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A MODERN TRADE POLICY FOR THE EUROPEAN UNION

A Report to the New European Commission and Parliament from the EU Trade Policy Study Group

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PREFACE

The new European Commission and the new European Parliament will face few challenges in the next five years that are as important and daunting as sustaining the open world economy and increasing the support for it. Support for trade liberalisation has been deteriorating in the past years. Reforms aiming at open economies up to global competition have been scant in the new Millennium. The magnificent wave of trade reforms starting in the early 1980s slowed down considerably in the early 21st century. While the 1990s was a remarkable decade for trade policy – with several major achievements such as the Uruguay Round, the Single Market of the European Union, the North-America Free Trade Area (NAFTA), the zero-tariff agreement on trade in ICT goods (ITA) – the first years of the 21st century have been a lost decade. There have hardly been any significant trade reforms at all. Countries have rather become defensive and anxious. Political leadership for trade liberalisation has been absent for many years now.

Since September 2008 and the start of the financial crisis, the trend towards deeper global integration has been reversed. The world has de-globalised for the first time since the end of the Second World War. Fears over a new Great Depression resurfaced in late 2008 as the world economy contracted sharply, but these fears never materialised into Depression-style politics. There has not been a replay of the noxious tit-for-tat protectionism that plagued the 1930s. After the Wall Street Crash in 1929, and a series of bank collapses in the early 1930s, governments succumbed to "beggar-thy-neighbour" policies: raw tariff protectionism and competitive currency devaluations. The economic climate grew nationalistic. We all know the horrors that followed.

It is comforting that political leaders today have not repeated the mistakes of the 1930s. Yet the absence of abysmal economic nationalism is no refuge for the creeping protectionism that has grown during this crisis. Too many governments have toyed with protectionist measures in the vain belief that such measures could slow down economic contraction for an individual economy at a time when the entire world economy was falling. But these measures, predictably, could not slow down contraction; they only prolonged the pain for everyone.

Unwinding protectionist measures and restoring growth in the global economy should be the prime focus now for European trade policy. Few regions in the world have as great a stake in global trade as Europe. It is only natural that the rest of the world looks to Europe for leadership in global commercial policy. Too often, however, they do not get a response. European leaders have all too often been occupied with internal squabbles that have constrained Europe's ability to lead. Institutionally, Europe is now in a much better position to lead in trade policy now that the Lisbon Treaty has been ratified. The question, however, is: what sort of leadership should Europe offer?

The European Trade Policy Study Group was formed to offer perspectives on EU trade policy at a time when European and global trade policy need thoughtful leadership. Members of this group come from global business with significant production and investment in Europe. They have for a long time been close observers of European and global trade policy. Some of them work for firms that were born in Europe; others for firms that were born outside Europe. Such distinctions may still matter to some, but not to global business with presence across the globe. The world is not flat, but modern business has globalised to such a degree that few companies today carry only one passport or only have one national identity. Globalisation has been for real, and it has affected the way any global firm operates. While multinationals a few decades ago could think of themselves in narrow geographical terms, this is simply no longer possible. The concept of a singular home market – a reserve for a company where it builds its products and market strategies before they are launched globally – is only possible for the company that has decided to go out of business. Modern leadership, in politics as well as business, can only be successful if it builds on this insight.

This report of the European Trade Policy Study Group offers a comprehensive account of trade policy today and strategies for the future. These have not been easy tasks. Global trade is ever more complicated, involving old and new economic powers as well as old and new trade barriers. Crystallising the key strategic priorities out of the many interests and views that shape EU trade policy is a delicate affair. Yet it cannot be avoided. Leadership is about defining core strategies that enlighten, motivate and guide policymakers and citizens. Too often in recent trade policy, these strategies have been missing. Unsurprisingly, results have been absent, too. Europe's trade policy leadership for the next five years – at home and abroad – should aim to reverse the trend of trade policy in decline.

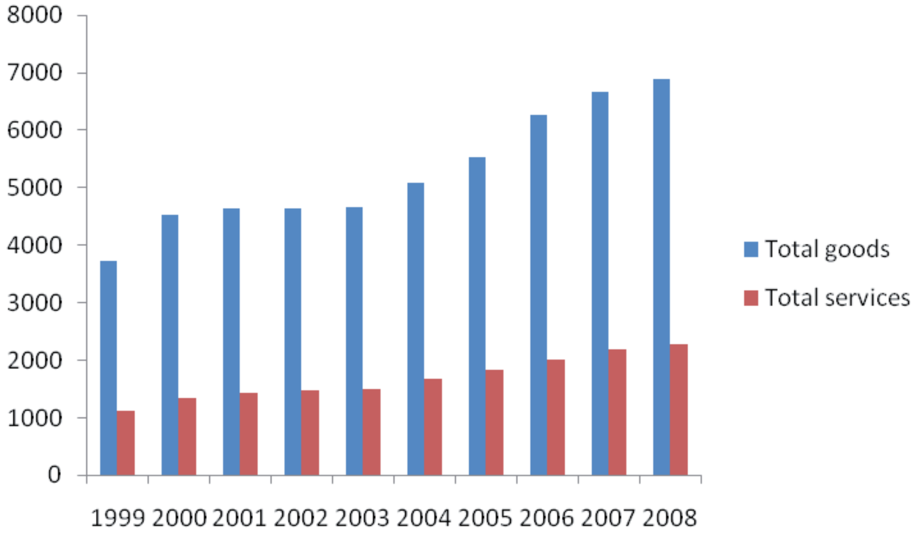
1. THE GLOBALISATION OF BUSINESS

The European Union is the biggest trading entity in the world. Even if internal European trade is discounted – that is, trade between members of the European Union – Europe's trade with the world exceeds the trade of China and the United States, respectively. The EU has earned this position through successive rounds of enlargements, and progressive liberalisation of trade.

However, Europe would not be at the top of the league unless it had outward-oriented businesses that have seized the opportunities created by fewer and smaller barriers to cross-border exchange. These opportunities have been seized in different forms: firms finding new customers abroad; firms finding better ways to produce abroad; firms innovating for the global market; firms finding better suppliers to import from abroad; and firms that find Europe a big and prosperous market to penetrate. In the world of manufacturing, there are only a few small pockets that remain untouched by globalisation. In Europe's agriculture and services sectors, however, there are still considerable barriers to cross-border exchange. It should not come as a surprise that the significant increase in income that most parts of Europe have experienced as a consequence of globalisation can, to a large extent, be attributed to falling or slowly increasing consumer prices for manufactured goods – and not prices for services or agricultural produce. In other words, consumers get more "bang for their buck".

This is important – especially as it is often neglected in the policy debate. Europe's growth in recent decades has to a considerable extent been driven by what has been called "Smithian growth" (after Adam Smith) – that is, growth spurred by increased specialisation through cross-border exchange. Economists often point to another source of growth – "Schumpeterian growth" (after Joseph Schumpeter): growth determined by innovation. There is no conflict between these two schools of growth. Both are essential to growth. And trade remains the central vehicle for dissemination of new innovations. Yet, as a matter of analytical distinction, countries tend to rely more on one factor than another in their growth. And growth in Europe has relied more on "Smithian growth" than, for example, the United States where "Schumpeterian growth" – innovation and creative destruction – has for long been a dominant factor of growth.

CHART 1: A DECADE OF RAPID TRADE EXPANSION: TOTAL EU TRADE (IN MN EUR)



Source: Eurostat; own calculations

This profile of European growth should especially be noted by policymakers and scholars that believe there is a conflict between borders open to cross-border exchange and what has been called the "European social model". Over the past two decades, Europe has had slower productivity growth than the United States and many other developed regions. The tax base has grown slowly and in many countries been unable to keep track with normal cost inflation in public expenditures. Consequently, the standard of public services has deteriorated.

Moreover, nominal wage growth has not been high in comparison with other decades or countries. Despite this development, however, most people in Europe have experienced a significant increase in real income – in purchasing power. This increase, higher than in periods of faster growth of nominal income, is to a considerable degree due to "Smithian growth" and the benefits from trade. Similarly, the increase in productivity that Europe has witnessed is to a large extent determined by the effects of specialisation and cross-border trade. Without the benefits from trade and specialisation in past decades, living standards would not have risen as much as they have done – far from it – and European growth would have fallen even farther behind growth in other developed regions.

It is disconcerting to witness how many policymakers, in Europe and elsewhere, have been prone to rush to the side of trade critics and blame globalisation for all sorts of problems in society. Not only are such views ignoring the economic history of Europe, but they also cause an anxiety in society over globalisation that simply is not warranted. Societies – whether open or closed – have always faced challenges to increase prosperity and welfare. The challenge for the productive sector to remain competitive is bigger in open economies than in closed. But this is hardly a problem; competitive pressures make the economy more stable, create more jobs, and increase opportunities for people in a fashion that closed economies can never do.

Moreover, such views often display a painful ignorance about how the modern economy and modern companies work. At the heart is the belief that a company can prosper, employ more people in a country, and pay more in national taxes if they are shielded from foreign competition. That argument was already invalid centuries ago, but it is even more so in a modern world of fragmented and globalised supply chains. For most goods or services that the average European company or consumer buys today, it is simply impossible to tell its nationality. The supply chain of any company has grown increasingly sophisticated. Often it involves many countries and several hundred suppliers.

Equally important, it is not of particular interest from the viewpoint of economics to learn if the final product has been made in Europe, the United States, China or elsewhere. For the simple reason that it says very little about what value of the production – that is, how much GDP – is actually created in an economy. Furthermore, in an assembly-oriented economy with components coming from many other countries than the country of assembly, the trade registration of the final products only tell one part of the story.

Take the example of an iPod. The average consumer buys an iPod that is "made in China". Trade statistics will tell you a similar story: an iPod is exported from China to other countries. But this is a simplistic story that neglects key facts. First, for a product like an iPod, with 451 components that are all light and cheap to trade, the final assembly is based on imported components from many countries. Second, production and assembly of components is only one part of the production; product development, marketing and retail are equally important from the viewpoint of GDP. In trade- volume terms, an iPod is considered a product of China. In GDP terms, however, it is not. Only a few percent of the price of an iPod can be attributed by Chinese value added.[1]

BOX 1: THE FRAGMENTATION AND GLOBALISATION OF SUPPLY CHAINS

As late as the late 1980s, a telephone in Europe was built from the first to the last component in one factory. Compare that with the highly fragmented supply chain of a modern mobile phone. The Finnish company Nokia has been estimated to handle more than 100 billion components every year. In 2006 its plants produced around 900,000 mobile phones – and handled around 275 million components every day. Most of these components are procured from other companies, and imported to the countries where Nokia has located its factories. A low estimate is that half of the number of components used to build a mobile phone has crossed a border. From one telephone to 100 billion components in less than two decades – this is the story of modern globalisation.[2]

One may think that a modern ICT product with many light components is an extreme example of supply chain fragmentation. It is not. Take the example of a chainsaw. The chainsaw producer Husqvarna sources its components from 250 suppliers from more than 30 countries. Every chainsaw is built on 150 different components and it is estimated that every chainsaw has components that have, in aggregate, crossed borders 80 times before the chainsaw is assembled in a Husqvarna factory.

In this world of supply-chain integration, how is it possible to determine the national origin of a product? The answer is simple: it is impossible. Moreover, it is a meaningless exercise and policy that is based on national origin or local-content requirements will do little, but preserve uncompetitive structures of production.

