European Commission

Commission Staff Working Document

External sources of growth

Progress report on EU trade and investment relationship with key economic partners

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Content

INTRODUCTION

Following the 2 March European Council [1], this paper reviews the contribution that deepening relationships between the EU and its key trading partners can make to a comprehensive strategy to return to growth and job creation in Europe. It shows how trade agreements could boost growth via both the demand and supply sides, by securing a dynamic external demand pillar for the EU economy and fostering competitiveness-enhancing structural reforms.

Potential benefits of pursuing an ambitious external trade agenda include GDP gains of about 2 % or more than € 250 bn and the creation of more than 2 million jobs across the EU.

The paper provides estimates of the potential benefits of pursuing an ambitious external trade agenda, pointing to GDP gains of about 2 % or more than € 250 bn — equivalent to the size of the Austrian or Danish economy — and the creation of more than 2 million jobs across the EU. Most of these benefits would occur in the medium term, with the progressive implementation of agreements. Yet pursuing the agenda is crucial in the short term, as it would send a strong signal that the EU is serious about reforming at home and securing markets abroad. This would have an immediate impact on investors' confidence.

More than two-thirds of the economic gains would come from potentially transformative agreements with the US and Japan.

Realising potential gains from trade assumes that the deals the EU is currently negotiating with important partners be concluded, with a satisfactory outcome. This year, free trade agreements (FTAs) are within reach with Canada and Singapore. Both are important precedents for other potential agreements with similar and/or neighbouring countries. A positive dynamic with South East Asian Nations (ASEAN) would reinforce EU's position in Asia. More than two-thirds of the economic gains would come from potentially transformative agreements with the US and Japan, so reviewing the future of our relationships with these partners is crucial.

On-going FTA negotiations with large emerging economies such as India or the Mercosur countries, albeit very challenging, are important to prepare for the future. With China, the option of an FTA is currently not being considered, but we are looking at opening negotiations on an investment agreement. The key question for the EU remains whether we will be able to conclude these agreements within a realistic timetable, at an acceptable level of ambition and with a balanced outcome of gives and takes. Stepping up the pace of negotiation and ratification would be essential to reap the benefits of trade.

1 'The European Council will next June review progress and discuss how the Union can deepen its trade and investment relationships with key partners', *Conclusion of the European Council*, 2 March 2012.

1. THE RATIONALE FOR TRADE POLICY IN SUPPORT OF GROWTH AND JOBS

Robust external demand is the main source of growth for the moment […] 90 % of global economic growth by 2015 is expected to be generated outside Europe, a third of it in China alone.

External economic relations have a crucial role to play in the EU's jobs and growth agenda. Boosting trade is one of the few means to bolster economic growth without drawing on severely constrained public finances. Robust external demand is the main source of growth for the moment, as domestic demand components (public or private) remain weak.

In fact, the contribution of trade to GDP in 2012 (+0.7 percentage points) should enable the EU economy to avoid falling back into recession this year, as the contribution of domestic demand and inventories is expected to be negative (-0.4 and -0.3 points respectively)[2]. The contribution of external demand to economic growth is bound to increase in future, as 90 % of global economic growth by 2015 is expected to be generated outside Europe, a third of it in China alone[3]. To be sustainable, economic recovery will therefore need to be consolidated by stronger links with the new global growth centres. In parallel with other initiatives taken in the framework of the Europe 2020 strategy, this means leveraging the EU's trade policy by continuing to implement our strategy of reciprocal market opening[4]. More trade also benefits growth via the supply side of the economy. Trade liberalisation is a major structural reform in itself, creating new opportunities for innovation and stronger productivity growth.

Trade and investment flows spread new ideas and innovation, new technologies and the best research, leading to improvements in the products and services that people and companies use. Trade and investment flows also allow the diffusion of green technologies, which in return will ensure sustained and sustainable growth (see box below)[5]. Long-term evidence from EU countries shows that a 1 % increase in the openness of the economy leads to an increase of 0.6 % in labour productivity[6].

About 30 million jobs in the EU, or more than 10 % of the total workforce, depend on sales to the rest of the world, an increase of almost 50 % since 1995.

Therefore deep and comprehensive, truly transformative agreements with our largest trading partners can be powerful catalysts for economic change. By operating on both supply and demand at the same time, the leveraging of trade policy is a condition for the success and sustainability of any recovery strategy. It is an essential complement to other internal EU instruments such as industrial policy tools or financing instruments for investment. It is essential for jobs as well. About 30 million jobs in the EU, or more than 10 % of the total workforce, depend on sales to the rest of the world, an increase of almost 50 % since 1995[7].

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2 European Commission, *European Economic Forecast*, Spring 2012.

3 IMF economic forecast by 2015: http://www.imf.org/external/pubs/ft/weo/2012/01/index.htm .

4 Communication from the Commission, 'Trade, Growth and World Affairs: Trade Policy as a Core Component of the EU's 2020 Strategy', COM(2010)612, 9.11.2010

5 Communication from the Commission, 'Rio+20: towards the green economy and better governance', COM(2011) 363 final, 20.6.2011

6 European Commission, *Raising Productivity Growth: Key Messages from the European Competitiveness Report 2007*

7 New measures of European Competitiveness: A Global Value Chain Perspective, *Background paper for the WIOD project presentation at the high-level conference on 'Competitiveness, trade, environment and jobs in Europe: Insights from the new World Input Output Database (WIOD)'*, April 16 2012.

