clear why this is a problem. Unless of course DG Trade sees its job as maximising net exports and allowing the EU to accumulate reserves as its contribution to the Lisbon Agenda; mercantilism indeed.

Over time we might expect the pattern of import demand to change from raw materials and intermediate inputs (including both capital goods and part processed manufactures which comprise elements in global supply chains) towards finished goods and towards goods and services with higher income elasticities, which ought to favour developed country exporters in the longer term. In the meantime the priority should be to increase the adaptability of EU producers and workers, and to be fair to the Commission, both papers are clear on the need to improve the quality and adaptability of workers and firms - all of which is down to domestic policy, not trade policy.

3.3 The Choice of Countries

There are eight countries or groups of countries specified as a possible FTA partner of interest in various parts of the Commission's papers. Of these, two, Russia and the Gulf Cooperation Council, are energy producers and seem to be whom the discussion about export taxes on raw materials (EU COMMISSION 2006b, p. 8) is aimed at. These are not the focus of my discussion and will be ignored in what follows. The US is the subject of a short discussion in both papers but is otherwise ignored. The remaining five are ASEAN, China, India, Mercosur and South Korea, all selected on the basis of growth and height of barriers. ASEAN, Mercosur and South Korea are also in some degree of negotiation over bilateral agreements with the USA and/or China. China is also dropped from the list because it '...requires special attention because of the opportunities and risks it presents' (EU COMMISSION 2006b p. 16). Implicitly the risks it poses seem to be from opening up the EU market to China in any FTA. That leaves a group of four. Of these, negotiations are already in train with Mercosur but seem moribund for reasons outlined above, notably, in this context, the difficulty of negotiating agriculture. That leaves ASEAN, South Korea and India. On the face of it, the complexities of negotiating with a diverse group such as ASEAN and the relative importance of agricultural market access to the EU (there is some overlap of ASEAN and Cairns Group membership) suggest that this will be a slow negotiation at best.

That leaves two prime candidates: India and South Korea. These do indeed have relatively high Most Favoured Nations (MFN) applied tariff rates. Korea had average tariffs of a little under 7% on manufactures and some 52% on agriculture in 2004 (WTO 2004) and India had average tariffs of around 15% for manufactures and around 40% for food and live animals in 2005 (TRAINS data base). They also both have a widespread regulatory and other barriers which do not conform to international norms. Both countries seem interested in negotiating a FTA with elements of deep integration though perhaps for different reasons.

It is probably not coincidental that both countries are protectionist on agriculture and were reluctant to offer up significant liberalisation of that sector in the DDA. A FTA with the EU is therefore likely to discomfit them less than a multilateral deal in the WTO. More bureaucratically, it also means that it will be less hard to meet the WTO ‘substantially all trade’ criterion, defined as 95% of bilateral trade by value and 90% of tariff lines in both agreements. Such an agriculture-light agreement would be useful to Korea in discussions with the US. Equally an agriculture-light agreement would speak to domestic opinion in India, while allowing the Indian government to ‘lock in’ elements of domestic and trade liberalisation without increasing market access to China by successful negotiating a FTA with the EU, rather than lowering MFN bindings in the WTO. Both countries have high tariffs and will need to be aware of the possibility of trade diversion since the EU has a low share in both markets.[4] This could be a high price to pay for protection from the US and China. Korea and China would then need to look in some detail at the WTO-plus aspects of any agreement to identify the deep integration issues that are likely to generate gains for them to offset any trade diversion losses.[5]

From an EU point of view, WTO-plus agreements with India and Korea should improve market access for specific industries and companies on some goods and services as well as increase Foreign Direct Investment (FDI). The extent to which this helps increase EU growth is more debatable. The danger is that agreements which generate trade diversion gains for the EU will lock resources into activities that are not to the long-term comparative advantage of the EU. Now the EU is a very large and very diverse economy and neither of these markets is likely to be other than one among many, these potential costs are never going to be large[6] and the short-term profits from such rent-snatching may be attractive for some years. None-the-less such arrangements could tend to reduce rather than to increase the flexibility of the EU economy. FTAs will certainly add to the lobby for less, rather than more, multilateral liberalisation if it is likely to erode EU preference on the Indian and Korean markets. Such FTAs will also make EU exporters and investors vulnerable to their partners signing FTAs with other countries or undertaking unilateral non-discriminatory liberalisation.