Take the example of the car scrapping scheme in the United States. Only cars from a limited number of producers (Chrysler, Ford and General Motors) qualified for the "cash-for-clunkers" subsidy. Other producers were discriminated against because the US government aimed to support American production – to steer consumers to "buy American". The only snag was that the eligible brands produce considerable parts of their cars abroad while many foreign producers have factories in the United States. One could not say if the production of a GM car required more American workers than, say, a German or Japanese car sold on the US market. In fact, Chrysler's Jeep Patriot has – despite its name – less American content that Toyota's rival Sequoia. Foreign car producers employed almost 403,000 workers in the US in 2008. Toyota built in 2008 1.66 million cars in the US.[3] Policy such as this is fundamentally at odds with the realities of global business.

BOX 2: VALUE ADDED IN EUROPE'S SHOE PRODUCTION: CASE STUDY OF THE EFFECTS OF TARIFFS

The most famous shoe brand in the world, Nike, is an advanced user of supply-chain globalisation and much of its success has been explained by its supply-chain structure. In fact, one could say that Nike today is more of a global sports innovation and research company than it is a shoe producer. By outsourcing the production of all of its shoes to many hundreds of suppliers across the world in its virtual supply chain, Nike has concentrated its own staff to developing performance technology and materials, product design and marketing.

Nike is not alone. All leading shoe producers in Europe have outsourced their production and directed local staff in Europe towards R&D and marketing. By fragmenting the supply chains, these firms have been able to "climb the value-added chain" and contribute with more aggregated value added also in Europe. In fact, it turns out that outsourcing of production has been instrumental in increasing the aggregated value added in Europe. That is, Europe would not have climbed the value-added chain in shoes unless its producers had outsourced low-skilled parts of the production to other countries. Moreover, when Europe slaps additional duties on imported shoes from brands with production in Europe, it is hurting value added in Europe more than it hurts value added in the exporting country and it is also penalizing European consumers. Even low-cost shoes made by European brands abroad have a higher share of their value added in Europe than in, say, China and Vietnam, two typical exporters of shoes.[4]

This may sound as an academic point of little relevance to policy. But it is of relevance to policy – in fact, it goes to the heart of ambitions and efforts to have higher, smarter and more equitable growth in Europe. And it is absolutely central for anyone who wants to understand the role of trade for a country that wants to climb the value-added chain – the move to more high-paying and high-yielding production. Put simply, without trade – and without a growing import of goods from countries with lower labour costs – it would be impossible for Europe to expand its wealth and move higher up in the value-added chain.

This is the explanation behind the fragmentation and globalisation of supply chains that we have seen in the past two decades; it has been a natural part of the process in developed countries to increase wealth. It is also a key explanation for the considerable expansion of trade that the world has witnessed in the past two decades. Furthermore, it explains the increasing role of emerging markets in the world economy. Countries like China, that prior to the crisis expanded its trade by at least 20 percent annually over the past 15 years, have integrated into the world economy by supplying intermediary goods to companies abroad and by becoming an assembly hub for parts and components for other countries in the region. What economists call "processing trade" – additional refinement of imported goods before they are exported – has been significant in China, accounting for up to 75 percent of all its trade for some years. Notwithstanding the emergence of Chinese multinational companies in some sectors, China's rise in trade has principally been a story of how it has increasingly enabled globalised supply chains for Western multinational firms.

To put this differently: it is refined business strategies and increased market competition that has driven globalisation in the past decades. Business has been at the centre of globalisation and the magnificent rise in income in many underdeveloped parts of the world. Developing countries' entry into the world economy has had a great impact on reducing unemployment, underemployment, poverty and destitution.

There are many takeaway points from this introduction. We will return to them later. But two points should be emphasised at this stage.

- Maintaining or increasing barriers to trade in today's world economy means that a country is hurting its own firms and their competitiveness.
- What distinguishes globalisation from previous eras of internationalisation are the fragmentation of production and the integration of markets. Barriers to market access in Europe do not help European firms; it rather prevents them from increasing their competitiveness on global markets.

2. THE GLOBAL ECONOMIC CRISIS AND TRADE POLICY

If finance was the first casualty of the economic crisis; trade was certainly the second. Since the crisis started, the world has witnessed a sharp contraction in trade. Overall, for the first time since the mid-war period, the world has de-globalised; not only has trade fallen considerably; so has global finance, FDI, and migration.

The global economic crisis has spawned fears of rising protectionism. Fears centre particularly on a repeat of the tit-for-tat protectionism in the 1930s. On June 17, 1930, the U.S. enacted its Smoot-Hawley Tariff Act which sharply increased tariffs on several hundred goods. Other countries in Europe retaliated, and this spiralling protectionism helped to turn a local stock-market crisis into a decade-long depression. Between 1929 and 1932 world trade fell by 30% and it took another four years until trade had recovered back to the aggregate volume of 1929.

Furthermore, as the prices of many traded goods fell sharply the value of trade consequently took a sharp hit. International prices on food and raw materials fell by 60-70% between 1929 and 1932. While some hoped protectionism in the interwar years to be temporary, barriers did not disappear quickly. Governments had to spend a few decades negotiating in the GATT and other international organisations to get rid of the protectionism imposed during the interwar period.

Alarm bells should ring when countries are getting closer to the trade and monetary policies pursued in the early 1930s. Fortunately, the worst fears over a repeat today of tit-for-tat tariff protectionism have not materialised. According to surveys by the World Trade Organisation and the World Bank, there is not much evidence of a sharp rush to increased tariffs.[5] Only about a handful of countries have increased tariffs since the crisis started last autumn (Argentina, Brazil, Ecuador, India, Indonesia, Russia, and Turkey)[6], and the increases have covered only a limited number of goods.[7] These new tariffs are vexing and destroying trade, but they do not pose systemic threats to the world economy or to the integrity of the world trading system.

Nor are there reasons to believe a destructive scenario of spiralling tariff protectionism to be an imminent threat. Certainly, some other countries will increase tariffs, believing it will ease conditions for local companies suffering from contracting demand. But such tariff hikes are not likely to trigger a retaliatory spiral à la the 1930s, or to cover goods that are significantly traded. There are two restraining factors.

First, countries have bound their tariffs in WTO agreements and understand they will be taken to costly compensation negotiations or dispute settlement if they raise tariffs above these limits. A number of emerging countries with significant tariff water – the difference between the bound levels and the applied levels – can raise tariffs without violating WTO commitments. Some emerging markets have already made use of the room for WTO compliant tariff hikes; others may do so as the effects of the crisis on output and employment grow worse. But it is not likely that these countries will rush to tariff hikes. Table 1 indicates the countries in which that may happen. A handful of countries could double and triple their tariffs without violating their WTO commitments. In the agricultural sector, increases could be even larger.

TABLE 1. TARIFF WATER IN EMERGING MARKETS

	TARIFFS ON MANUFACTURED IMPORTS		
	AVERAGE BOUND TARIFF (%)	AVERAGE APPLIED TARIFF (%)	TARIFF WATER RATIO
China	9.14	8.96	1.02
India	34.94	16.44	2.13
Mexico	34.91	13.33	2.62
Brazil	30.79	12.63	2.44
Turkey	17.03	4.69	3.63
Indonesia	35.55	6.75	5.27
Saudi Arabia	10.50	4.81	2.18
South Africa	15.72	7.85	2.00
Thailand	25.55	8.17	3.13
Argentina	31.84	12.57	2.53

Source: WTO Country Profiles

Second, countries with a significant participation in world trade cannot raise tariffs on a grander scale without damaging the competitiveness of their home firms. A significant portion of all trade today is trade in parts and components, or input goods, and companies have fragmented their supply chains to such an extent that it is difficult to trace the origin or nationality of a particular good. Advanced economies and emerging markets are densely integrated through such production networks. Import is needed in order to export, and new tariffs on input goods will adversely affect profitability and output higher up in the value-added chain. The supply-chain factor in global trade works in two ways: when demand falls there will be, as today, a considerable decline in total trade as the volume of trade per unit of consumption has increased. But a mercantilist, producer-oriented interest keeps governments from serious increases of tariffs; such measures would hurt domestic firms competing on the world market.

However, these two constraining factors do not prevent all forms of protectionism. WTO agreements are more powerful against tariff hikes than other forms of protectionism, e.g. non-tariff barriers and discriminating state aid to companies. Patterns of supply-chain fragmentation limit the temporary mercantilist value of a tariff increase, but they do not have the same effect on trade-distorting subsidies to domestic firms. Non-tariff protectionism is often more damaging than tariffs. Tariffs are quantified and companies can calculate their margins and the profitability of trade. Non-tariff measures, on the other hand, are often opaque. Foreign firms have difficulties in assessing the cost such measures impose on existing or potential trade. As such, the uncertainties are bigger.

It is rather this form of protectionism – creeping rather than spiralling protectionism – that governments are now succumbing to amidst the current economic crisis.

Current protectionist trends are similar to protectionism in the 1970s and 1980s. In the

1970s, oil-price hikes and other shocks triggered inward-looking, short-sighted mercantilist policies, not least in Europe and the United States. Immediate policy responses were not massively protectionist: there was no equivalent to the Smoot-Hawley tariff. Nonetheless, escalating domestic interventions exacerbated economic stress and prolonged stagnation, not least the spawning of protectionist pressures. Industry after industry, coddled by government subsidies at home, sought protection from foreign competition. The result was the "new protectionism" of the 1970s and 1980s.

Then, as now, manufacturers of cars in Europe and America faced bankruptcy. The U.S. Congress bailed out Chrysler in 1979. By then, the British government had already bailed out Rolls Royce and British Leyland, and Renault was saved by French taxpayers shortly after the Chrysler bailout. Several other sectors (wood and timber, energy and minerals, railways, airlines, shipbuilding) received government subsidies in the 1970s. Many European companies were nationalised.

Policies like "voluntary export restraints," "orderly marketing arrangements" and other mostly nontariff barriers were deployed to "manage trade." In the late 1980s, all these opaque measures affected approximately 40 % of world trade. The sectors that received subsidies at home also received protection from foreign competition. Through the 1980s, American car manufacturers were protected by VERs that restricted the number of Japanese cars exported to the U.S. Europe negotiated a similar agreement with Japan in 1983. To further restrict Japanese exports, some European governments imposed "local-content requirements" on the cars produced in Europe by companies like Nissan and Toyota. Many other sectors, like semiconductors and videocassette recorders, were also protected by VERs or similar measures. The French government even demanded that Japanese VCR imports enter France via Poitiers, a town hundreds of miles from the nearest port.

Many more references could be made to trade-distorting subsidies, increased non-tariff barriers, and other creeping protectionism in the 1970s crises. Similarly, in a few years time we could produce an equally extensive list of measures that governments undertook in 2008-2010. The process has already begun.

BOX 3: PROTECTIONIST MEASURES DURING THE CRISIS

The Global Trade Alert (GTA) is a project aimed at monitoring the use of trade-restrictive measures during the crisis.[8] Between November 2008 and December 2009, the GTA recorded 297 implemented measures that almost certainly discriminate against foreign commercial interest. If trade defence and safeguard measures are exempted, the aggregate number is 236. Of these, 130 measures have been introduced by G20 members.

Approximately 1214 tariff lines (at 4-digit level) have been affected by measures that discriminate. China is the most frequent target of these measures, followed by the EU and the US. There are several other measures in train that will or may involve discrimination against foreign commercial interests.

