The Changing Nature and Determinants of EU Trade Policies

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Abstract

EU trade policies and the environment in which they are determined are now considerably different from when the EU came into being in the 1950s. With the exceptions of agriculture and textiles and clothing, tariffs and quantitative restrictions on trade in goods have been reduced to historically very low levels. But trade policy is now about much more than border restrictions upon trade in goods. Trade in services and the impact of national differences in regulatory regimes are now firmly on the trade policy agenda. This paper describes the current multilateral and preferential trade policies of the EU. It highlights the increasing importance of regulatory issues and the fact that some of these are being addressed outside of both multilateral and standard bilateral free trade agreements. This reflects the mixed motives behind EU trade policies and that for trade with certain regions the typical political economy factors framing trade policy are no longer relevant. For example, liberalisation of transatlantic trade, in the limited form at present of mutual recognition of conformity assessment, is being strongly driven by large corporate business. This trend suggests that the pyramid of preferences usually used to depict EU trade policies is becoming very distorted.

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Introduction

EU trade policies and the environment in which they are applied have fundamentally changed since the coming into being of the EEC in 1957. In the 1960s and 1970s external commercial policy was focused upon tariffs and other border measures and trade in goods. This was a time when the relevant political economy paradigm was one in which the interests of import-competing firms were offset against those of export supplying firms when contemplating and negotiating international agreements to liberalise external commercial policies

During this period the EU embraced both multilateral and bilateral liberalisation. The common external tariff of the EU for industrial products has declined from an average of over 15 per cent in the early 1960s to around 3 per cent today. At the same time the EU became notorious for establishing a pyramid of trade preferences with different groups of countries in different tiers of market access. Thus, the level of formal trade protection in the EU is now generally very low. There are some exceptions with high tariffs remaining in particular sectors, primarily agriculture and textiles and clothing.

Commercial policy nowadays is much more diverse. It is no longer just policies affecting trade in goods which are on the agenda. The policy environment affecting trade in services and conditions influencing foreign direct investment have become increasingly important. In addition, EU preferentialism in trade policy is no longer synonymous with regionalism as the recent agreements with South Africa and Mexico demonstrate. As tariffs and quantitative restrictions have declined in importance attention has turned much more to a whole range of non-border policies, captured under the term of regulatory issues, which affect trade flows. These include technical standards and regulations and rules on intellectual property rights. The EU is addressing these issues at the multilateral level in the WTO, in regional trade agreements and in bilateral agreements on specific regulatory issues, such as the mutual recognition of testing and conformity assessment.

The last four decades have also seen the rising importance of multinational firms and the growth of intra-industry trade and substantial cross-boundary sourcing by large corporations. This has led to a substantial change in the political economy environment in which the

European Union determines trade policy decisions.[1] The typical model remains relevant for sectors such as agriculture and perhaps textiles and clothing which have largely been excluded from the liberalisation of border measures. However, for modern sophisticated industrial products, which now dominate EU import and exports, the main corporate players operate large international networks and are both importers and exporters. The attention of large corporate business has become concentrated upon removing differences in national regulatory systems, such as technical regulations, which raise the costs of operating global production systems. In general most of the effort at removing the barriers to market access caused by these differences in regulatory systems has taken place at the regional and bilateral level.

The aim of this paper is to take stock of EU trade relations and trade policies in this new environment. We outline the nature of both multilateral and bilateral trade policy commitments in goods, and briefly in services. We then discuss in some detail bilateral agreements on regulatory issues and concentrate upon issues relating to technical barriers to trade and specifically the mutual recognition of conformity assessment procedures. We contend that, if as is most likely, such agreements have a significant effect on reducing the costs of exporting between the two parties to the agreement, then they will be discriminatory. Since the EU has concentrated upon such agreements with MFN partners this suggests that the shape of the pyramid of preferences which is the standard analogy for EU trade policies is becoming distorted.

The Geographical and Commodity Composition of EU Trade

We start by providing a quick and simple overview of the main changes in the nature of EU trade over the past 30 to 40 years. Figure 1 shows the geographical structure of total (internal and external) EU imports of goods in three years: 1965, 1990 and 1998. In all three years we present the structure of trade for the current 15 members of the EU. Thus, we look backwards from the current EU membership and see how the geographical structure of this block has changed over the past 35 years. The figure shows the share of the main continents, which in trade policy practice are fairly synonymous with regional economic groupings or identities.

It is clear that the main growth in intra-European trade (including trade between what are now EU members as well as trade with the Balkans states, Central and Eastern European Countries, EFTA and EEA countries, Turkey and CIS countries) occurred prior to 1990. The

[1] Since the European Union does not have a legal personality, responsibility for external trade policy for goods, the issue of services will be discussed later, remains with the European Communities. However, for simplicity and to avoid confusion we will refer throughout to the European Union.

share of all European countries in the imports of the current 15 EU members increased from 59 per cent in 1965 to 72 per cent in 1990. This rise in the share of imports from other European countries occurred at the expense of falling shares for all other regions with the exception of Asia. The share of North America, for example, declining from 14 per cent of the total in 1965 to 8 per cent in 1990. The shares of both African and Central and South American countries were halved during this period. In the 1990s however, the broad geographical structure of EU imports has remained relatively constant. The key feature being a slight decline in the share of EU15 imports coming from other European countries and an increase in the importance of imports from Asia.

The picture for EU15 exports, shown in Figure 2, is very similar to that of imports: substantial growth in intra-European trade between 1965 and 1990 and relative stagnation of the share of such trade in the 1990s. The increase in the share of European countries in EU15 exports in the 1970s and 1980s led to a relative substitution away from EU exports primarily to Africa but also to North America and Central and South America. The share of Asia in EU15 exports remained fairly constant. In the 1990s the importance of North America and Asia as a destination for EU15 exports increased very slightly whilst the share of European countries in the exports of the EU15 countries fell. The information on both export and import shares suggest significant growth in the importance of European countries in the period before 1990 but little subsequent change. The major integration episodes of the 1990s, the Single Market and the enlargement of the EU to fifteen member countries have not led to any intensification of trade between the EU15 and European countries including intra-Union trade.

Figures 3 and 4 show the commodity composition of EU15 imports and exports in 1965 and 1998. Here the changes are more profound. In 1965 almost half of EU imports were of food and basic materials whilst by 1998 the share of these products had more than halved with over 80 per cent of EU15 imports being of manufactured goods. The growth in the share of manufactures being entirely concentrated upon finished manufactures. With regard to exports the importance of food and basic materials has declined from 22 per cent in 1965 to 13 per cent in 1998. Again the rise in the importance of manufactures is due entirely to the rising share of finished manufactures. Thus, these figures reflect the well-known fact that EU trade is increasingly of an intra-industry nature – the two-way exchange of finished manufactured products. We now proceed to look at how EU trade policy has changed over the past decades and briefly summarise the current state of multilateral and bilateral access to the EU market.

The Common External Trade Policy of the EU

Tariffs, Quantitative Restrictions and Anti-Dumping Measures

Tariffs

The Common Commercial Policy of the EU has been in a constant state of flux since its inception in the 1960s. This reflects the series of trade liberalisations negotiated under the GATT, the increasing number of preferential trade agreements and more recently the implementation of a genuinely uniform policy across member states after the creation of the Single Market in 1992. We start by discussing the common external tariff and quantitative restrictions and then consider the evolving nature of EU preferentialism. We then move on to discuss the increasing role of regulatory issues in EU trade policy and how these issues are likely to become increasingly prominent as globalisation proceeds.

The EU position on trade and trade liberalisation is clear (Pelkmans (1997)). The Masstricht Treaty (Art 3a) clearly defined the principle governing external trade policy as that "of an open market economy with free competition". More generally, the Treaty of Rome laid down the objectives of external trade policy as "the harmonious development of world trade, the progressive abolition of restrictions on international trade and the lowering of customs barriers" (Art. 110). Thus, in general there is a bias in the Treaty towards trade liberalisation and liberal trade. This has in turn been reflected by the active participation of the EU in the various GATT rounds. The (weighted) average tariff for industrial products has fallen from around 17 per cent in the late 1950s (Swann (1992)) to around 3 per cent after the Uruguay Round commitments are fully implemented. Thus, since the inception of the EC the importance of tariff protection has dramatically declined. There are, however, some important sectoral exceptions to this general leaning towards open markets and trade liberalisation, most notably in agriculture and also textiles and clothing.