Box 1: Trade and Green growth

Trade liberalisation is a key tool to deliver on Europe 2020's objectives of smart, sustainable and inclusive growth. Increased efforts to boost global trade and investment flows should help underpin sustained growth and diffusion of green technologies and other products and services that will help addressing the global societal challenges. By way of example, the global market for eco-industries is currently worth around €1000bn a year and is expected to triple by 2030. The EU is a market leader and holds roughly one third of the global market.

The EU eco-industry directly employs around 3.4 million people, around 1.5% of all Europeans in employment. Around 600,000 new jobs were created between 2004 and 2008, in sectors such as waste and water and new jobs will needed as Europe continues to move towards its aim of becoming a low-carbon and resource-efficient economy. Beyond eco-industry, around 5.6 million people are directly employed in jobs linked to the environment, in sectors such as organic agriculture, sustainable forestry and green tourism. These jobs are often less visible than other jobs in more "traditional sectors" as they are spread throughout Europe among firms helping to improve environmental performance.

2. THE ECONOMIC FRAMEWORK OF EU TRADE POLICY

The EU's action must be based on proper factual foundations, taking full account of the new dynamics of global growth and the international reorganisation of value chains. It must also be based on an accurate assessment of Europe's strengths and weaknesses.

2.1. A new geography of growth

The rise of emerging economies is one of the most important economic facts of our time. It has intensified competition in terms of price and quality as well as access to energy and other raw materials. It has also created a new group of affluent middle-class consumers. While growth is expected to be close to zero in the EU in 2012, the Chinese and Indian economies are still expected to grow by 6 to 9 %, even when they slow down.

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Emerging economies are significantly more open today than they were 10 to 15 years ago, either because of commitments as part of their accession to the WTO (China, Russia) or thanks to autonomous decisions to liberalise, which they take for their own benefit and which account for two-thirds of trade liberalisation in developing countries in recent years.

Import tariffs have on average gone down in China, from 19.6 % in 1996 to 4.2 % in 2009; from 20.1 % to 8.2 % in India; and from 13.8 % to 7.6 % in Brazil. But emerging economies still maintain significant barriers to EU exports and in some cases risk reversing trends towards opening[8]. Non–tariff barriers also create important obstacles to trade.

The EU, which, like other advanced economies, is already much more open to international trade, has a clear interest in fostering reciprocal trade opening with these countries, so as to reduce the asymmetry in levels of openness and promote a level playing field. This includes strengthening the protection of intellectual property rights (IPR), addressing non-tariff and regulatory obstacles to trade and supporting sustainable development[9].

2.2. The rise of regional and global supply chains

The rapid development of interdependent regional and global supply chains over the past decades has been a step change for both international economic integration and trade policies. Today, products are no longer made in one place from start to finish. Instead, they are put together in a long series of steps, often in different parts of the world.

This new organisation of production along global supply chains is blurring economic frontiers and transforming trade relations. For example a German export is very often also an export for the Czech Republic, Belgium or Poland. A significant amount of the value of a Chinese export is often produced in Europe. Nokia smartphones are made in China, but contain 54 % European added value.

Even an iPhone, designed in California and manufactured in Shenzhen, China, has a 12 % European contribution[10]. The same pattern is repeated in other production processes, from children's toys to passenger jets. This means that national exports and imports can no longer be approached from a narrow mercantilist angle.

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Not only are exports essential to economic growth and job creation, countries also increasingly need to import in order to achieve these.

Two-thirds of EU imports are raw materials, intermediary goods and components needed for the EU's production process. The share of foreign imports in the EU's exports has increased by more than 60 % since 1995, to reach 13 %.

Several lessons can be drawn from this new reality:

- The fundamental changes in global supply chains mean we need to look more closely at where value is added to products and less at where exports are booked. The core objective of the EU's trade policy then becomes to maintain, and where necessary, re-invent, Europe's place in global supply chains. While manufacturing in the EU remains of pivotal importance, it has to be acknowledged that in many sectors, no single country has the capacity to make products on its own any more. Trade is more and more about adding layers of value, from R&D and design to manufacturing of components, assembly and logistics.

8 European Commission, *Ninth Report on Potentially Trade Restrictive Measures identified in the context of the financial and economic crisis, September 2011 – 1 May 2012.*

9 in particular the commitment to internationally recognised labour and environmental standards

10 Xing and Detert (2010), iSuppli, Chipworks

Under these circumstances, raising the cost of imports reduces countries' competitiveness and ability to sell on global markets, affecting us all. This is a powerful reason for countries not to resort to protectionist solutions, even if such tendencies tend to reappear in economic circumstances like those we face today. We need to keep up our guard against them.

Last year, it became clear how strong new global interdependences were, when many companies around the world, including some in Europe, found that their lean and taut supply chains suddenly snapped after the disasters that struck Japan and Thailand.

- The Single Market is a cornerstone of the EU's ability to create jobs by trading with the rest of the world. European regional value chains have evolved thanks to the deepening of the Single Market and further enlargements. They have proven to be an increasingly important factor in the success of EU exports abroad.

  The share in the value added to Europe's exports by the 12 Member States that have joined the EU since 2004 more than doubled in 15 years (from 4.5 % in 1995 to almost 10 % in 2009). When EU firms export, they create jobs not only in the Member State from which the goods and services are shipped to the rest of the world, but also across the Single Market. This accounts for one third of the total number of jobs related to extra-EU exports[11].

- Another insight of the value-added approach is the importance of services to trade. This is by far the most dynamic component of jobs generated by exports (+ 3 million between 2000 and 2007), related to exports of both goods and services. About a third of the jobs generated by exports of manufactured goods are actually located in companies that supply the exporters of manufactured goods with auxiliary services. Services represent almost 60 % of the value we add to products exported from Europe.