TABLE 2: **CRISIS MEASURES – WHICH COUNTRIES HAVE INFLICTED MOST HARM?**

RANK	RANKED BY NUMBER OF MEASURES	RANKED BY THE NUMBER OF TARIFF LINES AFFECTED BY MEASURES	RANKED BY THE NUMBER OF SECTORS AFFECTED BY MEASURES	RANKED BY THE NUMBER OF TRADING PARTNERS AFFECTED BY MEASURES
1	EU27	Russia	Algeria	China
2	Russia	Ukraine	EU27	EU27
3	Argentina	China	Ecuador	India
4	Germany	Ecuador	Indonesia	Russia
5	UK	Indonesia	Russia	Indonesia
6	China	India	Ukraine	UK
7	India	EU27	China	USA
8	Indonesia	Japan	Belarus	France
9	Italy	UK	Mexico	Germany
10	Spain	USA	Germany	Argentina

Source: Evenett, Simon (ed.), 2009, *The unrelenting pressure of protectionism: The 3rd GTA Report*. London: CEPR/Global Trade Alert. Accessed at http://globaltradealert.org/sites/default/files/GTA_report_3.pdf

What has happened? Governments around the world have bailed out domestic banks and automotive industries. The World Bank estimates total auto industry support to amount to 48 billion U.S. dollars. Large subsidies have mostly been contained to a few specific sectors, but have also worryingly spread to other sectors. State-aid rules in the EU have been relaxed and certainly enabled suspicious state aid to be authorised in certain sectors.

The air has been thick with governments' nods-and-winks to banks to lend at home, not abroad, and to car companies to ensure that their subsidies are spent on production and employment at home, not abroad. U.K. banks receiving subsidies have been requested to deleverage abroad. The French support of its automotive sector appears to have pulled companies to move production from foreign countries to France. One hidden part of the U.S. bailout of its banks is a restriction on firms to apply for H-1B visas. Other countries have not gone as far as to impose new restrictions on labour migration, but political leaders have echoed calls for "British-jobs-for-British-workers"-style views.

"Buy national" provisions in government procurement have been attached to the U.S. fiscal stimulus package. Other governments, as in Spain and Sweden, have encouraged people to buy nationally produced goods. Government procurement has also been a favoured measure to support domestic manufacturers in Asian countries that are not members of the Government Procurement Agreement (GPA) in the WTO. Chinese provinces and Indonesia, for example, have singled out domestic steel mills as favoured subjects. Several Chinese provinces have gone much further; in Hunan the local government introduced in 2009 directions to government offices to buy passenger vehicles and raw materials, including medicines, made or sourced in the province. Non-tariff barriers (NTBs) have also increased in some sectors – from Belgian chocolate and Dutch eggs (China) to toys (India) and to auto parts and TVs and other ICT goods (Argentina). Apart from new sectoral NTBs, Indonesia has also limited the number of import entries.

Creeping protectionism may appear less confrontational than crude tariff protectionism but it is not correct to say such measures are less damaging to world trade than tariff hikes. The effect depends on the scale of measures and which sectors they cover. There are four reasons to be worried about current trends of creeping protectionism.

First, current protectionist measures can escalate and trigger tit-for-tat protectionism. Measures are strongly linked to fiscal stimulus packages, bailouts and to government behaviour. If recovery is slow, and if there will be a double dip, governments may move further in the protectionist direction to increase the effect of past and new stimulus packages. Increased subsidies are likely to trigger other countries to subsidise the same sector. This was the experience from the first round of subsidies to automotive companies. The U.S. subsidy to its producers triggered similar policies in Canada and Europe.

Second, WTO agreements do not directly discipline creeping protectionism as much as they limit the discretionary power of countries to increase tariffs. Many measures adopted today (e.g. non-tariff barriers or visa restrictions) are not covered, legally or effectively, by a WTO agreement. There is a WTO agreement on subsidies that certainly is actionable on some of the subsidies given to auto manufacturers, but the agreement itself has weaknesses, which explains why some countries have pushed for a stronger subsidy agreement in the current Doha Round. There is also a problem of transparency and with substantiating a complaint to the WTO; the effect a subsidy has on a company or on trade can be unclear. Finally, the disciplining effect from the WTO weakens if almost all countries participating in sectoral trade adopt measures that in one way or the other have the intention and the effect of subsidising local firms at the expense of foreign producers. The risk is that no country takes another country to the WTO to avoid an “Airbus-Boeing situation” where both parties accuse each other of unlawful subsidisation.

Third, subsidies, buy-local policies and non-tariff measures are often a more direct form of support than protection under tariffs. Such measures are often more difficult to eliminate once they are there. Political sensitivities tend to be higher.

Fourth, current creeping protectionism exacerbates protectionist trends that were underway before the crisis started. This should be the big worry for global leaders as they consider measures to prevent escalating protectionism.

Creeping protectionism was surfacing before the crisis began and involved other policies than those mentioned above. Antidumping actions have been on the march again for some time. The number of new global antidumping cases has taken a big jump. In the first half of 2009 the number of new antidumping initiations rose by 17 percent, and estimates show the increase continued in the second half. In 2008, the number of final antidumping measures increased by 22 percent. The increase is driven both by developing and developed economies.

“Standards protectionism” has proliferated – in agriculture and manufacturing – and increasing talk of climate or carbon-based tariffs have magnified protectionist threats. The EU has introduced a cap-and-trade scheme which will increase the cost of production and doing business for European producers vis-à-vis other countries. To avoid deteriorating competitiveness, and so called carbon leakage, it has been proposed that the EU should impose a border tax on imports from other countries. So far, such demands have been resisted despite pressure from several member states. The bill in the U.S. Congress on cap-and-trade makes provisions for similar arrangements against countries that do not reduce their emissions of carbon.

Knee-jerk "China-bashing" is becoming more prevalent, with accusations of "unfair trade" linked to "currency manipulation" and bilateral trade deficits. Calls for corrective measures against China are likely to increase as the new US administration has come close to officially labelling China a currency manipulator. The crisis itself, and its alleged roots in global imbalances, have increased the risk for trade measures to correct the imbalances. China is already the most frequent target in anti-dumping measures, and this trend is likely to increase.

Investment restrictions have increased, and the number of laws unfavourable to cross-border investment has increased in recent years. Countries as diverse as China and France have singled out strategic sectors and national champions to be protected from the embrace of open competition, or indeed the reality of globalisation. Investment protectionist tendencies can be seen everywhere in many sectors.

In this context of global creeping protectionism, how has the European Union fared? This is a difficult question. As Table 2 showed, the EU scores high in many aspects of measures that have inflicted harm upon other countries' commercial interests. At the same time, however, the EU has behaved better than most other governments as far as overtly headline protectionist crisis-related measures are concerned. This is to a large extent due to the Single Market and Common Commercial Policy in Europe and the disciplining effect they have had on European governments. Clearly, there have been "dogs that have not barked", to use a phrase of Sherlock Holmes. In contrast to other crises in history, competitive economic devaluations, tariff hikes and other beggar-thy-neighbour policies have not seen the daylight in Europe under this crisis. Nor has there been a significant increase in the use of trade defence measures, which has been the normal state of affairs in past downturns and recessions. Furthermore, Europe has not been using government procurement as a discriminative tool to support local industries.

In the context of crisis-related measures, the main concern is the relaxation of state-aid rules last autumn and the significant use of government subsidies. This is principally a story about discriminating state aid to the financial sector and to the automotive sector; subsidies to these sectors represent the vast part of subsidies given during the crisis. But there are also other sectors that have received state aid during the crisis – and in several of these cases serious questions can be raised about the extent to which governments thought it convenient to use the window of relaxed disciplines on state aid to press ahead with subsidies that have no immediate relation to the crisis but to long-term problems of competitiveness.

Taking account of broader developments, however, Europe acts as defensively in trade issues as most other countries in the world. There are important nuances that should not be neglected, but overall the agenda for commercial policy reforms have stagnated in Europe, too. The policy climate has become less friendly, if not hostile, towards trade-liberalising reforms. And there is, as has been reported by the WTO, an increasing trend in Europe towards the use of opaque restrictions on international trade, through non-tariff barriers, standards, SPS measure and similar forms of barriers to trade that bear resemblance to creeping protectionism.

3. THE DOHA ROUND AND THE WORLD TRADE ORGANISATION

The financial crisis and the economic recession came at a time when questions about the role and impact for the centre of global trade policy – the World Trade Organisation (WTO) – are increasingly significant and numerous. It is telling and worrying that the WTO has largely been on the sidelines in the trade-policy responses to the economic contraction. The entire world trade order (the structure of all trade policy) has been painfully absent from discussion and concerns over the global economy in the recent past. G20 leaders appear determined to rewrite the institutional structure of global economic institutions, but the neglect of trade-policy affairs in the drive for a new Bretton Woods structure bears witness to the current climate of opinion among political leaders, which is largely biased against further trade liberalisation, and the little political relevance the WTO is seen to have by them.

It is difficult to portray the status of the negotiations in the Doha Round of trade negotiations. Not much has happened since the July meeting in 2008 when efforts to finalise so-called modalities for the negotiations failed yet again. Some say negotiations will be resumed again in 2010, with the view of closing a deal in late 2010 or 2011. Others say the round is dead. Such discussion, however, is a dead-end street.

What is clear is that the negotiations are not likely to be successfully concluded if negotiators just continue to do what they have done in the past eight years. Business-as-usual can no longer be a strategy. The current strategy simply has not worked and it is a source of discontent that leaders cannot give frank views about what alternative course of action might be more likely to bring the round to a conclusion.

Business is repeatedly asked to express its support for the round and to push political leaders to that end. There should be no doubt that there is strong business support for an ambitious round that delivers new trade opportunities for businesses. Nor should it come as a surprise that business, as well as any other stakeholder, would have a lot more confidence in the round and take a more active part if political leaders showed that they were in a deal-making mode and negotiated seriously. This mood has largely been absent since the WTO ministerial meeting in Doha in 2001. Business can issue an endless number of statements pushing for the round, but this will not matter much when political leadership is absent and when negotiators cannot give proper accounts of the obstacles and how they can be addressed by alternative strategies. Business can make a persuasive case for trade liberalisation, but in the past years no one has been willing to listen.

The problems of the round extend beyond current negotiations. There should be no doubt that the multilateral order for trade policy is having an identity crisis. The problems facing the WTO are structural. Arguably, the WTO has not worked properly for more than ten years. It has not been a vehicle for freeing up trade, which is the raison d'être of the organisation. It is 15 years since the Uruguay Round concluded. Much has happened since then. And if the WTO cannot be made relevant as an organisation addressing contemporary concerns, governments will continue to lose faith in it. If no new liberalisation comes out of the WTO system in the next 15 years, there will probably be a crippled dispute-settlement system that is less respected and heeded. The rules-based approach to trade needs to be extended into new areas – e.g. investment and competition – and new sectors (e.g. energy). But on the basis of current trends, the WTO will go in the opposite direction. Obviously, this is of great concern to us and business generally. It should also prompt political leaders to immediately take action to prevent such a development from materialising.

The WTO's identity crisis is surprising. The WTO has never been as popular as today if one judges by the size of the membership; it has 153 members from all corners of the world and with different development status. Many other international organisations look to the WTO for guidance on how to build a strong, rules-based form of multilateralism. Yet the WTO is becoming less relevant to key issues facing the world economy and may be at serious risk of sliding into obscurity and irrelevancy.

How can we understand this development? There are several forces at play, but many of the problems displayed in the Doha round reflect strategic and structural problems that emerged from the altered mix of institutions, interests and ideas when a small and club-like GATT became a multilateral trade organisation. Together with other factors, such as an increased inclination by many countries to negotiate preferential trade agreements, the erosion of the "old" foundational basis has put the WTO in the shadows of the current developments of the world economy.

This is a paradoxical development: the achieved trade reforms in the WTO system have distinctly shaped the globalisation of commerce and contributed to the unprecedented growth of global welfare in recent decades. This development is also cause for concern. There are several reasons – on grounds of efficiency as well as equity – to anchor world trade and trade policy in a multilateral and non-discriminatory system. The overall benefits of a trading system that gravitates from a global institution are overwhelming and not an area of dispute in informed commentary. This holds for most, if not all, aspects of the WTO system – for market access issues as well as for trade rules and the regulatory framework. Moreover, an oft-neglected part of the WTO is that it gives all countries equal access to rules and dispute-settlement processes that tempers "predatory" passions among the big trading countries. This is of central importance to small and developing countries.