Table 1 shows the current trade weighted average common external tariff for the EU for industrial products. These averages are calculated using total 1997 trade values as weights and so do not take account of preferences granted to particular suppliers. However, as shown by Sapir (1998) over 70 per cent of imports enter the EU market at the MFN rate. We return to this below in the section on EU preferential policies. According to these data the EU average tariff for industrial products will fall to below four per cent in 2005.[2] The table also shows

[2] These averages do not include the effect of the Information Technology Agreement which will abolish tariffs on IT products.

that the proportion of trade entering at a zero tariff rate will increase from around 13 per cent in 1997 to almost 30 per cent in 2005.

The table also shows the key remaining problem with regard to the EU tariff, that of tariff peaks. Although the average industrial tariff is now relatively low, a significant proportion of imports enter the EU at very high tariff rates. In 1997 almost 13 per cent of imports were subject to a tariff in excess of 10 per cent. This was only partially addressed in the Uruguay Round, as there will only be a modest reduction by 2005, to around 10 per cent, in the share of EU imports subject to high tariffs. In the main this issue is concentrated upon clothing products where more than 90 per cent of imports in 2005 will still be subject to tariffs in excess of 10 per cent. The implication of this is that developing countries, who, in general, tend to specialise in the production of labour-intensive products such as clothing products, on average face higher tariff barriers in entering the EU market than OECD countries. This is compounded by the very high trade barriers to the EU market for agricultural products.

The EU does offer the developing countries preferential access in the form of the GSP. However, for products such as textiles and clothing, which are defined as 'very sensitive' the duty reduction from the MFN rate is only 15 per cent. In addition administrative rules ensure that only a fraction of imports from developing countries actually benefit from GSP treatment. Sapir (1998) reports that 79 per cent of dutiable imports from GSP beneficiaries in 1994 qualified for preferential access to the EU market, yet only 38 per cent actually entered the EU market with a duty less than the MFN rate. The reasons for this difference being the effects of rules of origin which specify the requirements for products to be treated as 'originating' and therefore subject to GSP treatment, and tariff-quotas for particular products, which set limits on the amount of imports which can receive beneficial access to the EU market.

Thus, even with GSP treatment developing countries face relatively high tariff barriers compared with developed countries. Table 2 shows that the average tariff for industrial products for US exporters to the EU was 3.5 per cent in 1997 and this will fall to 2.5 per cent in 2005. Table 3, on the other hand, shows that China, a GSP beneficiary faced an average tariff on industrial products in 1997 of 6.4 per cent, which will only fall to 5.3 per cent in 2005. Other examples are also informative. Moldova, a country in transition with average GDP per head of around $500 per annum, on average faces a considerably higher tariff on its exports to the EU than it levies on its imports from the EU. In other words EU producers, in

general face lower tariff barriers in exporting to the Moldovan market than do Moldovan exporters when seeking to sell in the EU market.[3]

The major achievement of the Uruguay Round in relation to agriculture was to increase transparency in the application of border policies and to obtain commitments on the level of domestic and export subsidies. With regard to border policies the main commitment was the tariffication of the range of non-tariff and variable levies that were previously used to protect EU agriculture and a reduction in the average level of the tariff. Between 1995 and 1997 the simple average EU tariff for agricultural products declined by 25 per cent to reach a figure of almost 21 per cent in 1997.[4] However, these commitments appear to have done little to improve overall access to the EU market. Between 1995 and 1998 the volume of EU agricultural imports (HS 0-21) from non-member countries fell by over 6 per cent and the share of the volume of extra-EU imports in total EU imports (extra + intra) declined from 38.6 to 35.1 per cent (Brenton and Nunez-Ferrer (2000)).

The EU tariff schedule for agricultural products is still dominated by tariff peaks for products such as meats, cereals and milk products. For example, in 1997 the simple average tariff (taking account of the ad valorem equivalents of specific duties) for fresh meat of bovine animals was 107.5 per cent with a narrow range from 94 to 125 per cent. For wheat the simple average tariff in 1997 was almost 77 per cent whilst for milk and cream the simple average was 59 per cent with a maximum tariff of 134 per cent (WTO (1997)). The Uruguay Agreement on Agriculture has made transparent these very high levels of border protection for certain agricultural products. Progress in making further reductions of these tariff rates is likely to be an important aspect of the next round of multilateral negotiations on agricultural trade.

Quantitative Trade Restrictions

[3] In 1997 the average tariff on Moldovan exports to the EU was around 9 per cent (around 7 per cent with full GSP benefits but in 1997 only one third of Moldovan exports to the EU which were entitled to preferences actually received them) whilst the average tariff on EU exports to Moldova was just over 4 per cent (Brenton (1999)).

[4] WTO(1997).

Non-tariff border measures have substantially declined in importance in EU external trade policy. The principal non-tariff measures imposed by the EU and EU member states in the past have been quantitative import restrictions and voluntary export restraints (VERs). Anti-dumping measures are separately discussed below. The past decade has seen a clear tendency towards the decreasing use of quantitative trade measures. Having significantly reduced tariff protection during the 1970s and 1980s the EU has now substantially alleviated the incidence of quantitative trade restrictions. In 1988 almost 11 per cent of EU imports were covered by core non-tariff measures (primarily quantitative restrictions and VERs). By 1996 this coverage ratio had fallen to just over 4 per cent.[5]

Two factors lie behind the declining use by the EU of quantitative trade restrictions: the Uruguay Round agreements and the completion of the Single Market. Under the Uruguay Round the use of voluntary export restraints was prohibited. In addition, the Agreement on Agriculture led to the tariffication of non-tariff measures. As noted above, however, this did not necessarily improve market access, since some quantitative restrictions and variable price levies where tariffied at very high and probably prohibitive levels. The Uruguay Round also addressed the other main sector where quantitative restrictions are prevalent: textiles and clothing. The industrial countries agreed to phase out the multi-fibre agreement (MFA), which together with its predecessors has controlled imports from developing countries for over 40 years since the comically titled Short-Term Agreement. The Uruguay Round agreement stipulated that bilateral quotas should be liberalised over a 10 year period from the creation of the WTO in 1995. However, under the terms of the agreement the industrial countries have been able to backload liberalisation of the most binding quotas for the most sensitive products until the final date at the end of 2004.

The fact that the most sensitive items will be liberalised at the final moment has led some commentators to suggest that in the face of substantial domestic pressures quotas will be prolonged or that a raft of safeguard measures will be introduced. This seems to be a realistic concern in the US, but in Europe the clamour for continued protection has not been heard. EU industry, following substantial outsourcing, appears resigned to the death of the MFA and is devoting its efforts to opening export markets in the developing countries whose quota access to the EU will be liberalised.

[5] These figures and subsequent data in this section are taken from Auboin and Laird (1999).

The EU countries adopted a common external tariff in the 1960s, as is fundamental in a customs union. However, the individual member states maintained their battery of national quotas for textiles and clothing products. In the 1970s the product scope of these restrictions was widened under the MFA and quantitative limits were based upon VERs negotiated at the EU level but then distributed on a national basis. Thus, for textiles and clothing the EU effectively became a free trade area with national volume protection (Pelkmans (1997)). Throughout the 1970s the scope of national volume protection increased to cover cars, footwear, bags, umbrellas, steel, televisions and a range of other products.

National volume protection requires the partitioning of national markets via border controls to prevent trade deflection (imports entering highly constrained markets via more liberal neighbours). Although this is inconsistent with the maintenance of a common commercial policy, which was required by the Treaty of Rome, and the freedom of movement of goods, national volume restrictions were never challenged by the Commission. It was not until the Single Market programme which started in the late 1980s and necessitated the removal of border controls between member countries that national volume restrictions were removed and a genuinely common external policy for trade in goods was finally established at the beginning of 1993. All trade restrictions maintained individually by member states were removed and were, in general, not substituted by EU wide restrictions. The exceptions are textiles and clothing products, where quotas will be fully liberalised by 2005, certain footwear products and Japanese cars, where the restrictions have subsequently lapsed, and bananas and steel products.

EU trade policy regarding bananas is rather unique in that external trade restrictions are not driven by the consideration of protecting domestic producers[6] but rather by developmental policy towards African and Caribbean producers. EU policy has been subject to a series of complaints at the WTO and is currently being reformed towards a tariff only system. There has been a massive reduction in the number of quotas and VERs in the steel sector. The number of tariff lines in the steel sector subject to non-tariff measures fell from 37 per cent in 1988 to less than one per cent in 1996. There remain a number of restrictions on imports from Russia, Ukraine and Kazakhstan.