- Similarly, while SMEs are relatively less involved in direct exports outside the EU (surveys estimate that 13 % of all SMEs export outside the EU), many of them are producers of parts and components or services embedded in the exports of larger companies. Still, the contribution of SMEs to exports can be improved, so as to enable them to benefit from the opportunities created by trade agreements. This is an integral part of EU's competitiveness strategy[12].

- In the knowledge society, intangible assets are a crucial component of many goods and services. Europe needs innovation to secure comparative advantage against competitors with lower labour, energy and raw materials costs. Effective IPR protection is therefore essential to fully harness the potential of European added value and deserve a prominent position in the European external trade policy.

11 N. Sousa & al. 'Extra-EU exports and employment', *DG TRADE Chief Economist Note*, No 2, 2012.

12 Communication from the Commission, 'Small Business, Big World — a new partnership to help SMEs seize global opportunities', COM(2011) 702 final, 9.11.2011

2.3. EU trade performance

The EU remains the world's largest exporter, importer, source and recipient of foreign direct investment. We have managed to hold on to our 20 % share of total world exports despite the rise of China, while Japan and the US have seen huge declines in their shares. We have a massive manufacturing trade surplus of € 281 billion, a figure that has increased five-fold since 2000 and has more than compensated for the increase in our energy bill over the same period[13]. The EU's surplus in services has expanded by a factor of 17 in 10 years, to stand at € 86 billion in 2010. Our balance on agricultural products[14] has shifted from a deficit of € 3.3 billion in 2000 to a surplus of about € 7 billion in 2011.

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Measuring our trade in value-added terms does not change the fact that Europe remains a large force in world trade. In the EU, openness and the extensive integration in global value chains was accompanied by an impressive capacity to export value added. In 2009, 87 % of the value of EU exports was produced in Europe. Countries that rely on assembly-type manufacturing, such as China, tend to have lower value added exports than economies such as the EU, the US and Japan that add key components based on R&D and design to the goods and services they export. The EU remains the biggest trading block in the world in value added terms, with its share of world trade stable at 22 %. This is higher than the EU's share in global trade using traditional trade statistics[15].

The EU retains close to 28 % (2.5 trillion dollars) of the total global income generated by the production of manufactured goods, against 18 % for the US and less than 16 % for China. This includes contributions from other sectors, such as services, that are incorporated into the manufacturing production process.

These results show that the development of global value chains is not hollowing out the EU economy. Rather, it confirms that welfare levels in the EU are based on a highly competitive and open real economy that remains an important global production centre.

These are huge achievements that should give us confidence for the efforts we need to make now. Significant divergences between Member States in terms of trade performance also provide significant room for progress. Improving trade performance is one of the most pressing issues – and challenges - for several of them to consolidate economic recovery.

13 Source: Eurostat, Comext

14 According to the WTO definition of agricultural products (ie without fish and related products)

15 World Input Output Database (WIOD), *op. cit*.

3. THE NEGOTIATING AGENDA

3.1. An active policy to engage our partners

To boost the contribution of trade to sustainable and inclusive growth in Europe, and in parallel to WTO negotiations where progress is proving to be difficult[16], we have pushed ahead with an ambitious bilateral agenda of reciprocal trade opening with our most important trading partners[17].

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We have first **targeted emerging countries**, as they are quickly becoming the new drivers of the world economy while their markets are still sheltered from foreign competition by significant tariff and non-tariff barriers. We are actively pursuing this agenda:

- Comprehensive free trade agreement (FTA) negotiations are on-going with India, a number of ASEAN countries and Mercosur. Table 1 illustrates EU interests in these negotiations in terms of trade and tariffs, while significant benefits are also expected on non-tariff aspects. The average tariff EU exporters face to access our FTA partners is almost three times higher (4.8 %) than the tariff partners face on the EU market (1.7 %). Malaysian tariffs are 13 times higher than ours. Tariffs in India and Mercosur are about two to three times higher than in the EU. Concluding these negotiations successfully would drastically reduce this asymmetry and help turn booming external demand into concrete benefits for Europe.
- With China, the option of an FTA is currently not being considered, but we are looking at opening negotiations on an investment agreement. Russia's WTO accession has opened up new prospects for deepening our bilateral relationship. The immediate focus is likely to be on the implementation of WTO commitments and the on-going negotiation of a new agreement.

Truly transformative agreements with our most advanced partners could help foster structural reforms and the modernisation of the EU economy

We are now **reviewing our relationship with our most advanced trading partners**. Truly transformative agreements with these partners could help foster structural reforms and the modernisation of the EU economy. Negotiations with Canada are on-going and could be concluded soon. Negotiations on a far bigger scale with Japan and the US could also be opened.

16 Negotiations on the market access areas within the Doha Development Agenda remain in an impasse that will unlikely be resolved in the near future. Still, there are areas where the multilateral process could advance: there is a tangible prospect for concluding a multilateral agreement on trade facilitation within the next year. The agreement would improve the efficiency of customs procedures among WTO members. The benefits to the global economy would be high. A study the Commission commissioned last year on the impact of the Doha round estimated that trade facilitation would add $96bn to world exports each year and $68bn USD to world GDP, which is as much as the total gains expected from goods and services liberalisation under the Doha mandate.

17 In parallel with trade and investment negotiations, the EU is also negotiating framework agreements/political cooperation agreements with many partners in order to upgrade the relationships on political and sectoral issues at the same time.

In parallel, we are also **enhancing our engagement in our neighbourhood**, where economic gains can be expected from deep integration and regulatory convergence. In particular, we have completed a deep and comprehensive FTA with Ukraine, with innovative features regarding energy.