Yet to operate properly in the twenty-first century, and in accordance with current concerns and opportunities, the structure of the multilateral trading order must be revisited. The current trend of world trade policy is profoundly moving away from the non-discriminatory nature of the WTO.

The current problems of the Doha Round are <u>not</u> coincidences or situations that could <u>not</u> be anticipated at the outset of the new Round. Largely they mirror the unresolved issues that emerged from the change from an organization focused on the manufacturing sector and the negotiation process, with membership limited (in effect) to developed countries, to a global institution with multiple ambitions in many sectors and a membership structure containing diverging interests and ambitions. In other words, the current set of problems reflects the transformation of the GATT into the WTO. This transformation has not been properly understood.

Essentially, this expansion of the WTO remit is natural: it is a corollary of a changing world economy; there are new concerns facing producers and consumers, and new emerging economic powers have brought their own preferences into trade policy. Furthermore, the expansion also reflects the successful post-war period of trade liberalisation which led to substantial reductions in industrial tariffs. Overall, these tariffs are in the developed world too low to merit an own round of trade negotiations. Yet the involvement of new areas and new issues implies that the WTO would have to function in a different way. The current institutional structure of the world trade order has not worked well in the last decade, and unless they are reformed the status of the WTO will diminish.

The new Commission and Parliament in Europe should give high priority to the World Trade Organisation. Europe, as the leading trading bloc in the world, is a great beneficiary of the WTO and would be the biggest loser if the relevance of the entire WTO system diminishes. Three priorities should guide work in the European Union towards the WTO, its relevance and integrity.

A. EUROPE SHOULD DEMONSTRATE LEADERSHIP FOR THE WORLD ECONOMY.

Europe should take leadership in brokering a Doha deal now. Time is of the essence. It is instrumental that the round finishes soon. With no Doha deal within reach before the end of 2010, it is plausible that the round will just fizzle out entirely without an orderly end. It will be forgotten, but not gone. However, it will remain in the way for other business to be conducted at the WTO. This is the worst-case scenario for the round. But it is the track current negotiations are following.

Europe is currently not one of the parties that are stalling negotiations. This is not to say that Europe does not face challenges in some sensitive areas; clearly it does. But these challenges are manageable and largely confined to the agricultural sector. It is in a position which gives it an opportunity to lead. It should take that opportunity. Not only will it pay off materially; it would also demonstrate that Europe has the capacity to assume international leadership.

B. EUROPE SHOULD DEFINE ITS LONG-TERM POST-DOHA INTERESTS

Europe should start investing intellectual time and energy into thinking about the post-Doha agenda for trade policy. This is more important than it sounds; it is about defining the core material rationale for the world trading system in the 21st century – the global as well as the European rationale. In particular, Europe should start an exercise to define what it wants from the WTO system in the medium-to-long-term.

This is not a philosophical exercise; it is about getting its own priorities right and defining its strategy accordingly. This is an area where Europe has obvious problems. It is not surprising that a regional trade bloc of 27 countries will have difficulties setting out strategies that are effective while at the same time reflecting the desires of all its members. But the absence of a comprehensive strategy means that Europe cannot get so much out of its external trade policy as it should. It also means that there is not a straight line between the core economic and commercial interests, on the one hand, and policies, on the other hand.

Moreover, this exercise is of importance to the WTO itself. The big members of the WTO – the members which have the highest stake in the world economy – are the only countries that have the capacity to lead. There are fewer countries than one thinks that can shoulder such political leadership. Globalisation has spurred trade in many emerging markets. The rising economic powers in Asia will become leading members of the WTO in future. But we are fooling ourselves if we buy all the hype about emerging markets and their immediate market power. They are still far behind Europe and the United States in terms of trade, FDI, foreign affiliate sales, corporate leadership, and innovation. Many of them have considerable institutional and political constraints preventing them from leadership. They have become middle powers – and as such they are important. But the giants of global commerce are still Europe and the United States. It is from them leadership has to come about the future relevance and integrity of the world trading system. But, importantly, the emerging economic giants, China and India, need to be fully integrated and assume the same level of responsibilities as they grow bigger in the post-Doha future.

The debate over the post-Doha agenda has already started. Commissions, working groups and individual scholars have proposed new ways to look at the WTO and its role in the global economy. Too often, however, this debate has steered into issues that are institutional or theoretical in nature – or issues that are simply too difficult politically or too abstract to warrant attention. The WTO is an intergovernmental organisation and is likely to remain so for the foreseeable future. Debating the notion of taking away the veto right of each member, which some scholars have suggested, is a cul de sac. It simply will not happen and should not take up time and energy.

What has been missing in the discussion, and where an initiative by Europe would play a significant role, is to re-establish the link between commercial benefits and agenda formation – that is, a *negotiation agenda based on targeting the issues that would deliver most economic and commercial gains*. This link is not absent in the current round, but it is weak. Negotiating market access will never be an act of free trade faith. Negotiated deals are rather a function of enlightened mercantilism; free traders go it alone and open their markets regardless of the choices of other countries. One can lament this state of affairs, but those who disregard it are in serious trouble. A better understanding of the major commercial benefits will also guide countries in selecting appropriate methods to achieve their ambitions.

Obviously, a post-Doha agenda will not be an all-inclusive, all-encompassing, single-undertaking activity. Countries will have to be more flexible on methods for negotiations. The configuration of countries involved will have to be a function of material interest in an issue, and the willingness to liberalise trade and improve rules, rather than purist multilateralism. Often, plurilateral agreements among coalitions of the willing would probably be a good choice. In other cases, alternative methods have to be used.

BOX 3: AN IDEA – FREE TRADE FOR THE DIGITAL ECONOMY

Few sectors are as global in nature as the ICT sectors. Trade in ICT products has exploded in the past ten years. Trade in ICT services is rapidly increasing, too. The sector is also an enabler of trade, facilitating increasing linkages across borders between producers and consumers. Equally important, ICT has facilitated global economic integration in sectors previously closed for trade. Technological development has reduced the technical restrictiveness of services. Sectors no longer have to be considered non-tradable for technical reasons. Furthermore, it is impossible to imagine the globalisation of supply chains in the past decades without the assistance of modern ICT to enable supply chain management.

Past trade initiatives have been instrumental in fostering this development. The Information Technology Agreement (ITA) from the late 1990s is a schoolbook example of trade negotiations freeing up trade and fostering growth. Around the same time, governments also agreed in the WTO to impose a moratorium on applying customs duties on e-commerce. But for a highly innovative sector, these past achievements are not enough. Many barriers remain and new barriers, such as licensing or encryption requirements, have been introduced. NTBs and ICT services were left outside the ITA. Furthermore, while the ITA was fraying at the edges from the start, new developments on the ground, e.g. technological convergence, present more profound challenges to the structure of the ITA.

But here is a new idea to address these problems: an International Digital Economy Agreement (IDEA). Building on past agreements, the IDEA would go further than just expanding the goods coverage of the ITA and principally:

- extend the coverage of the ITA agreement to all ICT products;
- open for liberalisation of, and stronger disciplines on, NTBs, including regulatory transparency
- liberalise ICT services: computer and related services, and telecommunication services
- improve and discipline trade facilitation

A sufficient number of countries have an interest in taking such an initiative. Few countries with significant shares of trade in these fields have strong defensive interests. They all have a rather offensive agenda. The IDEA could be done as a plurilateral agreement, but housed in the WTO and subject to its disciplines.

To some, such a course of action would be a diversion from pure multilateralism. Perhaps it is. But adopting a more realistic posture is not in conflict with advancing multilateralism. It is rather about acknowledging the immense economic differences between members of the WTO and making the best of the current situation. It is also consistent with previous results in the history of the WTO. There has always been a difference in what members have accepted to undertake in multilateral trade rounds. Special and differential treatment is today also a built-in principle in the operations of the WTO.

Moreover, members also demonstrated in the late 1990s that sectoral negotiations among coalitions of the willing are good methods to advance the WTO agenda while respecting the differences between members. The Information Technology Agreement (ITA) is a good example. The ITA, a zero-tariff agreement covering ICT products, is largely a function of transatlantic leadership. The agreement was initiated and principally negotiated by the EU and the US together with Japan. Other countries were informed about developments and were invited to join when the structure of the agreement was in place. Many countries also did join, including China and India (usually absent from other WTO zero duty agreements); the ITA today has 44 members (counting the EU as one). There are notable absentees – e.g. Brazil – but the agreement covers almost all trade in the ICT goods.

Furthermore, many countries decided to sign up and eliminate their tariffs despite having protective instincts and defensive interests in some of the ITA sectors. They did so on fear of being left outside and being disadvantageously positioned against other countries. In particular, the fear of being excluded from the globalisation of supply chains prompted several countries to join the ITA. If other countries pressed ahead with their ambitions to liberalise, an absentee would lose trading opportunities and inward investments from other countries. The documented benefits to competitiveness and productivity of increased usage of ICT products also played a role.

The ITA was a great achievement that spurred trade and technological innovation. It has demonstrated how trade is crucial to innovation as it disseminates innovations and makes it easier to investors to recoup invested resources. But the ITA was not flawless, and many of the flaws in it have now made themselves known.

Firstly, the goods covered by the ITA were not a complete list of ICT products. There are significant omissions, and as innovators are moving towards technological platform integration and multifunctional goods, there can be significant conflicts between one part of a good that is covered by the ITA and another part of a good that is not. Such conflicts have been brought to light in the current WTO dispute between the US and a group of Asian countries, on the one hand, and the European Union, on the other hand. The EU, for instance, has classified some LCD monitors as television sets, arguing that LCD monitors above a certain size are likely to be used for television purposes rather than anything else. LCD monitors used for computer purposes are covered by the ITA and are consequently duty free. Televisions sets, however, are not covered by the ITA and carry a fairly significant tariff in the European Union.

Another recent example concerned an EU proposal to introduce a tariff against imported mobile phones. Mobile phones are part and parcel of the ITA. But modern phones of course offer new technological services to customers, such as watching television. Hence: how should a mobile phone be classified – as a mobile phone or as a television set? The answer is pretty simple, and it was somewhat embarrassing to observe how the EU were seriously about to propose tariffs on one of the biggest and most innovative sectors in Europe. The main economic effect of such tariffs would have been to increase the cost of imported input goods used by the leading mobile phone companies as well as the consumer prices in Europe. This would have made mobile phones more expensive, and EU companies less competitive on the global market. Fortunately, the proposal was terminated.

Secondly, the ITA does not cover non-tariff barriers (NTBs) and many countries have recently moved to protect their domestic producers with such barriers. As Table 3 shows, NTBs are already high in many countries – especially in Asia – and the move to an increased use of such barriers threatens the vitality of the global market. An expanded and revised ITA should especially target these NTBs.

Thirdly, although most ICT goods trade is covered via the present ITA membership, major non-participating economies in Latin America, Asia and Africa should be encouraged to join the ITA.