[6] Apart from small-scale production in the Canary Islands there is no domestic output of bananas in the EU

Thus, although the incidence of non-tariff measures increased significantly in the 1970s, the late 1980s and 1990s have seen an annihilation of national quantitative restrictions and VERs in Europe following the Uruguay Round and the completion of the Single Market. After the phase out of the MFA and the removal of remaining steel quotas, quantitative restrictions will effectively be a trade measure of the past in Europe.

Anti-dumping Measures

The main trade defence, or contingent protection, instrument used by the EU is anti-dumping measures. Safeguard measures and countervailing duties are not of significance. The use of anti-dumping measures by the EU increased rapidly in the 1980s but the number of measures in force has subsequently stabilised. In 1990 there were 139 anti-dumping measures, there was a slight increase to around 150 measures in 1993 and 1994 but a subsequent fall to 141 and 142 measures in force in 1997 and 1998 respectively.

The products most often involved in these anti-dumping cases are mineral products and chemicals (primarily organic chemicals), textile products and machinery and equipment, mainly electrical machinery and equipment. Other products affected range from metals and steel products, to footwear, handbags and bicycles. Asian countries are most subjected to anti-dumping measures. In 1998, of the 142 measures in place, 92 (67 per cent) concerned Asian countries. There were only three cases against African countries, five against Central and South American countries and three cases involving North America. Most of the remaining 39 cases applied to Central and Eastern European countries and countries of the former Soviet Union. A very large proportion of EU cases involve countries in transition. In 1998 about one half of the cases where definitive duties were applied involved China and the members of the former Comecon (Central and Eastern European Counties and the former Soviet Union) bloc.

Where anti-dumping measures (ad valorem duties, specific duties, minimum prices, or price undertakings) are applied the average duty tends to be very high. Brenton (2000) calculates for a sample of cases from 1988 to 1995 an average duty (including ad valorem equivalents of specific duties) in excess of 25 per cent. Thus, anti-dumping measures are likely to have a major impact upon trade in the products covered. The average duty is considerably higher than the level of tariff protection affecting most products, with the exception of agricultural goods and products such as tobacco and alcoholic drinks. As noted above, the average tariff for industrial products entering the EU is now around 3 per cent. However, anti-dumping actions are by definition discriminatory. Imports from targeted countries are not only

discriminated against relative to domestic producers in the EU but also relative to non-named extra-EU countries. Brenton (2000) and Messerlin (1989) show that EU anti-dumping policies cause trade diversion and that this accrues primarily to non-EU suppliers. Prusa (1997) has found similar results for the US.

Anti-dumping policies are now very well entrenched as a part of EU external trade policy. Around 250 personnel are employed in the European Commission to solely deal with anti-dumping and anti-subsidy (of which there are very few) investigations. However, they remain subject to an extreme amount of criticism and continued suspicion that rather than a precise and careful application of well-specified rules, they are simply a protectionist device.

Finally, it is a misapprehension to expect that a free trade agreement with the EU would have a significant impact upon the use of anti-dumping measures by the EU. Specific undertakings regarding anti-dumping and safeguard measures have never formally been included in preferential agreements by the EU except for the EEA. The option of precluding anti-dumping measures in the future has been included in the EU-Turkish customs union. The Europe Agreements between the EU and the CEECs specify that before implementing antidumping measures the EU must provide the Association Council with all the relevant information with a view to finding a solution acceptable to both sides. However, after changing from the initial treatment of the CEECs as “state trading” to “market economies” the number of EU anti-dumping investigations increased despite this process of prior consultation. The Europe Agreements contain no provisions for the phasing out of anti-dumping policies or the threat of their use. The Essen Council of December 1994 gave an undertaking that ‘as satisfactory implementation of competition policy and control of state aids together with the application of those parts of Community law linked to the internal market are achieved, so the Union should be ready to consider refraining from using commercial defence instruments for industrial products’. The key issue, which has not been elucidated by the Council or Commission, is what constitutes ‘satisfactory implementation’ and under what conditions the Community would consider refraining from using contingent protection. In practice, anti-dumping measures will only be proscribed once these countries accede to the EU.

EU Preferentialism

A key feature of EU commercial policy has been that on the one hand the EU has been a keen proponent of multilateral liberalisation and the construction of an effective body of world trade law whilst on the other hand the EU has been at the forefront of discrimination in world

trade in the form of the proliferating number of preferential trade agreements that it has signed. There have been two waves to this preferentialism with perhaps a third wave emerging at the start of this new decade.

The EU was at the heart of the first wave of post-war preferential trade agreements in the 1960s and 1970s. The formation of the European and Steel Community in 1951 and then the European Economic Community in 1957 contributed to a series of attempts to emulate customs unions among less developed countries in the 1960s. Economic integration amongst the initial six members led directly to a response in Europe from non-participating countries in the form of the European Free Trade Association (EFTA) formed in 1960.

The EU was also pre-eminent in the subsequent spread of preferentialism, concluding association agreements with Turkey and Greece and the Yaoundé Agreements (and then the Lomé Treaties) providing, non-reciprocal often duty free access to former colonies in the 1960s. Bilateral free trade areas in industrial goods were introduced with the six EFTA countries and a series of preferential, non-reciprocal agreements were signed with Mediterranean countries in the 1970s. These agreements together with the implementation of the EC's Generalised System of Preferences in the early 1970s started the construction of the EU's infamous pyramid of preferences. We shall discuss how the pyramid has evolved in more detail below and will argue that as the range of trade related policy issues included in bilateral agreements has expanded the shape of the pyramid has become more complicated.

The second wave of EU preferentialism started to evolve in the late 1980s. As with the first wave, the preferential agreements were synonymous with regionalism. The only exceptions being the Lomé conventions and the GSP, which were primarily developmental in focus, with the former also reflecting historical legacies. This wave has been characterised both by a proliferation of new trade agreements as well as the extension and enhancement of existing bilateral relationships. On the one hand, the deepening of integration between EU members in the form of the programme to create the Single Market, led to a reformulation of the relationships between the EU and the EFTA countries in the form of the European Economic Area (EEA) and ultimately to the accession of three of the EFTA countries. The increasing number of agreements came first from the end of the division of Europe. The EU implemented free trade agreements with each of the 10 countries in central and Eastern Europe (CEECs) who have subsequently requested membership of the EU. EFTA quickly followed with its own agreements with these countries and mutual trade between a group of

the CEECs was liberalised under the CEFTA. In addition, the EU sought to enhance and re-invigorate existing trade agreements with Mediterranean countries. In part this reflected the perceived need to give attention to the Southern borders of the EU.

This second wave of EU preferentialism in fact followed a bout of regionalism elsewhere in the world, although it is generally felt that the actions of the EU indirectly contributed to the initiation of regional schemes in the Americas. The EU's fixation on creating the Single Market in the mid and late 1980s led to the perception that the EU was relatively uninterested in multilateralism which in turn pushed the US to seek strategic regional deals first with Canada and then with Mexico in the NAFTA (Pelkmans and Brenton (1999)).

Figure 5 shows the current state of EU preferentialism in the form of the, typically referred to, pyramid. The figure shows the composition of the various tiers which represent different degrees of preferential access to the EU market together with the share of external EU15 imports in 1965 and 1998 accounted by the various groups of countries. At the base are those countries which have only MFN, non-preferential access to the EU market. Although the number of these countries is small, six, they account for a very large proportion of EU external imports, 36 per cent in 1998. It is interesting to note that the size of the base has remained unchanged since the 1960s. In 1965 these countries accounted for exactly 36 per cent of extra-EU imports for the 15 member countries. However, there has been some substitution between members of the MFN group. The share of the two North American countries has fallen from almost 29 per cent of the total to around 23 per cent whilst the combined share of Australia and New Zealand has fallen from 5 per cent to less than 1.5 per cent. On the other hand the share of the two Asian MFN countries has risen from 2 to almost 12 per cent.

Next in the hierarchy come non-reciprocal preference schemes. As noted above the extent to which these agreements translate into actual preferential market access is limited by often complex origin rules, tariff quotas and quantitative restrictions. For example, in the EU agreement with Albania the EU offers exemption from customs duties and quantitative restrictions subject to a series of product specific annexes. Although the annexes in the Albania agreement cover only 5 per cent of the tariff lines they cover 62 per cent of Albanian

exports to the EU (TDI (2000)). These annexes typically set quantitative ceilings after which duties are imposed.[7]

Similarly around 60 of imports from the GSP countries pay the MFN duty. Figure 5 shows that in 1998 imports from the GSP beneficiaries accounted for around 30 per cent of external EU imports. Hence the MFN base of the pyramid is very broad. In this tier we have also included African and Caribbean countries who are party to the Lomè Convention. This agreement has primarily entailed non-reciprocal market opening by the EU. The new Lomè Agreement negotiated in 2000 extends this for a further period of eight years. However, after September 2002 the EU will initiate negotiations on reciprocal economic partnerships, with the aim of concluding such agreements by the end of 2007.