Deep and comprehensive FTA negotiations are on-going or soon to be launched with Georgia, Moldova and Armenia, as well as with Egypt, Jordan, Morocco and Tunisia. The targeted level of integration is remarkable, and the EU's neighbourhood policy builds on the strong relation and synergy between trade policy and foreign policy, thus contributing to an area of peace and prosperity.

Finally, we have just signed comprehensive FTAs with **Colombia – about to become the second largest economy in South America, Peru and Central America**. For development purposes, we have also concluded a comprehensive Economic Partnership Agreement (EPA) with the CARIFORUM group of States in the Caribbean and are pursuing negotiations with other **African, Caribbean and Pacific (ACP)** countries and regions.




Table 1: EU imports and exports of goods, by trading partner and trade agreement status (2011)*

	Share of EU imports (%)	Trade weighted EU import tariffs (%)	Share of EU exports (%)	Trade weighted tariffs facing EU exports (%)
1. Applied agreements	**24.3**	**0.4**	**28.3**	**3.6**
Chile	0.7	0.9	0.5	0.1
Mexico	1.0	0.2	1.5	0.3
South Africa	1.1	0.4	1.6	2.5
EFTA and Turkey	14.0	0.1	15.3	1.8
EPA Caribbean	0.2	0.0	0.2	10.8
EPA Papua New Guinea	0.1	0.0	0.0	n.a.
Korea	2.0	1.8	2.0	2.1
Mediterranean FTAs	4.4	0.3	5.4	9.2
Western Balkans	0.8	0.7	1.8	1.1
2. Concluded but not applied FTAs	**2.1**	**0.5**	**2.1**	**4.3**
Colombia	0.4	1.0	0.3	8.9
Peru	0.4	0.1	0.2	2.3
Central America	0.5	0.5	0.3	4.7
Ukraine	0.8	0.5	1.3	3.5
3. On-going FTA negotiations	**20.2**	**1.7**	**18.9**	**4.8**
ASEAN	5.6	2.3	4.2	2.9
Gulf Cooperation Council	3.6	0.4	4.5	5.8
Mercosur	3.2	4.4	2.8	10.5
India	2.4	2.5	2.5	9.0
Canada	1.3	1.6	1.8	2.8
Rest of ACP	4.1	0.0	3.1	9.2
4. Possible FTAs	**15.2**	**2.2**	**19.2**	**1.7**
Japan	4.1	3.2	3.0	3.7
United States	11.1	1.8	16.2	1.3
4. No FTA planned	**38**	**2.2**	**31.3**	**9.4**
China	17.5	3.5	8.5	7.6
Russia	11.1	0.1	6.8	11.6
Rest of the world	9.4	n.a.	16.0	n.a.

Source: MacMap, COMEXT and COMTRADE. * Trade shares are based on 2011, while tariff estimates are from 2010 or earlier, depending on reporter.

Box 2: EU — Korea: A landmark FTA which is already starting to provide results

The EU-Korea FTA is a prime example of our policy of ambitious and reciprocal agreements, providing opportunities on both sides. In force since 1 July 2011, it is the most ambitious trade deal ever concluded by the EU — and our first in Asia. It has clearly established the credibility of the EU's commitment to engage with Asia, while opening up a fast-growing East Asian market for EU exports. It has led to an unprecedented level of tariff dismantling and some ground-breaking provisions on non-tariff barriers. It will eliminate 98.7% of duties in trade value terms for both industry and agriculture within five years. The remaining tariffs will be almost entirely eliminated over longer transitional periods, with the exception of a limited number of agricultural products.

Some 70% of bilateral trade is now duty free; it is estimated that some € 850 million of import duties will no longer have to be paid in the first year. These are just the immediate benefits. EU exporters should be able to save up to €1.6 bn a year in duties once the FTA is fully implemented. There will be several billion euro worth of new opportunities in the services sector in the medium to long term. Cumbersome and expensive testing and certification requirements will be reduced. Transparency and predictability in regulatory issues will be increased, including the protection of intellectual property rights, while sectoral annexes on electronics, motor vehicles and parts, pharmaceuticals, medical devices and chemicals provide additional tools to tackle any emerging issue.

Concrete progress on the dismantling of the non-tariff barriers covered by these annexes will be very important for the success of this agreement and will inform our approach for other FTAs under negotiation. Finally, there will be enhanced access to government procurement markets.

As a result, it is estimated that the EU will increase its market share in several industry sectors (chemicals, machinery, other manufactured and food products) as well as in specific services sectors (e.g. business, financial, legal, telecommunications, environmental and transport services). It should also contribute to sustainable development in all its dimensions, i.e. as regards economic, social and environmental aspects.

It is the first FTA concluded by the EU to include a comprehensive chapter on trade and sustainable development, which puts a particular emphasis on the commitments of both sides to adhere to internationally recognised standards in the area of labour and environment. This is an ambitious agreement, which is already serving as a benchmark for future negotiations.

Although it might be early to draw final conclusions, there was a 35% increase in our exports during the first 9 months of implementation of the agreement, whereas our imports from Korea decreased by 5%. At least part of our export performance is due to the new opportunities created by the FTA. Exports of fully liberalised products as of day one increased by 46% against 36% for partially liberalised products and 23% for products not subject to any immediate liberalisation. By comparison, exports of the same fully liberalised products to the world at large have increased by 27%. The growth differential between the exports of these products to Korea and to the rest of the world means that the FTA has already potentially generated €1 bn extra exports or even more than € 2 bn if partially liberalised products are also considered. Our trade deficit has come down to just over €3.5 bn in 2011, from more than €11 bn in 2010 and well over €16 bn in 2007. EU companies significantly improved their performance on the Korean market in sectors such as cars and car parts, industrial machines, telecommunications equipment, iron and steel products, luxury handbags, pharmaceuticals and food and alcohol products. Although many of the improvements in market access under the agreement have already materialised, others will take time.