TABLE 3: NTBS IN HIGH-TECH SECTORS

	TARIFFS AND TARIFF RATE EQUIVALENTS ON SELECTED ICT GOODS			
	Average of AV Duties1	Average Tariffs incl. AVEs2	Ad-Valorem Equivalent of NTB in %3	Rate of protection4
8443: Printing and ancillary machinery				
China	10.86%	17.54%	0%	17.54%
Japan	0%	0%	0%	0%
Malaysia	5%	0%	28.72%	28.72%
USA	1.11%	0.77%	0%	0.77%
European Union5	1.75%	…	…	…
France	…	0.32%	0%	0.32%
Germany	…	0.32%	0%	0.32%
The Netherlands	…	0.32%	0%	0.32%
United Kingdom	…	0.32%	0%	0.32%
8518: Audio-electronic equipment, except recording devices				
China	5.79%	15%	0%	15%
Japan	0%	0%	63.93%	63.93%
Malaysia	17.81%	8.63%	42.48%	51.12%
USA	1.84%	2.43%	1.29%	3.72%
European Union5	1.64%	…	…	…
France	…	0.27%	0%	0.27%
Germany	…	0.27%	0%	0.27%
The Netherlands	…	0.27%	0%	0.27%
United Kingdom	…	0.27%	0%	0.27%
8521: Video recording and reproducing apparatus				
China	25%	41.59%	62.23%	103.82%
Japan	0%	0%	37.32%	37.32%
Malaysia	30%	0%	77.84%	77.84%
USA	0%	0.51%	0%	0.51%
European Union5	10.65%	…	…	…
France	…	2.52%	0%	2.52%
Germany	…	2.52%	0%	2.52%
The Netherlands	…	2.52%	0%	2.52%
United Kingdom	…	2.52%	0%	2.52%
8525: Radio and TV transmitters, television cameras6				
China	8.90%	15.61%	0.75%	16.37%
Japan	0%	0%	0%	0%
Malaysia	3.33%	1.62%	28.83%	30.45%
USA	0.97%	1.08%	21.19%	22.27%
European Union5	2.80%	…	…	…
France	…	0.29%	0%	0.29%
Germany	…	0.29%	0%	0.29%
The Netherlands	…	0.29%	0%	0.29%
United Kingdom	…	0.29%	0%	0.29%
8534: Electronic printed circuits				
China	0%	11.00%	0%	11.00%
Japan	0%	0%	0%	0%
Malaysia	0%	0%	0%	0%
USA	0%	0.76%	0%	0.76%
European Union5	0%	…	…	…
France	…	0%	0%	0%
Germany	…	0%	0%	0%
The Netherlands	…	0%	0%	0%
United Kingdom	…	0%	0%	0%

Footnotes: 1) WTO bound tariffs; 2) World Bank tariff calculations based on WTO's integrated database and UNCTAD's TRAINS, and MAcMaps database is used for ad-valorem equivalents; 3) Latest available World Bank data based on UNCTAD's TRAINS data-set and their own calculations;4) World Bank calculation (sum of tariffs, AVE of NTBs, and AVE of domestic support); 5) No NTB values for EU, selected EU countries are used as a proxy. Source: WTO and World Bank (for more information on the methodology used by the World Bank in the NTB calculations see Kee, Hiau Looi, Alessandro Nicita and Marcelo Olarreaga (2008). 6) For 8525 all 6-digit categories are included as listed below in the NTBs except for 852540: still image video cameras and other video camera recorders

Source: Dreyer, Iana & Brian Hindley, 2008, Trade in information technology goods: Adapting the ITA to 21st century technological challenges. Brussels: ECIPE

The zero-tariff ambition in the ITA has also been manifested in other sectors – and should be extended to many more sectors. The results have been similar: trade has been significantly boosted and dissemination of new innovations has moved faster. This demonstrates the power of zero tariffs. Even small tariffs can have a preventive effect on trade.

C. EUROPE SHOULD RESPECT CORE PRINCIPLES OF THE WTO

Europe should pay more attention to the core principles of WTO agreements and avoid policies that overtly challenge these principles. Generally, Europe is respectful of WTO rules. In the area of environmental policy, however, it has recently happened all too often that protectionism or industrial policy activism have been added to the policy without much reflection on their consistency with WTO rules. This may be a harbinger of greater conflicts to come. In fact, we may soon face a grand conflict between core WTO rules and policies to reduce the effects on competitiveness from climate change policies. Europe, as well as the United States, has threatened emerging markets in particular that it will impose the equivalent of a tariff on imports from countries that do not undertake acceptable reductions in carbon emissions – or, as in the case of developing countries in current climate change negotiations, cap future increases in carbon emissions at an acceptable level.

There is a large body of research and commentary over this issue. No one has yet been able to make a solid case that such measures, when taking into account practical matters over the likely design, would be consistent with WTO rules. There is, at best, a weak and theoretical case that has been presented. But the policies in the EU Emission Trading Scheme have laid down the tracks for measures to be proposed, perhaps even imposed. Even if policies do not go as far as introducing a new layer of tariffs in world trade, Europe has been toying with low-intense trade-restrictive measures in some of its climate-change related policy. Its biofuels policy is one example, and recent policies by the EU will take this policy farther in the direction of industrial-policy activism and protectionism. Disregarding WTO rules has a corrosive effect. It can spread to other areas of policy – and to other countries. Europe, which has benefited greatly from the dispute-settlement system in the WTO, should be very cautious and not go down this route.

4. A NEW STRUCTURE FOR EUROPE'S BILATERAL AGENDA

Preferential Trade Agreements (PTA), or bilateral Free Trade Agreements (FTA), are gaining currency. The number of PTAs in force has increased rapidly - roughly 250 existing PTAs have been notified to the WTO – and in all parts of the world there are currently many bilateral agreements being negotiated. With 60 PTAs negotiated and in the pipeline in Asia alone, we are only at the "end of the beginning" of the era of rapid PTA proliferation. All countries in Asia have now joined the FTA bandwagon, and there are many efforts to form regional trade blocs. The ASEAN group have planned to form a common market. China and ASEAN just launched a new FTA. Wider ambitions are being discussed for an East Asian Economic Community (bring in Australia and New Zealand). There is also talk about an Asia Economic Community, which also would involve India and other South Asian countries. Furthermore, a tariff-free APEC is still subject to discussion at APEC summit meetings. The Trans-Pacific Strategic Economic Partnership Agreement (TPP) is again being considered and seriously discussed.

The European Union has joined the FTA bandwagon again and in 2006 embarked on a new programme of PTAs. It has recently finished negotiations with South Korea and initialled an agreement (yet to be ratified). Attempts to start PTA negotiations with India and ASEAN have not yielded any results; nor have efforts to finish long-standing PTA negotiations with Mercosur and the Gulf Cooperation Council (GCC) been successful.

PTAs are difficult to square with a key principle to business: non-discrimination. Preferential Trade Agreements are by definition discriminatory. They are based on exchanges of preferential access to the markets between the contracting parties. However, one should be cautious about putting the issue of PTAs in Manichean terms, such as multilateralism versus bilateralism. It is incorrect to say that strong bilateral co-operation necessarily implies problems for multilateralism. The debate over bilateralism, regionalism and multilateralism often tends to become ideological. Nuances are lost and contexts are neglected.

Some PTAs are undoubtedly of great economic value. Some PTAs have also boosted multilateral activity. The Uruguay Round of trade negotiations finished around the same time as the EU concluded its single market and the NAFTA was signed. These are two of the most ambitious initiatives of regional and preferential trade co-operation ever undertaken, and they did not prevent members of the GATT from signing a multilateral agreement. In fact, one could make a powerful argument to the opposite end: these regional initiatives *helped* to push the Uruguay Round to a successful end. Regional as well as multilateral liberalisation was part of the same contemporary drive for general economic liberalisation. Regional liberalisation helped others to 'concentrate minds' and push for a multilateral deal in the fear that they would be disadvantageously affected by these initiatives unless overall tariff levels came down.

Similarly, the successes of the Kennedy Round in the 1960s can partly be attributed to the European implementation of the common market and the common commercial policy (starting in 1957). The United States feared, correctly, that reduced barriers within Europe would adversely affect the competitiveness of American firms, relative to European firms, on the European market. Especially so as the formation of the common commercial policy in Europe at that time (the Customs Union) implied increasing tariffs in some of the member states that had run comparatively liberal trade regimes (e.g. Germany). Therefore, the US government made considerable efforts to make sure that a new GATT round was started and that it finished successfully with significant reductions in overall tariff levels.

When at the United States Trade Representative (USTR), Robert Zoellick, currently the head of the World Bank, re-launched the idea of "competitive liberalisation". Building on the recent past of a multi-track trade policy, Zoellick claimed competing ambitions between countries to sign bilateral agreements would not only be a strategic tool of US trade policy but also spur multilateral results as bilateral agreements would be stepping stones to a WTO agreement. The idea of competitive liberalisation has rightly been discredited for its lack of economic rigour. One could also hesitate on grounds of political economy. But it is wrong to say that bilateral initiatives in principal can have no positive effects on multilateral negotiations. It depends on the type of initiatives. Most bilateral trade agreements are of little or no systemic importance. They do not achieve much tariff liberalisation, and seldom go far beyond WTO commitments in key rules. Consequently, they are of little economic importance. The typical bilateral agreement is either between two small economies (south-south) or between a big and a small economy (centre-periphery). Both types of FTAs have adverse effects on the multilateral trading system. They provoke some trade diversion, but do not push other countries towards multilateral liberalisation. Some of them also clog up trade by complex webs of rules-of-origin regulations. But to be fair: the effects are typically marginal. There are also a few bilateral agreements between bigger economies – the US-Australia Free Trade Agreement being the premier one. But there are no agreements between the biggest economies – and it is these agreements that would have systemic effects.

In an ideal world, PTAs would not be needed. But they cannot be wiped out from the map of trade policy. A balanced approach to PTAs would put the emphasis on these aspects.

- Countries should be cautious to engage in preferential trade deals. When they do engage in such agreements, it should be agreements of significant economic and commercial value with lasting effects. Furthermore, they should have a significant liberalising effect: countries should have to undertake significant economic reforms as a consequence of a bilateral agreement. Run-of-the-mill PTAs with small economies are most often not worth it.
- Countries engaging in a PTA should strive to offer multilateralisation of the preferences in an agreement. Bilaterals, when called for, should be a crowbar to open markets and push for sound trade reforms. It should not build fortresses that make it difficult for other countries or for global business to access markets.

Against these benchmarks, how has Europe's new policy for bilateral agreements fared?

Not very well, is our assessment. Admittedly, it is too soon to give a proper judgment as Global Europe, the programme for bilateral trade negotiations, was only launched in 2006. But the problems this agenda have faced were expected and should have prompted another course of action. What were these expected problems?

First, the intention of these bilateral deals was, in broad terms, to target middle-sized economies with some significant barriers and ask them for preferential access without having to give so much in return. Hence, behind the FTAs was the idea that such negotiations are good tools to solve problems facing ones own business. The other party would deliver policy change; Europe would not have to offer much policy change at all as "the logic of big numbers" (EU is a much bigger market than those targeted) would give the other party significant increases of export volume to Europe. That is, at best, an optimistic rational. It is difficult to negotiate PTAs between countries of different size – especially if they are at different development levels. Often it becomes a one-way street of demands. When done well, such PTAs can help one country to push for key reforms and lock them into an agreement. Too often, however, negotiations do not progress in such a fashion. This leads up to a simple observation: the success, or not, of a negotiation is a function of the involved intentions. Europe's bilateral strategy has of course been based on a mix of intentions, but too many of the targeted FTAs have had unbalanced conditions that have prevented results.

Second, most of the countries targeted in Europe's FTA strategy have not been of sufficient systemic importance for these negotiations to have a positive effect on multilateral talks. It was feared at the outset of Global Europe that it would destroy the Doha Round as Europe now would usher many countries into deepened bilateralism. That turned out to be an unwarranted fear. Global Europe has had no impact at all on the Doha Round. The prime reason is to be found in the Round itself, but Europe's selection of FTA partners neither pushed themselves nor deterred third countries.

This point, however, extends beyond short-term tactics. A good FTA should have an impact on other countries, but it should not be an impact that corners them or makes it difficult to get access on an equal footing. It should rather be an impact that is easy to "multilateralise" and that sets a level of ambition that others have to agree to if they also want to be part of the preferential club. Also this observation points in the direction of country selection. To achieve these ambitions with an FTA, it is other big economies that should be targeted.