Within the GSP group the EU has made vague commitments to consider free trade agreements with the European CIS countries (Belarus, Moldova, Russia, Ukraine) and with MERCOSUR, the Andean Pact and the Central American Common Market. The EU has been negotiating for many years a free trade agreement with the Gulf Cooperation Council (GCC). Currently the process is blocked by the EU's insistence that the GCC members first form a customs union.

Next in the hierarchy of preferences comes a group of free trade agreements with non-European countries. With the exception of the agreement with Israel, all of these agreements are new (Mexico, South Africa, Morocco, Tunisia) or under negotiation (other MEDs) and all of these countries have climbed up from the non-reciprocal tier. Above this tier comes a group of free trade agreements with European countries characterised by much deeper integration in terms of regulatory reform, an issue to which we return in detail below. The agreements with the EEA countries and Switzerland are long-standing and have been subject to substantial evolution. The Europe Agreements with the Central and Eastern European countries are more recent (negotiated in the early 1990s). All of the agreements in this group are with countries who are potential members of the EU.

The discussion suggests that a third wave of EU preferentialism has perhaps become apparent in the 1990s in the form of preferential agreements which do not have a regional identity. It should also be noted that recent agreements have been implemented with countries having substantially different levels of income and development than the EU. This trend will

[7] The EU has recently (COM (2000) 351) revised its commercial policy approach to the Balkans and reduced the number of tariff ceilings. Nevertheless, only limited duty free access remains for textile

continue if progress is made in adopting the range of prospective agreements that have been raised by the EU. The EU has recently signed free trade agreements with South Africa and most recently Mexico. The free trade agreement with Mexico is clearly linked to the NAFTA. However, neither agreement has been driven by pressing border-related foreign policy concerns, as was the case with the Europe Agreements and the MEDs.

Potential EU membership has always been a defining characteristic of the depth and often breadth of EU agreements. Being European is a pre-requisite for EU membership. However, the scope for additional trade agreements in Europe is now limited. The ten countries in Central and Eastern Europe have extensive free trade agreements and are in the process of the comprehensive adoption of all EU rules and regulations as part of the process of their accession to the EU. Turkey, too, is now seriously considered as a future EU member. That leaves the Balkans and the European CIS countries. These countries form a major challenge to EU foreign and commercial policy in the next decade to which we return below.

How far will this third wave extend? Sapir (1998) and Pelkmans and Brenton (1999) discuss why countries seek free trade agreements with the EU and the reasons why the EU is interested in negotiating such agreements. Both stress the mixed motives behind the EU's approach to bilateral free trade agreements. The main factors seem to be

- Foreign policy issues: 'trade policy has always been the principal instrument of foreign policy for the EU' (Sapir (1998) p726). The pattern of preferential trade agreements of the EU reflects the differing geo-political interests of the individual member states. In addition, the EU has always used free trade agreements as an essential element towards providing regional stability on the borders of the EU.
- Commercial Diplomacy: to improve market access for EU suppliers in third country markets
- Development policy issues: Lomé, the first generation of MED agreements and the GSP reflect development concerns. The use of trade policies to try and achieve development objectives is particularly apparent in the high profile case of bananas.

Within each of these broad categories a range of economic and political issues are represented. An important issue is that as the EU grew in economic size and political importance is began to act as an active economic hegemon. It has combined a liberal approach

and clothing products and for agricultural products.

to multilateral trade liberalisation with a far-reaching concessionary approach to preferentialism in its expanding sphere of influence. The latter is used in a way which seeks to strengthen domestic reforms in the partner and promote multilateral liberalisation. Access to the EU market, financial aid, economic cooperation and infrastructural links are used to ensure compliance and preclude free riding (which was initially tolerated from the MEDs, Turkey and the African and Caribbean signatories to the Lomé treaty). This economic hegemony can be politically sensitive when the hegemonic power refuses to make significant concessions in policy areas of high importance for partners (agriculture, for example).

This problem arises when considering the potential for the third wave of EU preferentialism, that is with countries where issues of regional stability are not paramount. The difficulty that the EU faces in extending its network of free trade agreements to other countries is WTO rules and the CAP. Article XXIV of the GATT demands that free trade agreements cover 'substantially all' trade between the partners. This is now generally accepted within the Commission as meaning that any agreement must cover at least 90 to 95 per cent of trade.[8] This coupled with the absolute resistance within the EU to the liberalisation of trade in sensitive agricultural products (grains, beef, milk, diary products, sugar) makes it difficult to see how agreements could be concluded with countries in say Mercosur or in the Andean pact. Table 4 shows that the share of agricultural products in these countries exports to the EU are substantial, around 60 per cent in the case of Mercosur and almost 75 per cent for the Andean countries. The share of agriculture in EU imports from partners with recently concluded free trade agreements is much lower. Only 32 per cent of South African exports to the EU in 1998 were of agricultural products, whilst in the same year around 28 per cent of Mexican exports were of agricultural products.[9]

Currently free trade negotiations on agricultural products proceed on a detailed product by product basis. This ensures a minimal amount of market opening in the EU since special interests are able to influence the negotiations at a very detailed level with little scope for trade-offs. It also reflects the hegemonic power of the EU and the way that the EU currently wields that influence.

[8] Note that this does not mean that 95 per cent of all tariff lines must be covered. It is 95 per cent of tariff distorted trade which is measured. Thus, products subject to prohibitive tariffs tend not to be liberalised.

[9] This did not prevent some bitter haggling in the South African case over the use specific names for certain alcoholic beverages.

Note that EU bilateral trade agreements are now fundamentally different from those of the 1950s and 60s. The EU is now actively pushing for the end of non-reciprocity in its agreements with the ACP countries and the Mediterranean countries. In the past the EU tended to conclude reciprocal agreements only with potential members of the EU. This reflects the opposition at the time of the US to the expansion of preferential trade agreements. Indeed, Sapir (1998) documents that the original plan for trade preferences with the ACP countries was for reciprocal arrangements but in the face of US objections this was abandoned and a non-reciprocal system was implemented. This has now changed of course by the participation of the US itself in preferential trade schemes. It is interesting to note from the data on the shares of EU15 imports in 1965 and 1998 (in Figure 5) that the countries and country groupings which have been in the non-reciprocal tiers (Mexico, South Africa, MEDs, Lomè, Balkans, GSP) have all lost market share. This non-reciprocal group of countries as a whole provided 51 per cent of EU15 external imports in 1965 but only 40 per cent in 1998. Countries which have implemented agreements requiring mutual abolition of trade barriers have increased their share of EU imports. However, some of this increase is due to the Central and Eastern European countries whose trade with the EU prior to the 1990s was suppressed under the previous regime but which quickly achieved the levels of trade associated with 'normal' market economies by the mid 1990s (Brenton and Gros (1997)).

In addition trade agreements are now about much more than trade policies. A key feature of recent agreements is that they go far beyond the removal of tariffs and quantitative restrictions and cover a whole range of regulatory issues relating to technical regulations and standards, rights of establishment, competition policy and state aids, and trade in services. Attention to these issues has been termed as deep integration (Lawrence (1996)), to which we now turn. It is somewhat ironic that as formal trade barriers have declined the demand for trade agreements with the EU has increased. As shown above, with the exception of agricultural products, which are in part or in the main excluded from liberalisation under EU agreements, EU tariffs are generally quite low. Thus, the desire for free trade agreements with the EU is now stimulated by much more than just the removal of tariff restrictions.

The inclusion of the new issues is asserted to be non-preferential and therefore not subject to the rules of Article XXIV of the GATT. However, a number of authors are now beginning to actively question this assumption (see, Baldwin (2000), for example). In a number of cases the EU, as in the mutual recognition agreement with the US, has signed agreements on regulatory issues outside of formal free trade agreements. We shall argue below that these

types of agreement cover a significant proportion of trade from MFN partners and if, as there are grounds to suspect, these agreements provide preferential access for the products covered then the structure of the pyramid of trade preferences is becoming distorted. Thus, for example, countries towards the top of the pyramid, such as Mediterranean countries and the CEECs, do not face tariff barriers on their exports of industrial products. However, domestic firms in these countries face the costs of achieving conformity assessment to technical standards in both the home market and in the EU. On the other hand, for certain products, US exporters have to pay the MFN tariff to access the EU market but may avoid some costs of exporting since testing to EU standards carried out in US laboratories can be accepted as conformity assessment in the EU. If the cost reduction from avoiding duplicity of conformity assessment exceeds the magnitude of the external tariff for a particular product, then US exporters may have the most preferred access to the EU market.