This commitment to an ambitious bilateral trade agenda has already produced results with the successful conclusion of a new-generation FTA with Korea, which entered into force last year (box 2). It shows that even in difficult times, we are able get ambitious trade deals which provide concrete benefits for the EU economy.

The EU is now pursuing an agenda of bilateral negotiations on an unprecedented scale. It is certainly the most ambitious trade and investment agenda in the world.

All in all, we are now pursuing an agenda of bilateral negotiations on an unprecedented scale. It is certainly the most ambitious trade and investment agenda in the world.

Despite difficulties in moving forward in the multilateral context, we have not stood still in the face of rapid changes in the global economy: FTAs covered less than a quarter of EU trade before 2006; concluding on-going negotiations would bring this figure up to half; and moving forward with the US and Japan would bring it up to two-thirds.

The months ahead will provide important opportunities to take our agenda forward. The key question is whether it will be feasible to conclude these negotiations within a realistic timeframe and at a satisfactory level of ambition.

3.2. State of play and prospects for bilateral relations with strategic economic partners

- **On-going FTA negotiations with India, ASEAN countries, Mercosur and Canada**

– Taken as a whole, the Association of South East Asian Nations (**ASEAN)** is the EU's third largest trading partner outside Europe. It offers significant growth opportunities in dynamic markets that are often difficult to access due to high tariff and non-tariff barriers. FTA negotiations with a group of seven ASEAN countries were launched in 2007, initially based on a region-to-region approach.

  Because progress was slow and structural differences within ASEAN significant, negotiations are now moving forward on a bilateral basis. They are now at an advanced stage with Singapore. Prospects for concluding what looks to be a high-quality FTA before the end of 2012 are good.

  Negotiations are also on-going with Malaysia and could conclude in the first half of 2013 if Malaysia takes the necessary decisions after the elections which are expected soon. Both agreements hold an important precedent value for other ASEAN FTAs. Negotiations have just been launched with Vietnam. This progress has rekindled interest in the Philippines, Indonesia and Thailand, which are now showing willingness to re-engage after several years. Ultimately, bilateral FTAs should serve as building blocks for a region-to-region agreement. This could take shape once a critical mass of bilateral FTAs with individual ASEAN countries is reached and once ASEAN countries have achieved greater integration among themselves. In this respect, the completion of the ASEAN Economic Community in 2015 will be crucial.

– **India** is a high-potential emerging economy that has experienced rapid growth and deep changes in recent years and is only starting to develop its full economic potential. It is a market of more than a billion consumers, though only a fraction of them holds a level of purchasing power equivalent to the European middle class.

Still, the Indian middle class (currently representing 150 million people, but expected to reach 600 million in 20 years) is growing steadily and will represent a key market for European products in the years to come. The EU is historically India's largest trading partner, but is fast losing ground to China and the UAE.

The conclusion of an ambitious agreement would be a major step towards consolidating our position in India, but also towards re-shaping our bilateral relationship.

An EU-India free trade zone would cover a quarter of the world's population and 30 % of its GDP. The agreement would be the largest and most significant deal ever concluded by either the EU or India and the first major agreement of the EU with a key emerging economy.

The level of ambition goes well beyond what India has agreed with other countries so far, covering issues that India has previously dismissed in the WTO context (such as investment and competition) or largely excluded from negotiations with other bilateral partners (public procurement). A mutually beneficial agreement would also set an important precedent, with implications going beyond India, as it would be our first case of engaging a large emerging country in such a reciprocal trade opening exercise. It therefore has the potential to be a real game changer for global trade.

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We have come a long way in these negotiations and are now facing the most difficult issues. Concluding the deal will depend on successfully addressing them. Latest indications suggest that India remains very engaged and committed to finding solutions which are mutually acceptable. However, this will not be easy as in some cases they would require India to undertake legislative or regulatory changes. The key question therefore is whether it is feasible to conclude negotiations at a satisfactory level of ambition, while also taking into account India's political calendar.

– FTA negotiations between the EU and **Mercosur** were re-launched in May 2010, following concrete indications of a shared willingness to negotiate an ambitious FTA. The stakes, economically and politically, are very high for both parties, as the aim is to create the biggest region-to-region free trade area in the world. Negotiations are of particular interest to the EU, considering the high tariffs applied in Mercosur and the high levels of EU investment in the region. Improved levels of protection and enforcement of intellectual property rights in Mercosur, including better protection of EU geographical indications, are also of importance.

For Mercosur, this agreement is a unique opportunity to improve market access to their biggest trade partner at a time when others risk gaining an advantage through new FTAs and while Mercosur has yet to conclude an agreement with a major trade partner. However, protectionist tendencies in the region, and the latest internal developments in Mercosur, create significant challenges for negotiations.

– The EU is Canada's second most important trading partner after the US, and Canada is keen to rebalance its trade towards our side of the Atlantic. Being able to compete with US exporters on a more level playing field also offers clear gains for EU operators. We are currently moving into the final straight of negotiations launched in 2009. Concluding them is one of the Commission's main trade policy objectives for 2012. This would give additional impetus to an already deep and well-functioning relationship.

Negotiations with Canada aim at going beyond what has been granted in previous agreements by the EU as well as by Canada. Concluding these negotiations is one of the Commission's main objectives for 2012.