In other words, the problem with Europe's new strategy is that it is too close to many of its past bilateral trade deals with smaller countries that have desired accession to the EC/EU or that have been part of past colonies. With Global Europe, the EU wanted to move towards commercially relevant PTAs but it stopped halfway by targeting middle-sized economies rather than big economies.

With a new Commission and a new Parliament, this is a good time to revisit the structure of Global Europe with the view of setting out a new agenda. One should not, however, pre-judge the outcome of such a move. The important thing now is that Europe asks itself the right questions. What could be done?

A. The EU should start with a frank assessment of which of the current negotiations are unlikely to yield results in the next five years. If there are such items on the agenda, they should be dropped. There is no point wasting time on the negotiations that have not delivered if there is not a serious belief that obstacles to a finished deal, whatever they are, will go away soon.

B. The EU should examine the idea of targeting the big economies for bilateral negotiations. These economies are the US, China and Japan. There is no doubt that such negotiations could yield significant economic benefits. However, they might also present difficulties that are too big to justify such negotiations. No one can today give a clear account of what such bilateral deals would entail; it will require much more analysis and reflection to arrive at a conclusion. But it is with these countries that the greatest benefits would be generated and the biggest impact (for good or ill) on the world trading system would be found. In particular this is valid for China, being recognised as an emerging economic giant, but still in many respects benefiting from developing country status, allowing in part increased restrictions on market access.

C. Europe should use non-PTA frameworks more extensively to seek solutions to selective problems it has with countries. Too often the choice seems to be between a multilateral deal and a PTA. But it is probably more feasible to deal bilaterally or plurilaterally with countries on a limited number of issues without having to go through the entire machinery of a fully-fledged negotiation.

Europe has tried this strategy in the recent past with China and the United States. With China it launched in 2008 a High Level Trade and Economic Dialogue (HLTED) that followed on the heels of the Strategic Economic Dialogue between China and the US. In 2007, Europe launched together with the US the Transatlantic Economic Cooperation (TEC), which aimed at regulatory harmonisation in a few selected areas. Neither the HLTED nor the TEC has been a success. Frankly, they have been great disappointments. Practically nothing has been achieved in these formats. If these cooperative mechanisms are to be maintained, they need to start delivering substantive results. If not, they should be dropped to allow for other formats to be discussed and tried.

Is it the format that has proven wrong? Not necessarily. It is more likely that it is the selection of countries that do not fit with this format and the ambitions attached to the initiatives.

Small-scale cooperation is likely to work better with smaller economies. With big economies involved, even the smallest change will be cumbersome. Efforts easily fizzle out when small changes with small benefits are at the centre.

A different format for bilateral trade-policy relations is in some circumstances also a necessity for Europe, especially in its relations to Russia.

- Russia is not a member of the World Trade Organisation. Hence, it is ruled out that Europe can embark on negotiating a fully-fledged PTA with Russia as long as the latter insists on being outside the WTO. At the same time, there are too many concerns and irritants in Europe's commercial relations with Russia for Europe to just wait for Russian WTO accession. These concerns have to be addressed much sooner. One can discuss how this best can be done, but as neither multilateral nor bilateral PTA approaches are an option, Europe needs more flexible formats accompanied by a high level of political commitment.
- The integration of neighbouring countries into Europe's economy is not yet a finished business. Much remains to be done. But the PTA format is not a workable solution for improved commercial relations with, for instance, some of the Eurasian countries. Other solutions need to be sought.

In sum, Europe should calm its passion for new PTA negotiations. PTAs should not be ruled out just because they are discriminatory, but when they are pursued they should entail considerable commercial and economic value and as little discrimination as is possible. Europe's problem with access to other markets can sometimes be more easily tackled by other initiatives – plurilateral initiatives or non-PTA bilateral initiatives.

5. AUTONOMOUS TRADE REFORMS: THE DOMESTIC TRADE AGENDA

Trade policy is often thought of in two ways: multilateral trade policy and bilateral trade. Equally important, however, is the domestic trade policy, especially in a trade bloc like the European Union. Trade literature calls this autonomous (or unilateral) trade reforms; that is, countries undertaking trade and trade-related reforms regardless of other countries' choices.

Autonomous liberalisation of external barriers to trade was a guiding principle in the pre-1914 climate of economic policy, and has been a forceful mode of liberalisation in many developing countries in the last decades. Beginning in the 1960s, Asian Tigers launched strong programmes of autonomous trade reforms, based on a gradual opening to the world market. New Zealand and Australia undertook similar reforms. In the group of post-socialist transition countries, Estonia is the country most associated with autonomous trade reforms. These countries have largely been bottom-up liberalisers and undertaken reforms before they have bound their policies in trade agreements negotiated with other countries – bilaterally or multilaterally. "Liberalise first, negotiate later" was the slogan of the Mart Laar government in Estonia from 1992 onwards.

China is the star pupil of autonomous liberalisations in recent decades. Building on the experience of the Asian Tigers, China started its reforms in the late 1970s, and trade reforms were pushed substantially in advance of its membership in the WTO. In the wake of China's reforms other Asian countries followed, especially India. The process has been one of "emulation by competition". China has increased the level of competition in the world economy and other countries have, autonomously but reluctantly, liberalised in order not to be disadvantageously positioned against Chinese competitiveness and its ascending role on the global economy. The World Bank estimates that of all tariff liberalisations since 1980, 65 percent have been achieved unilaterally, outside the context of a trade negotiation. Autonomous reforms also played a central role in the post-war policy climate in Europe, especially in Germany, and in the post-Cold War policy milieu in transition countries (especially in Estonia).

Yet along with the general slow-down of liberalisation in the developing as well as the developed world, autonomous reforms are no longer considered to be politically feasible. Alarmingly, in countries like China, past reforms have also been retracted as new regulations have been increased (e.g. the recent proposal over spyware technology on laptops and new onerous licensing requirements). The increasing tendency to hinge domestic trade and economic reforms upon reciprocal give-and-get mechanisms and agreements has also made the unilateral route less accessible, not to mention less appealing.

Yet autonomous reforms are closely linked to multilateral reforms. Arguably, they are in many ways pre-conditions to a successful multilateral structure of trade policy. Before countries can commit to substantial agreements in a multilateral setting, or indeed in a bilateral/regional setting, the domestic "trade-related" reforms codified in such agreements must have been started. Often, domestic reforms come before countries agree to lock them into a trade agreement. There is also a strong link between domestic (internal) reforms and trade (external) liberalisation. The latter does not work without the former; they stand or fall together.

The idea of a top-down structure in which countries multilaterally (or regionally) commit to liberalisation before making progress on domestic reforms, has worked relatively well in the past, but less so today. Many of today's key issues cut to the core of domestic policy and institutions, and reforms here will essentially emerge from within (endogenously) rather than from outside (exogenously) – reforms will be achieved bottom up rather than top down. As trade policy today is more about non-border barriers and advances into trade-related areas (e.g. the so called Singapore Issues) and regulatory affairs (welfare policy, labour markets, et cetera) it is increasingly important to understand the mechanisms for trade-policy reforms that ties unilateral and multilateral methods to each other. WTO progress will never be made on many of the new and future issues unless countries have undertaken necessary reforms before the multilateral process gets rolling. This points to the need for countries to prepare themselves more vigorously for multilateral trade reforms by advancing a domestic reform agenda that can form the basis of WTO commitments at a later stage.

Europe is in several ways in a good position to push autonomous trade reforms that subsequently can push global reforms. The single market for goods in Europe has created open and rules-based policies for cross-border trade. Europe has already liberalised considerably internally. Extending this openness to its external policy is easier than in many other countries.

Yet this is not the full story. EU domestic liberalisation and policy harmonisation are incomplete. In fact, in several key areas for Europe's own and foreign economic policy – e.g. service liberalisation and the integrity of intellectual property rights – Europe does not have a domestically-harmonised policy that allows it to be as offensive and strategic as it should in its external dealings with other countries.

Such fragmentation is happening more in the EU than in other jurisdictions. In the EU, as elsewhere in the OECD, the core ambition of post-war trade policy – to eliminate tariffs and other border barriers – has largely been achieved. But the next frontier in trade policy – the reduction of non-border barriers embedded in domestic regulation – trespasses on other policy areas, such as the regulation of services sectors, health and safety standards, food-safety standards, intellectual property protection and government procurement. These are inherently "domestic". Hence trade policy's ever-expanding range enmeshes it in lots of domestic policy thickets. Yet there is an additional aspect to this development in the EU, given its peculiar hybrid of supranationalism and intergovernmentalism. Trade policy is one of the EU's few "hard" policy areas in that policy making is centralised in Brussels. From the Brussels vantage point, trade policy is also foreign policy and development policy. This makes it a tempting tool of action for other EU policy areas that might not be directly "trade related", but in which direct EU competence is weak.

Another source of fragmentation is the limits to EU supranational jurisdictional competence in new areas of trade policy. The EU's competence has been extended to cover some aspects of services and intellectual property rights. But these new competencies are limited, and they do not mandate the Commission to negotiate ambitious new trade agreements in these areas. Furthermore, there is no unified EU-wide regulation in both policy areas: the EU does not have a single market for services or a Community-wide patent system. This is a clear constraint on the EU's negotiating power vis-à-vis third countries.

BOX 4: A DIGITAL SINGLE MARKET

Europe has taken the first steps to create a single market for services. But many more steps remain to be taken. It appears unlikely that a new initiative to go for full liberalisation will be taken in the next five years. The wounds from the fight in 2003 and 2004 over the Single Market Directive have still not healed. However, much new liberalisation can be achieved without bumping into the same obstacles again.

Europe should, for example, initiate a Digital Single Market. For many of the digital services, border barriers remain important blockages to cross-border integration. This was echoed in the Policy Guidelines that Jose-Manuel Barroso presented to the European Parliament in the autumn of 2009. The initiative aims at eliminating internal barriers standing in the way of digital distribution of cultural and other products and services. As digital distribution and communication is becoming ever more important to European growth – and to European trade – eliminating internal barriers would boost the European economy.

Investment policy is another area with limited EU jurisdiction (apart from "post-establishment" matters, which are subject to Single Market rules). The Commission has secured a mandate to negotiate some investment issues related to the General Agreement on Trade in Services (GATS) in the WTO. But this is a narrow mandate; it does not cover many investment issues that are front and centre in today's world of global economic policy. In fact, in these areas EU member states compete with each other to secure advantageous access to third countries. The energy sector is similarly problematic: the absence of a single market for energy cramps the EU's ability to negotiate commercial agreements with third countries.

BOX 5: SINGLE MARKET FOR ENERGY

Europe has a fragmented energy market. Markets are segmented along national borders, there is too little investment in cross-border grids and transmission capacity, and too often the energy markets are subject to uncertain political conditions. Governments heavily regulate the energy market, and are often only too happy to doctor with regulations in a way that creates unstable investment conditions.

A single market for gas has been on the cards for a long time, and in a number of legislative packages Europe has taken steps in that direction. However, too many member countries have not been prepared to liberalise their home market and allow for single market disciplines.

The absence of a single market for energy also affects Europe's relations with energy exporters. With a fragmented market, and a politically divided membership, Europe cannot use its market power to discipline the behaviour of other market actors and secure necessary conditions for reciprocal access for trade and investment to other markets. Other tools could be used to that end, but without the core foundation of a single market there will not be a full common policy in external relations. And when normal market disciplines are out of order, erratic behaviour of market actors can grow sour and cause political friction.