---

4 See EVANS et al. (2006): Chapter 3 for analysis to support this judgement.

5 Again see EVANS et al. (2006): Chapter 3 for guidance on this matter.

6 Unlike the problems of lock-in suffered by ACP countries on commodities such as bananas and sugar as a result of EU preferences.

4 The Impact on the Multilateral System

From an economist's perspective, non-discriminatory liberalisation normally trumps discriminatory liberalisation. So the trend of big developed countries shifting from multilateral to bilateral trade liberalisation seems likely to reduce global economic welfare. More, since third parties lose from bilateral liberalisation when the big players indulge, it encourages others to play the game as well with a potential avalanche adverse selection to follow. This not only adds to the spaghetti bowl effect of overlapping and different bilateral agreements identified by BHAGWATI but it also progressively reduces the interest of governments and firms, in particular, in non-discriminatory liberalisation. Now the EU, as noted in section 2, has a long history of bilateral trade policy but, although it covers a lot of countries, it does not cover much more than 40% of trade in goods by value. The extension of this policy to bigger players on the world market will rapidly make the EU a larger preferential than multilateral trader which would without doubt, and despite the Commission's protestations to the opposite, have repercussions on attitudes to the WTO particularly if agriculture and other sensitive products were carved out from the big, new FTAs.

5 Conclusions

It is hard not to sympathise with the Trade Directorate of the EU Commission. Despite a moratorium on new FTAs, the renegotiation of the ACP agreements and the new EU Neighbourhood policy have led to a significant increase in the volume of FTAs under consideration with a concomitant impact on bureaucratic priorities. At the same time the WTO negotiations on the DDA have broken down, in part because of EU rigidity on agriculture. Worse, in the background, the support for global and EU economic integration has faded among electorates. To some degree the corporate sector is not perceived to be engaged in the WTO agenda to the extent it was during the 1990s, while continuing to complain about trade and investment barriers in new and exciting markets particularly in Asia and Latin America. This lack of business interest and lack of progress in the DDA undermines the important trick the GATT, and then the WTO, pulled off by engaging the export lobby's interest in opening foreign markets against the import lobby's interest in keeping the domestic market closed. Meanwhile, the EU's biggest partner, and to a degree, rival in the WTO, is negotiating bilateral agreements at an increasing rate, notably in Asia.

Policy options are thus evaporating if trade liberalisation is to be kept as a priority. Unilateral liberalisation except by extreme stealth is not feasible. A new form of high-profile reciprocal trade liberalisation that promises significant and wide-ranging benefits to the export sector is therefore necessary if the show is to be kept on the road. Bilateral FTAs with the fast-growing emerging economies particularly in Asia fits the bill especially if agriculture can be quietly sidelined, which agreements with India and Korea would do. Dressing this in Lisbon Agenda rhetoric helps reassure the more liberal members of the Union and the rest of the Commission that this is meant to help EU, growth even if the real Lisbon-friendly trade policy would be unilateral or multilateral non-discriminatory liberalisation.

The truth is that EU trade policy is now firmly on a bilateral course and that it will be increasingly difficult to get it back on a multilateral track particularly if the EU's move encourages other countries to follow suit. The underlying justification is the same old mercantilist game that was played in the GATT and the WTO but the potential costs of bilateral agreements are potentially higher, both domestically and globally.

References

ABBOTT, RODERICK (2006), *personal communication*, 3 December 2006.

EU COMMISSION (2006a), *Global Europe: Competing in the World: A Contribution to the EU's Growth and Jobs Strategy*, COM(2006) 567 final, Brussels.

EU COMMISSION (2006b), *Annex to Global Europe: Competing in the World: A Contribution to the EU's Growth and Jobs Strategy*, Staff Working Paper, COM(2006) 567 final, Brussels.

EVANS, DAVID et al. (2006), *Assessing Regional Trade Agreements with Developing Countries: Shallow and Deep Integration, Trade, Productivity, and Economic Performance*, a report for the Department for International Development, University of Sussex.

GAULIER, GUILLAUME et al. (2006), *Sectoral and Geographical Positioning of the EU in the International Division of Labour*, a report for DG Trade, CEPII, Paris.

WTO - World Trade Organization (2004) *Trade Policy Review of Korea 2004*, Internet: http://www.wto.org/English/tratop_e/tpr_e/tp235_e.htm (as of 8 December. 2006).