Negotiations aim at going beyond what has been granted in previous agreements by the EU as well as by Canada, e.g. on government procurement. Improved levels of intellectual property rights protection and enforcement in Canada, including better protection of EU geographical indications, are also a crucial interest for the EU. We are also developing a comprehensive investment framework, including provisions for investment protection following the new competence granted to the EU by the Lisbon treaty in this area. All this offers the prospect of reaching a truly transformative agreement, which will set a very important precedent for possible future agreements with other large developed countries.

- **Potential new agreements with Japan and the US**

– The EU and **Japan** are the largest and fourth largest economies in the world respectively. Despite the huge size of the Japanese market, EU companies come up against serious non-tariff barriers in the form of discriminatory regulations, unique standards, anti-competitive behaviour, weak corporate governance and discriminatory public procurement practice.

Japan has one of the lowest import penetration rates of any country in the OECD (6 % — one fifth of the OECD average.) Likewise, it has the lowest level of inward foreign direct investment (FDI) in the OECD.

Opening up Japan to European trade and investment would yield very considerable gains for the European economy, while signalling the EU's determination to strengthen its economic links with East Asia.

Only 3 % of global European FDI is in Japan. Over the past five years, EU exports of goods to Japan declined 6.1 % on average per year, while the EU's total exports grew by an annual average of 0.7 %. Japan was the EU's third most important export destination in 2003, while today, it ranks only seventh. There is clearly untapped potential in sectors where EU industry is very competitive, such as the pharmaceutical, medical devices and food sectors. The EU-Japan trade and investment relationship is clearly underperforming and could be greatly enhanced.

Japan is acutely aware that its current economic situation is unsustainable. The Japanese government is pursuing a double strategy, revitalising domestic attempts at reform while seeking strategic alliances with its key trading partners. It is in both Japan's and the EU's interests that it succeeds in this strategy.

Opening up Japan to European trade and investment would yield very considerable gains for the European economy, while signalling the EU's determination to strengthen its economic links with East Asia. The project of a comprehensive EU-Japan FTA is a key plank of this strategy.

Both sides engaged last year in defining the scope and level of a potential FTA in a way that would provide effective solutions to tackle obstacles to trade, so as to ensure there is a level playing field in Japan for all businesses and entities to compete on equal terms.

This is crucial in particular for non-tariff obstacles and those of a regulatory nature, both in goods and services. The two sides have now agreed a solid and ambitious scoping paper, covering goods, services, investment, public procurement, intellectual property, sustainable development, trade facilitation, etc. It also covers roadmaps for the solution of a comprehensive (but not exhaustive) list of Non Tariff Barriers in 10 areas of trade in goods, leading in some cases to concrete outcomes in the next few months and in others to a negotiated outcome that would, if satisfactory, strictly parallel EU concessions on tariffs.

The EU and Japan have also recently found an agreement on market access in the railway procurement market. The agreed compromise foresees that Japan will take effective measures to render the Operational Safety clause (OSC) more transparent and non-discriminatory and eventually allow EU suppliers to participate to public tenders. The EU will in parallel and according to the same timeframe withdraw its objections to the delisting of the 3 privatised Japanese railways companies (JRs) from the WTO Government Procurement Agreement.

The EU's economic relationship with the United States is by far its most important, unrivalled in scope and intensity.

– The EU's economic relationship with the **United States** is its most important, unrivalled in scope and intensity. Despite the economic downturn of recent years, the US and the EU remain each other's most important trade and investment partners. They enjoy the most integrated and largest economic relationship in the world, as illustrated by unique levels of mutual investment stocks (€2.4 trillion). Total US investment in the EU is three times higher than in all of Asia. EU investment in the US is around eight times the amount of EU investment in India and China put together. Investments are thus the real driver of the transatlantic relationship, contributing to growth and jobs on both sides of the Atlantic. More than 15 million people are employed by European companies in the US or US companies in Europe.

The transatlantic relationship has enormous potential which is far from being fully exploited. Given the low average tariffs (under 2%), the key to unlocking this potential lies in tackling non-tariff barriers. These consist mainly of customs procedures and behind-the-border regulatory restrictions. They come from diverging regulatory systems as regards technical regulations, conformity assessment procedures, sanitary and phyto-sanitary (SPS) restrictions and security provisions. These barriers are more difficult to address than tariffs, especially in formal agreements, as they are based on different approaches to regulation, often deeply rooted in historic or societal approaches and political realities.

The EU-US High Level Working Group for Growth and Jobs set up at the 2011 EU-US Summit has been actively engaged in finding ways to tap into this potential.

It has gained considerable momentum in the past few months and has just presented its interim findings. To fulfil the Summit mandate to create jobs and growth, a future agreement would need to be transformative in nature and aim at the highest possible level of ambition in all areas under the form of a comprehensive FTA.

The extent to which a comprehensive EU-US agreement would foster greater convergence/equivalence of our respective approaches to regulation, both for goods and services, will be of critical importance. An ambitious bilateral agreement could develop high standards regarding rules and principles in areas significant to trade, such as raw materials, competition or investment.

- **Two strategic relationships involving different instruments: China and Russia**

– Trade with **China** continues to grow rapidly, with the prospect of making China the EU's largest trading partner both for imports and for exports in 2012 for the first time ever. The EU has been China's biggest trading partner for several years. This clearly makes our relationship 'too big to fail' on both sides. Yet it is also the most difficult relationship to manage right now, with significant challenges for European companies and persistent impediments to trade, investment and operating in China.

Among factors to be taken into account are an opaque regulatory environment, both open and hidden discrimination, an unequal playing field in financing, scope of business, access to government contracts, etc.