Current Trends in EU trade Policies: Deep Integration

The current environment in which EU trade policies are set is considerably different from that of 40 years ago when the EU's common trade policies were being established. Today tariffs and quantitative trade restrictions are substantially lower and less prevalent. However, it has been increasingly recognised that considerable problems still face firms wishing to trade and invest abroad. These barriers arise from differences in the regulatory regimes imposed in various countries, which act to segment markets along national lines, constraining the ability of firms to effectively compete across national boundaries. The market segmenting effects of these policies may not necessarily be intentional. For example, conformity with health, safety and technical standards requires testing and certification, which will normally be required of both domestic and imported products. But if every country maintains its own standards and testing procedures then exported products will face a multiplicity of conformity assessment and hence higher compliance costs and this will tend to reduce international trade flows.

At the same time, and in part due to the reduction in traditional trade barriers, the world economy has become more integrated. This has been reflected in rising volumes of trade and investment flows and increasing international interdependencies between firms. The activities of multinational firms are now much more important and this is altering the political economy which envelops trade policy making. A large proportion of trade is now intra-firm trade, that is trade which takes place within multinational enterprises. Over 40 per cent of trade between the US and the EU is intra-firm trade (Clausing (2000)). More generally, there has been an

increase in the extent to which firms outsource parts of the production process to overseas suppliers leading to a 'sequential, vertical trading chain stretching across many countries' Hummels *et al* (1999).

A number of important implications for trade policy follow from this environment, the key issues being:

- Further trade liberalisation is strongly supported by large corporations, that is multinational firms and firms which both import and export. The traditional political economy model where pro-protection import-competing firms vie with pro-liberalisation export firms in the political market for protection is now much less valid. As a result political efforts become focused upon achieving liberalisation with countries and within industries where firms are both exporting and import-competing, that is where intra-industry trade is dominant (Baldwin (2000)).
- The emphasis of liberalisation will be upon eliminating differences in national regulations which segment markets and make internationally integrated production costly. Tariff barriers are now relatively unimportant and, where significant, can be circumvented by multinational firms through transfer pricing policies.

It is in this context that the leaders of large corporations have strongly supported recent regional and bilateral trade initiatives in Europe (the creation of the Single Market), in North America (NAFTA) and in Asia (APEC). The role of business in influencing deep integration has been increasingly institutionalised, for example, in the Transatlantic Business Dialogue (TABD) and in the Pacific Business Forum. Much of the initiative for, and the propulsion behind, the EU-US agreement on mutual recognition of conformity assessment came from the TABD, which is pushing for further liberalisation of market access barriers. Business leaders are not ignoring the possibility of multilateral initiatives through the WTO. However, the gradualist approach and the perceived inability of the WTO to keep abreast of actual developments in the world market appears to be dampening business enthusiasm.

Deep integration can be defined as agreements by governments to reduce the market segmenting effects of differences in national regulations by the coordination, harmonisation or mutual recognition of national laws, regulations and enforcement mechanisms.[10] We now proceed to discuss the EU approach to regulatory barriers, looking first at internal

[10] From Hoekman, Schiff and Winters (1998).

liberalisation and then at EU external policies in this area. We concentrate upon technical barriers to trade, which remain one of the most important causes of market segmentation and which have been particularly important in recent EU bilateral trade policy initiatives.

Technical barriers to trade (TBT's) can arise whenever a producer may have to alter his/her product in order to comply with differing partner country requirements such as for health, safety, environmental and consumer protection issues. These requirements can be imposed by both governments (technical regulations) and non-governmental organisations (non-regulatory barriers, standards). The legal character of technical regulations distinguishes them from non-regulatory barriers or standards; namely, the latter are voluntary, not legally binding and arise from the self-interest of producers or consumers involved, for example, to improve the information in commercial transactions and ensure compatibility between products. The former mainly relates to either technical specifications or testing and certification requirements such that the product actually complies with the specifications to which it is subjected (conformity assessment).

Technical regulations strike at the heart of business operations affecting business pre-production, production, sales and marketing policies. The need to adapt product design, re-organise production systems, and multiple testing and certification can entail a significant cost (or technical trade barrier) for suppliers of exported goods to a particular country, the magnitude of which differs across products. The removal of TBTs within the EU is a central tenet of the Single Market since it is crucial for the provision of equal conditions of market access throughout the whole of the European Economic Space. The removal of such barriers promotes trade and efficiency and serves to strengthen competition by undermining the fragmentation of the EU market.

Previous analysis of the completion of the Single Market in the existing EU countries suggests that the removal of technical barriers to trade may be of great significance. CEC (1998) calculates that over 79 per cent of intra-EU trade may have been affected by technical regulations in 1996. Similar calculations are shown in Table 4 for EU trade with a range of countries in 1997. These data demonstrate that a large share of EU imports and exports are of products which are subject to technical regulations in the EU.

Instruments for removing Technical Barriers to Trade

EU policy related to standards, testing and certification requirements is currently based upon two approaches: enforcement of the Mutual Recognition Principle (MRP) and if this fails, the

harmonisation of technical standards in each member country. Each approach will now be discussed in turn.

Mutual Recognition

The basic EU approach has been to promote the idea that products manufactured and tested in accordance with a partner country's regulations could offer equivalent levels of protection to those provided by corresponding domestic rules and procedures. However, this often requires accreditation of testing and certification bodies and a mutual recognition arrangement (MRA) between bodies because member states often regulate for the same product risks in slightly different ways (or in the same way but requiring duplication of conformity assessment). 'Mutual Recognition' tends to apply where products are new and specialised and it seems to be relatively effective for equipment goods and consumer durables, but it encounters difficulties where the product risk is high and consumers or users are directly exposed.

Harmonisation

Where 'equivalence' between levels of regulatory protection embodied in national regulations cannot be assumed, the only viable way to remove the TBT in question is for the member states to reach agreement on a common set of legally binding requirements. Subsequently, no further legal impediments can prevent market access of complying products anywhere in the EU market. EU legislation harmonising technical specifications has involved two distinct approaches, the 'old approach' and the 'new approach'.

The old approach mainly applies to products by which the nature of the risk requires extensive product-by-product or even component-by-component legislation (chemicals, motor vehicles, pharmaceuticals and foodstuffs) and is carried out by means of detailed directives. In the main achieving this type of harmonisation has been slow for two reasons. First of all, the process of harmonisation became highly technical since it sought to meet the individual requirements of each product category (including components). This resulted in extensive and drawn-out consultations. Secondly, the adoption of old approach directives was based on unanimity in the Council. As a result the harmonisation process proceeded extremely slowly. Indeed the approach was ineffective since new national regulations proliferated at a much faster rate than the production of EU level directives on a limited set of products (Pelkmans (1987)).

It became increasingly recognised that there was a need to reduce the intervention of the public authorities prior to a product being placed on the market. Moreover, the decision-making procedure needed to be adapted in order to facilitate the adoption of technical

harmonisation directives by a qualified majority in the Council. This has been done by the adoption of the 'new approach' and applies to products, which have "similar characteristics" and where there has been widespread divergence of technical regulations in EU countries. What makes this approach 'new' is that it only indicates 'essential requirements' and leaves greater freedom to manufacturers as to how to satisfy those requirements, dispensing with the 'old' type of exhaustively detailed directives.

The new approach directives provide for more flexibility than the detailed harmonisation directives of the old approach, by using the support of the established standardisation bodies, CEN, CENELEC and the national standard bodies. The standardisation work is achieved in a more efficient way, is easier to update and involves greater participation from industry. A further feature of the new approach is the use of market surveillance and the choice of attestation methods that are available: by self-certification against the essential requirements, by using generic standards or by using notified bodies for type approval and testing of conformity of type.