Such policy fragmentation constrains the EU's current agenda for trade negotiations. The lack of a unified policy for services and investment has decreased the chances to negotiate a substantial trade agreement with India, whose core ambition is to get better access for Indian investors and service suppliers to the EU. Investment and services are core concerns European multinational firms have with access to the Chinese market. Core problems in EU-Russia relations – investment protection in the energy sector, rampant violations of patents, etc, – cannot be adequately dealt with by the EU as it has no mandate for protection of European investments abroad and no common energy policy.

Conventional wisdom holds that these deficiencies will be overcome as soon as the Lisbon Treaty is adopted. That may not be true. Some investments policy will certainly be harmonised. But far from all investment protection issues (e.g. portfolio investments) will. Europe should also be prepared for a situation where individual member states will fight to retain competence on investment policy. Ultimately, this may have to be settled by the European Court of Justice (assuming no changes to the current treaty text). Even if the ECJ rules in favour of an expansion of jurisdictional competence, it will cover only a small part of relevant investment issues.

In sum, there are four areas of immediate concern in the context of domestic or autonomous trade policy.

A. *Single market for services*. The EU does not have a proper single market for services and a key priority for the new European leadership should be to press ahead with remaining reforms, including the creation of a digital single market. The absence of a single market for services slows down growth in Europe and constrains its ability to take leadership in global services policy, not to mention its negative impact on Europe's competitiveness and productivity, whilst Europe's move towards services and knowledge-intensive industries is expected to continue.

B. *Common patent policy*. The EU does not have a common patent policy and should rectify this weakness. It drives up the cost of innovation in Europe, and restricts the ability of Europe to lead internationally, when patent policy is not centralised to EU institutions. Patents are the backbone of the IPR system. They are crucial for investments in research and innovation. In contrast to some other IPRs, patents represent enormous value to the European economy as it is central to some of the core sectors in Europe: automotives, chemicals, pharmaceuticals and telecommunication goods. In many ways, the patent system needs to be strengthened.

BOX 6. RESEARCH, INNOVATION AND PATENTS

Patents are crucial to corporate investments in research and development (R&D). Without patents, and the limited period of exclusivity they offer, investments in innovation would be considerably smaller. They offer a chance for the investor to recoup an innovation investment – an investment that often would not be done if others immediately could make use of the innovation without paying for it. Theoretically, this is also the defence of copyrights, but patents are distinctly different from copyrights as they are much more difficult to obtain and cover genuine development of knowledge and innovation.

Table 4 ranks the sectors in Europe that spend most on research and development. Not surprisingly, these sectors are also the most R&D and IP intensive sectors. Companies from these sectors also dominate the list of the biggest individual R&D spenders in Europe.

Chemicals and pharmaceuticals are the two sectors that are most dependent on patents. They both work with long research cycles, but the variable cost in the production of their goods is small. An average medicine, for example, has been estimated to cost around 800 million USD to develop, but the variable cost of a single pill, once the innovation has been achieved, is very small. Hence, without patents it would be easy for others to just use the result of the 800 million USD investment and price the medicine at a much lower price as they do not have to recoup the 800 million USD in their sales.

For green innovations, strong protection is central to the commercial viability. In energy and energy technology, European companies are at the edge of research and innovation. Rapidly increasing resources are invested in research on new energy technology to increase energy efficiency and lower the emission of greenhouse gases. Surprisingly often there are calls to violate the intellectual property protection green innovation. European politicians also echo such calls. Yet if this protection would be eroded, innovation and dissemination of green innovation would slow down considerably. And Europe would lose significant amounts of sales, value added, and jobs.

There is considerable room for improvement of Europe’s patent system. The effective duration of a patent is sometimes too short as a patented product needs to go through many other regulatory steps before it can be placed on the market. The patent quality, and the enforceability of patents, varies too much in Europe, with some countries offering high quality while other countries do not. The cost of obtaining and renewing patents in Europe can also be prohibitive. Furthermore, European authorities do not devote as much energy to upholding patents in third countries where they are violated. This is partly a consequence of the mixed responsibility of policy in Europe.

TABLE 4. THE FIVE BIGGEST R&D SPENDERS IN EUROPE (MN EUR)

	R&D 2008
Automotives	30 413
Pharmaceuticals	19 825
Telecommunication equipment	12 020
Aerospace & defence	7 547
Chemicals	7 339

Source: European Innovation Scoreboard, 2009, *The 2009 industrial R&D investment scoreboard.* Seville: European Commission Joint Research Centre

C. *The Common Agricultural Policy (CAP)*. Few things constrain Europe's ability to lead globally as much as its programme for agricultural subsidies and high tariffs on agricultural import. The programme is costly, eating up around 40 percent of the EU's budget. It prevents alternative investments in research and development. Equally important, advanced industrial and services sectors in Europe pay a price for the emphasis Europe puts on protecting agriculture in global trade negotiations. If Europe is not prepared to give improved market access to exports of agricultural produce, these exporters will maintain barriers against Europe's industrial and services firms. Consequently, the CAP should be considerably reformed as Europe moves toward its next budget framework (starting in 2013).

D. *Trade defence instruments*. Few areas of trade policy are as opaque and non-transparent as trade defence policy: anti-dumping, anti-subsidy and countervailing duties. The last Commission launched an attempt at having this policy reformed in Europe, with the aim of establishing a policy consistent with economic concerns and the globalisation of Europe's production. The attempt, however, failed; few areas of trade policy in Europe are as sensitive and divisive as trade defence instruments. The reform would have been important, mainly for two reasons.

   Firstly, while Europe, together with the United States, has been the biggest user of trade defence instruments for the past decades, it is now emerging markets who are the most frequent users. And Europe is often a target of these actions by emerging markets. Hence, the calculus for an extensive use of trade defence instruments has changed.

   Secondly, too often antidumping authorities in Europe are at great pains to demonstrate the justification for trade defence measures and have to use arguments that are simply not convincing. This is the case in many of the consumer products that face anti-dumping duties.

   A reform of TDI is not about throwing the policy overboard. There are legitimate cases when trade defence instruments are warranted, such as when a foreign firm practices predatory pricing or gets considerable subsidies that distort fair market rules for competition. Trade defence instruments should be constrained to such cases. Using them for other purposes – e.g. simply to protect from foreign competition a few non-competitive companies with virtually no exclusive production in Europe in sectors such as textiles, garments, and shoes – only makes other countries inclined to treat European exporters in the same way. Furthermore, TDI measures do not result in production remaining in or returning to Europe; they just lead to production moving to countries that do not face an additional duty.

6. "HORIZONTAL AGENDA": KEY PRIORITIES FOR EUROPE

In previous sections we have discussed forms of trade policy and the domestic trade agenda. Let us finally turn to Europe's priorities in its external trade policy. A trade policy should be comprehensive and systematic. It should cover all sectors and issues. For an entity of 27 members, it is all the more important that all countries with an interest feel their concerns are reflected in trade policy.

Europe's trade policy also needs to be effective and target the main commercial priorities. This is an area where there is significant room for improvements. Too often, Europe cannot make strategic priorities and leave the Christmas-tree wish-list approach. It is especially important to have clear strategic priorities when Europe seeks non-PTA methods to advance deeper commercial integration or solve concerns. Such formats only make sense if the priorities are limited to a few selected areas and concerns.

One should be respectful of the difficulties in selecting strategic priorities. It is by nature a selective approach – a zero-sum exercise. Yet an inability to make priorities damages all and compromises the entire trade policy.

What are the priorities that should be front and centre in Europe's approach? Let us mention five areas with key commercial content.

A. Zero tariffs in key sectors

European outward-oriented business has strong interests in eliminating tariffs – at home as well as abroad. Often the tariffs are small in Europe and give hardly any protection. They are only a nuisance – for importers as well as exporters. Other countries with higher tariffs present greater difficulties. In Europe's bilateral and post-Doha approach, the ambition should be to select the sectors in Europe that make the highest contributions to GDP and have the greatest trade potential, and go for zero tariffs in these sectors. There is little point toying with formulas for percentages reduction. It should be full elimination.

B. A comprehensive NTB approach

The main barriers to trade and commerce today are often non-tariff barriers and regulations preventing cross-border integration. Any new trade agreement should be judged upon its ability to reduce such barriers. It is reduction of such barriers that will deliver the biggest benefits to European business. New bilateral agreements should have a strong agenda for reducing or eliminating NTBs and regulatory hurdles. This is the core agenda for goods as well as services.

These core NTBs differ from country to country. Discrimination in government procurement is one frequent NTB in countries that are not full signatories to the WTO Government Procurement Agreement. Such policies affect many advanced sectors in Europe with high GDP contributions – everything from green technologies, such as windmills and turbines, to telecommunication equipment, to registration and pricing of pharmaceuticals. Establishing fair rules without discrimination in government procurement should be one of Europe's key priorities in its trade policy.

Technical barriers to trade are another vexing problem for many European firms targeting markets in Asia. These TBTs, in areas such as automotives and telecommunication, are often so high that a full elimination of tariffs in these countries would not lead to a significant increase of trade. In such cases, NTB reductions should take priority over other desires.

NTBs are most productively addressed in a sectoral context, by their very nature often being technical and specific. An approach combining zero-tariffs and addressing NTBs (as an expanded ITA could cover) should be used when possible.

C. Investment protection and transparency

The world economy is driven as much by investment as by trade. And the growth in investment over the past two decades has by far outpaced trade growth. But investment is subject to fewer disciplines that limit arbitrary and discriminatory practices. There needs to be a profound upgrade of investment agreements and the investment component in Europe's bilateral approach. Two areas are crucial.

First, European firms should get improved investment protection for its foreign investments. Investment protection should be extensive and similar to what Europe offers foreign investors. It should include the possibility of investor-state dispute settlement. A proper investment protection should also cover key personnel. The European Union should also act to get other countries to comply with an investment agreement in the event that dispute-settlement is not an option for the individual investors.

Second, Europe should make itself more open to investments and avoid new excessive regulations for portfolio investors. It should, however, also impose stricter transparency requirements on foreign investors. Sovereign Wealth Funds and other government-owned investment vehicles from autocratic countries with sometimes dubious ambitions for its investment policy are increasingly important in global investment and finance. They cannot be stopped; nor should they. But there should be greater demands on transparency.

D. Intellectual Property Rights (IPRs)

Intellectual Property Rights (IPRs) are central to large portions of the European economy and critical to the success of the Barroso Commission's 2020 strategy. Without proper protection, the business model in many sectors would collapse. IPR protection is also central to trade. With strong protection, companies feel confident to export to other countries and to invest there. In this way, trade and IPRs stand or fall together. If IPR protection is relaxed, dissemination of new technology through trade will diminish.

Many IPRs are under political fire. There has been a strong drive to dilute the integrity of patents in recent years. Surprisingly, some European governments and EU institutions have been unwilling to oppose messages of those who wants to walk in that direction. This is very worrying – especially as new demands keep being made on companies to give away their intellectual property for an alleged higher purpose. A European innovation climate that stimulates continued investments in R&D is fundamentally dependant on strong IPR protection.

Europe has not been successful in getting better enforcement of IPR legislation in other countries. While political commitment is there, Europe's demands are often too generalised. Rampant violations of core IPRs are facts of life for European firms abroad – especially in countries like China. Often it is an absence of enforcement that causes problems. But in some countries there are also problems with insufficient legislation.

Considerable value is also at stake and Europe needs to put a lot more emphasis and a sharper focus on its core IPR demands. Naturally, that should start with enforcement of TRIPS legislation. But it cannot end there. TRIPS sets an international standard for IPRs, but not a very high standard. Legislative improvements are needed in key emerging markets.

Take the example of the pharmaceutical sector – a sector that depends on patent protection. Even if a country has signed up to TRIPS, the integrity of a patent is still challenged because of long, cumbersome, opaque and non-transparent procedures for approval of molecules and medicines, insufficient regulatory data protection, rules for procurement, a s f. Many of these aspects are crucial for the integrity of the patent itself; without them, the patent is sometimes of little, or even no, use.