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EU priorities in dealing with China at present are (a) investment (in many areas the only way to be competitive in the Chinese market); (b) procurement (a huge market in China, given the size of the country, its need for modernisation, and the pervasive role of the state); (c) protection of intellectual property rights and technology (reduced market opportunities for European companies which cannot deploy their best technologies and know-how due to the fear of infringement of intellectual properties rights, and even theft of their key technologies). To this end, at the EU-China Summit on 14 February 2012, both sides confirmed their commitment to work towards the launch of negotiations on an investment agreement that would be rich in substance, i.e. covering all issues of mutual interest (market access and investment protection).

China's role in the world economy and on the EU's economic horizon is bound to increase further and it will present both huge opportunities and challenges for Europe. Nevertheless, we should expect continuing tension between China's desire to catch up and our desire to keep the relationship anchored in openness and the respect of international trade rules that are also in China's long-term interest. Moreover, our tools are limited.

Beyond the prospect of an investment agreement and some other ‘targeted’ negotiations (e.g. on geographical indications), there are limited opportunities to deepen our relationship with China in the same way as with other countries at this time. The on-going negotiations for a Partnership and Cooperation Agreement (PCA) whose economic aspects would replace the 1985 Trade and Cooperation Agreement are stalled because of very different views on the desired level of ambition.

– **Russia** is not only the EU's biggest neighbour and one of our largest export markets, but also our most important energy supplier. Vice versa, the EU is Russia’s most important trading partner by far, accounting for more than half of its imports and exports. After 18 years of negotiations, Russia’s accession to the WTO, which should take effect in the coming months, achieves the EU’s top priority in its trade policy towards Russia and will be a milestone in EU-Russia relations.

It also brings Russia formally into the global trading system and enables use of the WTO’s dispute settlement system as necessary. This should help sort out bilateral trade irritants and improve the business environment for EU operators by providing more predictability and stability.

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The average final binding tariff ceiling for Russia will be 7.8 % (much lower than for other BRIC countries), compared with a 2011 average of 10 %. This results in a saving of €2.5 bn annually for EU exporters and could stimulate an estimated €3.9 bn of additional EU exports per year.

The immediate task for the EU is to pursue and monitor Russia's full and faithful implementation of its multilateral commitments. Negotiations on a successor agreement to the Partnership and Cooperation Agreement (PCA) are on-going and will require further progress on trade and investment provisions. Negotiations remain difficult. Russia is heavily engaged in its own regional economic integration process. Recent protectionist measures taken by Russia (a ban on live animal imports and questionable anti-dumping investigations, as well as statements by President Putin promising compensation to Russian producers for reduced import duties in the form of new non-tariff barriers) are a real cause for concern. Violation of WTO rules is not acceptable, and the EU will swiftly defend its operators’ interests, resorting to the WTO dispute settlement mechanism if necessary.

3.3. Potential economic gains

The cumulative impact of all on-going and potential negotiations could provide an increase of about 1.2 percentage points of GDP or some € 150 bn to the EU economy in the short to medium term (table 2). Productivity gains stemming from trade integration further increase the impact of trade agreements by more than half. Once taken into account, the longer-term effect of all on-going and potential negotiations could amount to 2 % of GDP or more than € 250 bn.

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On-going negotiations with the ASEAN countries, Canada, India, and Mercosur would generate almost a third of total potential GDP gains, while possible agreements with Japan and the US would account for more than two-thirds. This would of course depend on the actual outcome of negotiations.

Table 2: Potential impact of trade agreements on GDP, exports and jobs in Europe

	USA*	**Japan**	**Canada**	**ASEAN**	**India**	**Mercosur**	**China Investment ***	**Sum**	**Productivity effect ****	**Sum (incl. productivity effect)**	**Jobs*** (1000)**	**Pour mémoire: Korea**
GDP (%)	0.52	0.34	0.08	0.035	0.03	0.17	0.03	1.2	0.8	2.0		0.075
(€ billion)	65.7	42.9	10.1	4.4	3.8	21.5	3.8	152.2	103.1	255.3		9.5
Total Exports (%)	1.40	1.20	0.69	1.60	0.55	0.65	0.07	6.2			2164	1.20
(€ billion)	*29.4*	*25.2*	*14.6*	*33.7*	*11.6*	*13.7*	*1.4*	*129.6*				*25.2*
Total Imports (%)	1.35	1.20	0.39	1.40	0.55	0.66	0.06	5.6				1.10
(€ billion)	*29.0*	*25.8*	*6.0*	*30.1*	*11.8*	*14.2*	*1.3*	*118.2*				*23.6*

Source*:* Based on studies commissioned by DG Trade. Comparisons between different agreements should be done with caution due to different methodologies used. *Note:* Absolute figures refer to EU GDP and trade figures for 2011. * This study does not simulate any reduction in tariffs, only in non-tariff barriers. A DG Trade simulation of an EU-US 100% tariff removal estimates EU real income to increase by 0.02% or €3.3 bn. ** An increase in trade exposure of 10 percentage points (here assumed to equal exports + imports over GDP) could lead to an increase in output per working-age person of 4 per cent, see OECD (2003), *The Sources of Economic Growth in OECD Countries*. *** The Jobs figures are based on the coefficient of 16700 jobs embodied in each €billion of extra-EU exports as presented in Sousa, N. &al. *op. cit.*

These agreements could add more than 2 million jobs to the EU economy or 1 % of the EU total workforce. This is equivalent to one tenth of the number of presently unemployed people and to the net increase in unemployment witnessed between March 2011 and March 2012 in the EU, in the midst of the debt crisis in Europe. On the other hand, structural change would also involve job losses in some sectors, which requires active policies to help manage change.