At the multilateral level, the traditional GATT approach of reciprocal concessions is not easily applied in the area of regulatory differences and deep integration. The WTO Agreement on Technical Barriers to Trade reiterates the principals of most favoured nation treatment and of national treatment as being applicable to all aspect of standards and conformity assessment. However, the agreement goes further in obliging governments to ensure that technical barriers are not more trade restricting than necessary to achieve a legitimate objective, in committing governments to harmonise national standards with international standards, in providing for acceptance of equivalent testing procedures in third countries, and in providing a framework for dispute settlement. In practice, however, the issue of reciprocity of conformity assessment procedures and acceptance of test results from other members has not received any significant attention in the multilateral context.

Bilateral Agreements on Conformity Assessment

Harmonisation and mutual recognition have been actively pursued by the EU in external bilateral agreements, not always in the context of a comprehensive trade agreement. Mutual recognition is also one of the most important objectives on the agenda of APEC. Baldwin (2000) distinguishes between negotiated harmonisation, hegemonic harmonisation and mutual recognition. At the international level negotiated harmonisation is unlikely to be feasible. Hegemonic harmonisation and mutual recognition are currently being employed by the EU in

bilateral agreements. Hegemonic harmonisation entails small countries and less-developed countries adopting the regulations of the EU although there are substantial differences in obligations between the various agreements that the EU has entered into. The EU has followed the mutual recognition approach with countries such as the US, Canada and Japan.

For example, Article 51 of the Partnership and Cooperation Agreement (PCA) between the Ukraine and the EU contains a general commitment on the part of Ukraine to adopt the *acquis*, or body of law, of the Community, such that 'Ukraine shall endeavour to ensure that its legislation will be gradually made compatible with that of the Community' (Article 51(1)). A similar clause is present in the Europe Agreements with the Central and Eastern European countries although the Central and Eastern European countries must use their 'best endeavours' to ensure compatibility with Community legislation.

Elsewhere, the free trade agreement with Mexico contains little substance on regulatory issues and in particular, on technical barriers to trade whilst the agreement with South Africa includes a commitment to develop agreements on mutual recognition of conformity assessment. The EU has no formal trade agreement with the US but it does have a mutual recognition agreement for conformity assessment of specific products. Under a MRA each country is given the authority to test and certify in its own territory, and prior to export, the conformity of products with the other countries regulatory requirements.

The EU-US MRA agreement covers the following selected sectors: telecommunications equipment, electromagnetic compatibility, electrical safety, recreation craft, pharmaceutical good medical practices, and medical devices. Table 5 shows the share of these products in EU imports from various countries in 1998. Thus, the MRA with the US covered almost 13 per cent of EU imports from the US. The value of this trade exceeds the value of EU imports in the top tier of the pyramid in Figure 5. Thus, if recognition by the EU of US conformity assessment for the sectors covered significantly reduces the costs of exporting to the EU for US firms then the pyramid of preferences will become rather distorted.[11]

Mutual recognition agreements can be expected to bring a number of benefits. In particular, the expense, time and unpredictability of obtaining approval can be reduced if the product can be tested for conformity in the country of production. Unfortunately, at present we do not have good estimates of the impact that the MRA will have on the costs of exporting. Survey

evidence from OECD (2000) suggests that 'mutual recognition agreements of conformity assessment procedures have had a distinct and beneficial effect on the costs of compliance'. There is also the argument that the amount of resources and effort dedicated by business in pushing forward the agenda on mutual agreements strongly suggests that the benefits to firms of such agreements are non-negligible. Thus, in the near future a substantial proportion of trade from those countries in the bottom tier of the pyramid, all bar Taiwan have either negotiated or are negotiating an MRA with the EU, could enter the EU market more easily than goods from other countries in higher tiers.

Interestingly, a much smaller share of EU exports to the US comprises products covered by the MRA; around 7 per cent in 1998. The table also shows that these products are also an important part of the exports to the EU of a number of other countries. Over one sixth of Taiwanese exports to the EU in 1998 were of products covered by the EU-US MRA. These products also being important in the exports of Korea and Japan to the EU. Thus, if the MRA has a significant impact on the costs of US exporters of these products it could have important implications for the exports of other suppliers of the EU market.

The EU and the US have put forward the MRA as being consistent with WTO obligations. This is true in the sense that the Agreement on Technical Barriers to Trade calls upon members 'to be willing to enter into negotiations for the conclusion of agreements for the mutual recognition of results of each other's conformity assessment procedures'. This appears to grant MRAs an exception to the most favoured nation (MFN) obligation of the WTO. Mathis (1998) argues that this exception could be challenged if a MRA imposes origin rules which preclude the possibility of third-country goods to be accepted in one party to the MRA after conformity assessment in the partner. However, given that given that MRAs reduce the costs of market access to the signatories of the agreement but not for excluded countries, they are preferential, violate the principle of non-discrimination which underlies the WTO and are potentially trade diverting. MRAs which contain rules of origin merely exacerbate the degree of discrimination.[12]

[11] The extent to which these cost reductions are actually realised will depend upon the way that the MRA is implemented on both sides of the Atlantic. Initial impressions are that efforts regarding implementation are negligible relative to the energy devoted to negotiation.

[12] Origin rules are present in the EU-Switzerland MRA. Baldwin (2000) quotes sources suggesting that the EU sought to have rules of origin in the MRA with the US. The US, however, resisted not on the grounds of discrimination against other trading countries but on the grounds of the practicality of identifying the country of origin for sophisticated industrial products.

The European Council has specified a list of priority countries with whom negotiations on MRAs should be conducted. The list comprises the US, Canada, Japan, Australia, New Zealand, Hong Kong, Israel, Singapore, Philippines, China, South Africa, Malaysia, Indonesia, Thailand and Turkey. Recently, the EU has signed Protocols on European Conformity Assessment with a number of Central and Eastern European countries as part of the process of accession to the EU. Note that all South American countries and all bar one African country are excluded from this list. In terms of the spirit of the GATT/WTO and the principle of most favoured nation treatment it would seem appropriate that the EU not preclude a MRA with any trading partner. In fact the EU should be more open in stating that any country which can demonstrate appropriate testing systems should be able the negotiate a MRA with the EU. This could encourage companies which provide testing and conformity assessment procedures in EU or other OECD countries to invest in countries which do not have strong facilities in this field.

The Commission has raised the possibility that the range of bilateral MRAs that the EU may shortly have could be made plurilateral. Indeed it has been suggested that EU bilateral MRAs could be networked with those of other countries or trading blocs (APEC has made some progress on conformity assessment) to create a plurilateral framework. However, this enhances the danger that countries in Africa, Asia and South America, which are denied the possibility of negotiating such agreements, will be increasingly marginalised.

The agenda of mutual recognition between the EU and the US is being pushed forward, under the influence of the TABD. By the end of the year 2000 it is expected that two further agreements will be signed on machine safety equipment and calibration. More generally, these bilateral negotiations offer the scope for mutual recognition agreements on all products covered by the New Approach in the EU as well as a number of Old Approach sectors. Table 5 shows that if mutual recognition agreements were to be negotiated for all existing new approach products then nearly 16 per cent of EU imports from, and 12 per cent of exports to, the US would in total be affected.

At present integration between the EU and the US has been confined to the mutual recognition of conformity assessment. There has been no attempt to move towards the mutual recognition of regulations or towards harmonisation of regulations. However, the MRA may be a stepping stone to more adventurous integration in the future. The forces pushing for bilateral agreements on mutual recognition are in general are quite different to those which

typically underlie free trade agreements negotiated by the EU, where, as we argued above, a range factors including foreign policy considerations as well as economic implications are important. A key feature of EU-US relations on this issue has been the dominant role played by business and the lack of the typical political market for protection whereby the Commission has to balance the interests of import-competing firms against those of exporters. Baldwin (2000) suggests that the main losers from the liberalisation of technical barriers to trade are small firms. The removal of factors which cause market fragmentation has a pro-competitive effect that leads to the taking over, merging or exit from the market of the least efficient, usually small, firms. The result is a market structure with fewer, larger more efficient firms.

It is unlikely that large business will be content to stop at mutual recognition agreements. As certain cost raising barriers are removed, such as the duplication of conformity assessment, the impact of remaining technical barriers to trade will become even more apparent. As we mentioned above the increasing importance of international production networks will lead to ever greater demands for the removal of cost raising differences in national regulatory regimes. Indeed, the Seville Declaration, which launched the TABD, states that the goal is to 'ensure that laws and regulations converge wherever possible to allow market forces to accelerate economic growth'. In addition, the increasing importance of multinational firms and the greater role of business in influencing regulatory decisions suggest that there will be forces pushing towards the informal international harmonisation of standards and regulatory barriers. For example, the main industry players often make an important contribution to the setting of standards. If these main players are the same on both sides of the Atlantic then there will be a tendency towards common standards.