Europe has tried to solve some IPR concerns in its bilateral approach. It has not been successful. Too often it has been the same old Christmas-tree wish list approach with so many demands that the other party just stops listening. There is a great need for strategic priorities – priorities based on the economic value to Europe of IPRs.

7. TWENTY RECOMMENDATIONS FOR A NEW EU TRADE AGENDA

THE TRADE POLICY climate in the next five years will be difficult – in Europe as well as abroad. The recovery cycle will be comparatively long and affect the climate for trade reforms. The new Commission and Parliament inherit an already ambitious agenda. The Lisbon Treaty reforms will have to be institutionalised and a proper working order between the Commission, the Parliament and the Council will have to be structured. None of this should provide cover for weak political leadership; it rather suggests that Europe now will need much stronger political leadership for its trade policy. Repeating the mistakes of the past five years, and ending this period with as few results as was achieved in the past period, is simply not an option. It would damage the European economy. However, it is crucial that the approach is realistic and that Europe aims for what it is possible to achieve. It is even more important now, at the beginning of a long recovery cycle, that reforms aim at strategic sectors and issues that can yield significant value for the economy. To that end, and on the basis of the earlier discussion in this paper, the following recommendations should be a benchmark for what should be achieved in the next five years.

GENERAL RECOMMENDATIONS

EDUCATE AND ENLIGHTEN!

Strategic and long term trade policy leadership – at home and abroad – is to a large extent about educating and enlightening policymakers and citizens of how the modern economy works and the benefits of trade. Today's European institutions fail in this regard. The political support for global and regional leadership in trade matters is falling. As Europe's integration with the world grows deeper and becomes ever more advanced, it is even more important than before to improve the public understanding of modern trade and global commerce. Especially the European Commission has a special educational responsibility and should invest much more time and departmental resources in increasing the public understanding of trade and the world economy.

REVIEW RECENT DISCRIMINATING MEASURES

The crisis did not trigger a replay of the tit-for-tat protectionism in the 1930s, but too many trade restrictive and discriminatory measures have been introduced during the crisis, also in the EU. Creeping protectionism is also growing. The EU should appoint a Group of Wise Persons to review its own policies during the crisis and examine their effects on trade, trade finance, and economic growth. Opaque protectionism and discriminatory practices thrive on lack of transparency.

ESTABLISH A REVIEW AND TRANSPARENCY BOARD FOR TRADE

Europe lacks common institutions or structures that review trade policy and offer analysis for future strategies and reform. The Commission puts far less resources into analytical support than other governments of big economies – and some of the EU member states. Consequently, Europe's trade policy lacks a "culture of evaluation". As EU's trade policy institutions will change with the Lisbon Treaty it becomes even more important to have bodies that give sound analyses of current and future trade policy. For example, a Review and Transparency Board, resembling the Australian Tariff Board and Australian Productivity Commission, can give core analytical structure to trade policy and help to establish an evidence-based approach that undermines institutional rivalry and fractional tendencies.

MULTILATERAL APPROACHES

BROKER A DOHA DEAL – NOW!

The Doha Round needs to finish soon. Time is of the essence. Without a finished Doha Round within a year – as set out by the latest G20 summit – there is a serious risk that a structured end of the round cannot be achieved at the same time as it will prevent other business from taking place. The Doha Round will not be the "Gold Standard" agreement envisioned at the start. But it is better to end it with what has been agreed so far, than to aim for the stars. Europe should take leadership to broker a deal. It has a much bigger stake in the multilateral trading system than other countries, but it is not one of the countries that are blocking negotiations now.

DEFINE LONG-TERM, POST-DOHA INTERESTS IN THE WTO

Clearly, future global trade policy will be different from multilateral trade policy in the past centuries. Everyone is acknowledging that a new approach is needed at the WTO. But few have defined for themselves what their core interests are and what strategies are needed to pursue those interests. Trade negotiations are forums to pursue strategic economic interests. Trade policy should aims for big commercial and economic gains. Not understanding one's core interests undermines the vitality of trade policy and trade-policy organisations. Understanding them, and linking them to domestic reform agendas, like the successor to the Lisbon agenda for competitiveness, is far more important than looking at new grand institutional designs of the WTO.

INITIATE NEW PLURILATERAL AGREEMENTS

Much business can be done at the WTO through coalitions of the willing in selected sectors and on selected issues. Such agreements can also substitute bilateral approaches that run the risk of introducing too much discrimination into world trade. As the leading trading entity of the world, Europe has much stronger interests than most other countries in most sectors. It is only natural that Europe takes the leadership in setting out the profiles of new plurilateral agreements.

NEXT STEP FOR THE DIGITAL ECONOMY

The ICT sector is central to the European economy. Europe took the leadership in the late 1990s to negotiate a trade deal for information technology products; an initiative that spurred trade and growth. Now new steps have to be taken. The Information Technology Agreement (ITA) needs to be extended and needs to take account of NTBs. ICT services need to be liberalised and subject to trade disciplines; too many countries are doctoring with trade restrictions in the world of digital services. This could be done by initiating negotiations for an International Digital Economy Agreement (IDEA).

RESPECT THE RULES!

As the biggest trading bloc in the world, Europe has a big interest in ensuring that countries are respecting agreements and rules of the WTO. Too often, Europe ushers its own policy in directions that seriously risk violating core WTO rules. These policies often emerge from other areas than trade, e.g. environmental policy. Europe should avoid legislation that it knows may conflict with its WTO obligations and be symbolically challenging. With a conflict over trade and climate change policy looming, this becomes ever more important.

BILATERAL APPROACHES

REVIEW CURRENT APPROACH

Europe is engaged in many bilateral negotiations. Some of them have been on the cards for many years. Others look unlikely to be finished anytime soon due to political obstacles. Europe should take a dispassionate approach to the launched bilateral negotiations and review how likely it is that they will finish anytime soon. Negotiations that are not likely to mature into agreements soon should be dropped.

BE CAUTIOUS WITH BILATERAL – AND GO FOR THOSE THAT MAKE COMMERCIAL SENSE!

Bilateral trade deals are far from ideal; they introduce discrimination into the trading system. Too often, they lead to hardly any significant liberalisation. Europe should be dispassionate and not ideological in its approach to Free Trade Agreements. Some FTAs can considerably liberalise trade, open markets to European business, boost growth and help to stimulate greater action on the multilateral front. It is bilateral trade agreements with other big economies that could deliver significant value to the European economy and help to stimulate activity on the multilateral front.

MAKE BETTER USE OF TARGETED, NON-FTA BILATERAL FRAMEWORKS

The best alternative is not always to go for full negotiations over a Free Trade Agreement. A better strategy can be to target selected irritants in a bilateral relation and find a framework for reciprocal bilateral negotiations over those irritants. This has been the rationale for the High Level Trade and Economic

Dialogue with China. Yet this strategy has not delivered. In contrast to the Strategic Economic Dialogue between China and the US, which delivered results in many trade areas, the EU has not been able to achieve anything in its bilateral talks with China. This suggests that it is not the format that is wrong; it is the substantive content and the lack of political buy-in at top levels that are missing.

EXTERNAL PRIORITIES

REDUCING NON-TARIFF BARRIERS

Non-tariff barriers (NTBs) often protect an economy to a greater extent than tariffs. Europe should put NTBs front and centre in all its external trade policy. The benchmarks for what NTB negotiations should accomplish should be high – far higher than in today's approach.

DISCIPLINED GOVERNMENT PROCUREMENT

The EU has disciplined its government procurement in its competition policy and in the Government Procurement Agreement (GPA). Other countries, including the US, have not gone as far as the EU. And many EU companies are heavily discriminated against abroad in government procurement. This discrimination represents big losses.

STRENGTHENED INTELLECTUAL PROPERTY PROTECTION

Europe loses significant sales and value added because of intellectual property violations, especially of patents, in third countries. Too often the EU neglects to give sufficient priority and focus to violations of IPRs in its external action. To an innovation-based economy, it is of existential importance that intellectual property is respected.

INVESTMENT PROTECTION AND TRANSPARENCY

Europe needs an investment policy that better protects its foreign investments. Too many issues are uncovered in Europe's investment approach and standard BITs in Europe fall behind American BITs in securing protection. Europe should also have greater requirements for investment transparency. Europe should be more open to foreign investments than it is today, but it should demand that foreign investors are transparent.

THE DOMESTIC TRADE AGENDA

SINGLE MARKET FOR ENERGY

Europe's energy markets are fragmented and too regulated. They need to be freed up and enable much more cross-border investment and trade. This is also central to Europe's energy security and relationship with energy exporters. A single market for energy would introduce better market disciplines and avoid bitter political fights over energy relations and investments.

SINGLE MARKET FOR SERVICES

The first step to create a single market for services has been taken. Now it is time to increase efforts to give trade in services similar conditions as internal trade in goods. The proposal to create a digital single market should be pushed.

Other initiatives should be taken, too. But Europe should avoid launching a grand fight in the way they did when the original directive for a single market for services was tabled.

COMMON PATENT SYSTEM

Europe needs a stronger patent system that protects investment in research and innovation. It also needs a common patent policy that reduces the cost of patent application and that enables Europe to enforce patents more vigorously abroad.

REFORM THE COMMON AGRICULTURAL POLICY (CAP)

Europe is set to reform its Common Agricultural Policy (CAP) as it moves closer to the next budget framework. This is a good opportunity to reform agricultural policy and reduce spending on agricultural subsidies.

DISCIPLINE THE USE OF ANTIDUMPING

Europe should discipline its use of trade defence instruments. Antidumping policy has improved in the past years, but further improvements are needed to avoid a policy that hurts Europe's own economy and triggers other countries to act non-cooperatively with European firms. Trade defence measures are warranted, but in too many cases Europe just uses this policy to protect some coddled sectors that are uncompetitive rather than sectors that are faced with uncompetitive behaviour from foreign firms.

FOOTNOTES

1. This story of the production of an iPod is based on Linden, Greg, et al, 2009, “Who captures value in a global innovation network?: the case of Apple’s iPod”. *Communications of the ACM*, vol. 52(3).
2. Reinhardt, Andy, 2006, Nokia’s magnificent mobile-phone manufacturing machine, Business Week, August 3, 2006. Accessed at http://www.businessweek.com/globalbiz/content/aug2006/gb20060803_618811.htm
3. Slaughter, Matthew, 2009, What is an American car?”, *Wall Street Journal*, May 7, 2009
4. National Board of Trade, 2007, *Adding value to the European economy*. Stockholm: National Board of Trade. Accessed at http://www.kommers.se/upload/Analysarkiv/Arbetsomr%C3%A5den/EUs%20yttre%20handelspolitik/AddingvaluetotheEuropeaneconomy.pdf
5. World Trade Organisation, 2009, Overview of developments in the international trading environment, *Annual Report by the Director-General*, World Trade Organisation WT/TPR/OV/12, 18 November 2009
6. Trade remedies like antidumping are not accounted for as such measures are targeted against specific countries/exporters.
7. Ecuador, however, has imposed tariffs on more than 600 items.
8. Evenett, Simon (ed.), 2009, *The unrelenting pressure of protectionism: The 3rd GTA Report*. London: CEPR/Global Trade Alert. Accessed at http://globaltradealert.org/sites/default/files/GTA_report_3.pdf
9. Figures for 2008, however, do not show crisis-related antidumping as it takes a longer time for an antidumping case to “mature”, i.e. getting material evidence over a longer time period.
10. UNCTAD, 2009, *World Investment Report 2009*. New York/Geneva: United Nations Publication.