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Concluding all these agreements could boost the EU's total exports by 6 %, worth close to an additional € 130 bn. Increases in exports to specific partners are obviously higher, ranging from 24 % with Canada to more than 105 % with Mercosur. EU imports would grow as well, albeit at a slightly lower rate.

Most of the benefits of potential trade agreements would have to be expected in the medium term, once agreements are progressively implemented. Yet a credible commitment is also crucial in the short term as it sends a strong signal that we are serious about reforming at home and securing markets for our businesses abroad. That would have an immediate impact on investors' confidence.

4. THE ENFORCEMENT AGENDA

While trade negotiations are essential to prepare for the future, the most effective way to boost the contribution of trade to growth in the short term is to ensure robust enforcement of our existing rights under current rules. That means having a systematic, consistent and strategic approach to defending our interests. This means deploying all the tools at our disposal, from diplomatic and political contacts to negotiations, regulatory cooperation, and WTO and bilateral mechanisms. A strategic approach to market access has been an increasingly prominent feature of EU's trade policy since 2006[18].

The Commission recently released its second annual Report to the European Council on Trade and Investment Barriers. It focused on the six strategic partners who represent 45 % of our trade — the United States, China, Japan, Russia, India, and Mercosur. The report shows that we are delivering on our enforcement agenda. We have scored important victories in China, winning our raw materials case at the WTO and delivering considerable progress on the indigenous innovation policy. Barriers to our telecommunications equipment and access to cotton have been fully resolved in India. We have made significant progress on procurement, customs and regulatory issues in Japan and the United States.

While trade negotiations are essential to prepare for the future, the most effective way to boost the contribution of trade to growth in the short term is to ensure robust enforcement of our existing rights under current rules.

We make full use of the trade instruments at our disposal to ensure that rules are respected. When all interventions fail, we have consistently shown we are ready to take countries to the WTO dispute settlement, as we have just done in the case of Argentina's import restrictions. Overall, analysis shows that we have been as successful as the US over the past five years in defending our interests before the WTO, with a slightly lower number of cases initiated, but higher rate of success. Over the last ten years, we launched the same number of offensive WTO cases as the US.

A strategic approach to market access has been an increasingly prominent feature of EU's trade policy.

18 Communication from the Commission, "Global Europe: Competing in the World", COM(2006)567, 4.10.2006

We are also changing gear in the implementation of FTAs, a very important aspect considering the volume of bilateral negotiations. The EU-Korea FTA puts new emphasis on implementation and enforcement: in addition to thematic committees, seven specific working groups have been set up to ensure proper implementation, while previous agreements used to leave this to a single committee which met only once a year to cover all aspects.

Box 3: China and raw materials: WTO cases

Last year, the EU won a WTO case against China's restrictive and discriminatory policies regarding raw materials, a ruling that was confirmed on appeal at the end of January. The case concerns nine important raw materials (bauxite, coke, fluorspar, silicon carbide, silicon metal, zinc, magnesium, manganese, yellow phosphorus) on which China has imposed quantitative export restrictions, export duties of up to 70 %, minimum export prices and other restrictions linked to the quota and licence administration. China has now to comply with this ruling and bring its export regime in line with international rules by the end of 2012.

The economic stakes are significant, but the ruling is also valuable in sending a clear signal that export restrictions cannot be used as a protectionist tool to boost domestic industry at the expense of others. EU imports of raw materials from China covered by the WTO case reach €1 bn a year and the real economic importance goes well beyond this figure as these raw materials are inputs for a large range of products. For more than half of them, the EU relies on imports for more than 60 % of its consumption (more than 90 % for bauxite, manganese, and magnesium). For four raw materials (phosphorus, magnesium, manganese and refractory grade bauxite), China is a leading source, with over 80 % of world production. The impact of its distortive measures is twofold. First, restrictions lead to different price levels for Chinese and EU operators. Often export prices are 50 % to 100 % higher than Chinese domestic prices. As the cost share of these raw materials in downstream manufacturing can be considerable (often 50 % or even more), such a price differential is a decisive competitive disadvantage. Second, restrictions seriously affect the availability of raw materials outside China. About 4 % of EU industrial activity, accounting for 500 000 jobs, is potentially affected. The chemical, steel and non-ferrous metal industries, as well as their downstream clients, are the main sectors concerned. They include a range of industries, such as producers of beverage cans, CDs, electronics, vehicles, ceramics, refrigerators, batteries and medicines to name just a few.

On 13 March 2012, the EU, together with the US and Japan, launched a second challenge to China's export restrictions on raw materials. This case covers 17 rare earths, as well as tungsten and molybdenum, on which China imposes export quotas, export duties and other restrictions. These measures significantly distort the market and favour production in China at the expense of companies and consumers in the EU. Rare earths feature unique magnetic, heat-resistant and phosphorescent properties. They are used to produce highly efficient magnets, metal alloys, phosphors, optical material, battery material, ceramics and special abrasive powders. These materials are key components of many downstream and consumer products such as wind power turbines, catalysers (for car and oil cracking), energy-efficient bulbs, engines for electric and hybrid vehicles, flat screens and displays (LED, LCD, plasma), hard drives, car parts, camera lenses, glass applications, industrial batteries, medical equipment or water treatment — to name just a few. Rare earths may only be a minor component of the finished product, but often, they cannot be substituted. Where they can, this results in a redesigned and/or more costly final product. Their non-availability can lead to the disruption of whole value chains. China is a monopoly supplier of rare earths, with a 97 % share of world production.