Trade In Services

Trade in services has increased in importance in recent years. The key services which are now traded are travel and tourism, transportation services, financial services, including banking and insurance, and professional services, such as accountancy and business consultancy. In the EU around 50 per cent of total trade between members comprises services (Barth (1999)). However, there remain severe restrictions on services trade. Internally, the EU has been much less successful in removing barriers to trade in services than it has in creating a single market for industrial goods. This is suggested by the fact that whilst the share of internal goods trade increased from 28.4 to 31.5 per cent of Union GDP between 1992 and 1997 the share of

traded services increased little over this period. Nevertheless, there are signs of increasing integration from the amount of foreign direct investment in services activities within the Union which has increased more rapidly than overseas investment in other activities (CEC (1999)).

International service transactions can often be distinguished by the direct contact between providers and consumers that needs to take place, although some services, such as international telephone services, can be traded across borders in the same manner as trade in goods. In many cases either the consumer must move to the place of production, as in tourism, or the factors used to produce the service must be located in the country of consumption. The latter can be undertaken through foreign investment to create an overseas commercial presence, as is usually the case in the provision of financial services, or through the temporary movement of workers, for example, in the provision of business services. Thus, liberalisation of services requires not just the removal of barriers to cross-border flows of service products but also the effective elimination of obstacles to foreign direct investment and the movement of workers.

Current EU external trade policy with regard to services reflects both multilateral commitments made under the General Agreement of Trade in Services (GATS) and provisions in bilateral trade agreements. The EU is, however, far from establishing a common commercial trade policy for services. This reflects in part the desires of member states to maintain a degree of national discretion in setting policy for certain services, for example, in providing access to national airports to foreign airlines. It also encapsulates a continuing evolution in the EU as to extent of the Unions competence to conclude international agreements in services. The Union's competence to conclude international agreements can come from two sources[13]: express provisions in the treaty, for example, Article 133 provides for the Union to negotiate tariff agreements; and the jurisprudence of the European Court of Justice. With regard to the latter the Court has ruled that other provisions of the Treaty and measures adopted within those provisions may confer external competence. The existence of "internal rules" bestows external competence to the Union. Hence there is a relationship between the exercise of internal competence and that of external competence.

Although it is not disputed that the EU has exclusive competence for the Common Commercial Policy, there is contention over the exact scope of the Common Commercial

[13] See House of Lords (2000) Appendix 4

Policy. For trade in goods it is now clear, after the creation of the Single Market and the removal of the national quantitative restrictions, that the EU has exclusive competence to conclude international agreements and that because of the primacy of Union laws over domestic law there is little scope for national policy discretion.[14] For trade in services the situation is less clear. In the face of the increase in the number and range of issues on the negotiating table under the Uruguay Round, the Court of Justice was asked to decide the extent of the Common Commercial Policy. In the meantime a compromise was reached between the Commission and the Member States on defining common positions. In effect the Commission negotiated on behalf of all member states who then entered country specific reservations on particular services and market access issues. With regard to services, the Court, consistent with the GATS, identified four modes of supply, cross-border supply, consumption, commercial presence and movement of persons, and concluded that the Common Commercial Policy applies only to the first method.

The Court did rule that existing "internal rules" with regard to transport and intellectual property did convey limited external competence in these areas. For example, counterfeit goods fall under external EU competence but other aspects of intellectual property rights are subject to concurrent competence. However, the Amsterdam Treaty inserted a new provision (Article 133 (5)) that exclusive EU competence could be extended to services and intellectual property subject to consultation with the European Parliament and a unanimous decision in the Council. In the absence of such an agreement it is likely that Union competence will increase as more "internal rules" are adopted in these areas (sometimes by qualified majority voting).

The GATS was the first multilateral agreement on trade in services. However, whilst bringing some extra discipline to the area of trade in services it is generally accepted that this first step towards multilateral liberalisation did not generate substantial market opening (Hoekman (1995)). The agreement did however, start a process by which effective liberalisation may be provided in future negotiations. The contracting parties accepted two key sets of obligations under the GATS. Firstly, a set of general concepts and rules, of which unconditional MFN treatment is the principal obligation, which apply to measures affecting trade in all service sectors, except those explicitly mentioned in the Annex to the agreement (the 'negative list'). In principle, the exemptions may not last longer than ten years, and will be subject to

[14] There is one area, export credit agencies, where national competence has not been relinquished.

negotiation in future rounds. Secondly, there are specific commitments on market access and national treatment regarding listed sectors and sub-sectors (the 'positive list'), although particular qualifications, limitations and conditions can be maintained for each of the itemised sectors and sub-sectors. It is obstacles to market access which are prohibited with the following six measures being explicitly identified: limitations on the number of suppliers; ceilings on the value of transactions or assets; restrictions on output; limitations on employment or on the number of persons supplying a service; constraints on the type of legal entity via which a service is provided; and ceilings on foreign share holdings or on the value of foreign investment.

It is very difficult to ascertain the extent and magnitude of trade barriers in services and the extent to which these will be alleviated by the GATS. There is however, little doubt that for many service products constraints on trade remain considerable. Analysis of the commitments made under the GATS suggests that in many service sectors substantial violations of national treatment and significant restrictions on market access remain. Hoekman and Primo Braga (1997) calculate that commitments made by high-income countries represent just under half of the total commitments that could have been made. Of these commitments only one quarter entail the removal of all restrictions on market access and national treatment. The degree of liberalisation by low-income countries is substantially less. One important feature of the GATS is the commitment to progressive liberalisation in the form of 'successive rounds of negotiations' to reduce barriers to trade in services and provide effective market access.

The first set of mandated negotiations commenced in 2000. There are a number of reasons why the EU will be keen to achieve a successful outcome form these negotiations. The continued presence of substantial barriers to trade in services together with low tariffs and non-tariff barriers on industrial products, leads to the possibility that effective rates of protection for these industrial goods may be negative if the prices of intermediate service inputs are substantially higher than world market prices. Thus, pressure from manufacturing industries for low cost service inputs to enhance ability to compete on international markets is likely to keep the issue of services trade liberalisation high on the EU agenda. In addition, the EU perceives that in certain service sectors, such as financial services and telecommunications services, EU countries have a comparative advantage, which has been enhanced by the liberalisation of internal EU trade. Thus, standard mercantilist concerns will generate pressures for increasing access to overseas markets.

The issue of services also arises in EU bilateral free trade agreements, although coverage and the extent of liberalisation vary greatly across the different agreements. Similar to the rules governing preferential trade in goods, the GATS (Art. V) requires that bilateral trade agreements have 'substantial sectoral coverage' and that they eliminate 'substantially all discrimination'. The GATS also requires that overall barriers to services trade of countries not included in the preferential agreement should not rise for each sector and sub-sector.

Liberalisation tends to be much deeper in agreements with countries who are prospective members of the EU, such as the Central and Eastern European countries, although the recent agreement with Mexico offers the prospect of far reaching liberalisation. Within three years of this agreement entering into force a joint council 'shall adopt a decision providing for the elimination of substantially all remaining discrimination in the sectors and modes of supply covered'. Nevertheless, this decision can be delayed until after the mandated negotiations at the WTO for further multilateral liberalisation under the GATS. In contrast the agreements with Tunisia and South Africa, for example, contain little substance on services and rights of establishment beyond a restatement of existing commitments under the GATS.

Conclusions: The Future of EU External Commercial Policies

EU trade policies will continue to be determined by different and sometimes conflicting factors. Here we try and identify the key issues and influences and how they vary according to relations with different regions of the world. Thus, in relations with North America and Asia the strong influence of large corporate interests will push forward an agenda on removing regulatory barriers to trade.

In Europe strategic and foreign policy concerns are paramount. The key remaining commercial policy dilemmas facing the EU are in its relations with countries in the Balkans and with the European CIS countries. Their location and the similarities of their industrial and trade structures with the acceding countries in Central and Eastern Europe, mean that these countries are likely to be economically affected by the next enlargement of the EU.[15] Given their political instability and geopolitical importance, they will be priority cases in terms of EU foreign policy. However, the implementation of the standard EU foreign policy response of a free trade area is complicated in these countries by problems of judicial and

[15] For example, a very large proportion of Moldovan exports to the EU comprises apple juice. Poland is also a major producer of apple juice. After accession Polish producers will enjoy a more than 20 per cent margin of preference in the EU market relative to Moldovan producers. It is most likely that the accession of Poland will lead to trade diversion away from Moldovan producers.

administrative capacity to implement the increasingly onerous obligations that the EU seeks in such agreements. The EU will also have to offer unprecedented access in agricultural products if FTAs with these countries are to be consistent with the accepted requirements of the WTO and substantial trade diversion for certain agricultural products from the next enlargement is to be avoided.

In North Africa and the Mediterranean region trade relations will be determined by the extent to which free trade agreements, such as those with Tunisia and Morocco, can be implemented with other countries in the region. Again, this area is important from the foreign policy context of the EU. Trade relations with African and Caribbean countries will continue to be determined in a development context with energies over the next ten years being concentrated upon implementing a system of reciprocal bilateral free trade agreements as envisaged under the new Lomé agreement. In both of these cases the hegemonic role of the EU is a dominant factor.

The sphere of influence of the EU is weaker in Latin America and there is little possibility of the EU negotiating free trade agreements which exclude sensitive agricultural products from tariff liberalisation. Thus, the extension of EU preferential treatment into Central and South America will be constrained by the extent to which the CAP is further reformed. Reform of the CAP is also a crucial issue with regard to further multilateral trade negotiations. Without genuine market opening by the EU for key agricultural products, such as beef, milk products and cereals, there is little prospect of success in the ongoing negotiations in Geneva on agricultural trade liberalisation or in a wider trade round if that were to be launched.

Trade relations with North America and Asia will reflect the growing importance of large corporate interests in pushing forward their agenda on trade facilitation. The process with the US and Canada is much more advanced as reflected by the mutual recognition agreements. In addition formal relations are clearly defined on a bilateral basis with these countries and the TABD has proved to be effective in influencing policy priorities. With regard to Asia the principal forum with the EU is the Asia-Europe Meeting (ASEM) in which dialogue takes place between the EU and seven members of ASEAN (Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam) together with China, South Korea and Japan. Again, corporate interests are involved via the Asia Europe Business Forum but progress on addressing technical and other regulatory barriers to trade is likely to be much slower than in transatlantic relations.

Thus, EU trade policy is becoming increasingly diverse whilst covering a broader range of issues and a wider set of bilateral relations. The forces framing trade policies are varied and different frameworks are evolving for different issues and for trade with different regions and countries. Given the absolute magnitude of the trade flows involved, increasing importance is being given to transatlantic relations and the removal of technical barriers to trade, which are of particular interest to large multinational corporations seeking to most efficiently operate global networks of production facilities.

The trend towards ever increasing flows of foreign direct investment suggests that the role of multinationals in influencing trade policy developments will continue to be enhanced. This is leading to a trade policy process which is necessarily bilateral and often discriminatory and one which is selective in terms of product and sector coverage. These are issues which have typically been of concern to the WTO in assessing the impact of preferential trade agreements on third countries. Given the current lack of clear WTO disciplines in preferential trade facilitation it is important that the EU consider carefully the impact of this trend in bilateral trade policies on trade in general. This requires an assessment not just of the implications for current trade flows but whether such agreements may affect the ability of developing countries to enter the markets for particular goods as they climb the ladder of technical sophistication in the array of goods that they produce.

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Table 1 The Structure of Extra-EU Imports of Industrial Products and Import Tariffs

	Imports	Share	Weighted Average Tariff	Weighted Average Tariff	Share of Imports with t=0		Share of Imports with t>10	
	ECU 000		1997	2005	1997	2005	1997	2005
Pharmaceuticals	7870030	1.71	0.00	0.00	0.00	100.00	0.00	0.00
Inorganic, Organic Chemicals and Fertilizers	23647614	5.13	5.41	4.44	21.95	25.77	7.82	0.02
Other Chemicals	13476458	2.93	5.80	4.66	2.30	23.17	1.88	0.11
Plastics	19214501	4.17	6.63	5.12	11.93	12.90	25.74	0.00
Raw Hides and Skins	3177045	0.69	1.83	1.69	58.10	58.14	0.00	0.00
Wood	10955426	2.38	2.14	1.41	51.06	73.28	0.00	0.00
Wood Pulp	11935585	2.59	3.18	0.00	46.34	49.44	0.00	0.00
Textiles	15839614	3.44	6.32	4.85	21.34	22.59	20.93	0.04
Clothing	39105933	8.49	12.76	11.62	0.18	0.18	94.18	92.41
Footwear etc	8299742	1.80	9.62	8.93	0.22	0.22	28.62	28.62
Stone, Cement etc	2801607	0.61	4.96	4.11	2.38	20.78	11.20	11.20
Iron and Steel	16492414	3.58	3.56	1.37	9.54	55.88	0.00	0.00
Base Metals	23273435	5.05	3.65	3.24	34.26	36.15	1.80	0.00
Non-electrical Machinery	94852731	20.59	2.61	1.51	7.12	38.79	0.01	0.00
Electrical Machinery	75789835	16.45	5.06	4.07	1.33	13.90	7.64	6.49
Motor Vehicles	30414253	6.60	8.47	7.97	0.00	2.56	8.15	3.13
Other Transport Equipment	18655524	4.05	0.59	0.43	82.24	82.87	0.01	0.00
Precision Instruments	27421251	5.95	3.90	2.60	5.34	30.27	0.00	0.00
Miscellaneous Manufactures	17489947	3.80	3.73	2.02	0.34	42.14	0.34	0.00
Total Industrial Products	460712945		5.01	3.93	12.69	29.62	12.73	9.71

Table 2 The Structure of EU Imports of Industrial Products from the US and Import Tariffs

	Imports	Share	Weighted Average Tariff	Weighted Average Tariff	Share of Imports with t=0		Share of Imports with t>10	
	ECU 000		1997	2005	1997	2005	1997	2005
Pharmaceuticals	3261537	2,95	0.00	0.00	0.00	100.00	0.00	0.00
Inorganic, Organic Chemicals and Fertilizers	6283667	5,68	4.84	4.12	28.43	31.47	4.87	0.05
Other Chemicals	5568076	5,03	5.38	4.27	1.82	28.23	0.86	0.15
Plastics	4996221	4,52	7.01	5.28	12.11	13.80	32.14	0.00
Raw Hides and Skins	379122	0,34	2.79	2.33	39.37	43.87	2.38	0.00
Wood	1542466	1,39	2.14	1.58	56.05	69.63	0.00	0.00
Wood Pulp	3539149	3,20	2.41	0.00	55.96	60.78	0.00	0.00
Textiles	1439430	1,30	6.94	5.43	8.92	8.94	19.36	0.01
Clothing	783375	0,71	11.54	10.45	3.92	3.92	81.22	73.18
Footwear etc	152855	0,14	7.56	6.98	0.51	0.51	10.62	10.62
Stone, Cement etc	920772	0,83	4.37	3.47	1.15	19.13	2.90	2.90
Iron and Steel	1416315	1,28	3.92	1.94	4.67	38.99	0.00	0.00
Base Metals	2533101	2,29	4.61	3.98	9.28	12.72	0.40	0.00
Non-electrical Machinery	33273890	30,08	2.39	1.49	15.79	38.27	0.00	0.00
Electrical Machinery	18415024	16,65	4.28	3.20	2.67	18.74	1.21	0.76
Motor Vehicles	4694891	4,24	7.22	6.35	0.00	8.48	3.15	2.73
Other Transport Equipment	9031319	8,17	0.86	0.65	75.69	75.89	0.02	0.00
Precision Instruments	10770911	9,74	3.24	1.62	7.83	47.98	0.00	0.00
Miscellaneous Manufactures	1604603	1,45	3.44	1.88	2.88	36.68	0.06	0.00
Total Industrial Products	1,11E+08		3.53	2.50	17.57	37.33	2.99	0.81

Table 3 The Structure of EU Imports of Industrial Products from China and Import Tariffs

	Imports	Share	Weighted Average Tariff	Weighted Average Tariff	Share of Imports with t=0		Share of Imports with t>10	
	ECU 000		1997	2005	1997	2005	1997	2005
Pharmaceuticals	89876	0.26	0.00	0.00	0.00	100.00	0.00	0.00
Inorganic, Organic Chemicals and Fertilizers	1238287	3.55	5.44	4.66	19.42	21.30	6.00	0.00
Other Chemicals	504081	1.44	5.40	4.48	7.41	22.66	0.92	0.13
Plastics	1508003	4.32	6.91	6.09	1.56	2.05	4.08	0.00
Raw Hides and Skins	2523980	7.23	5.40	4.51	0.49	1.03	13.83	0.00
Wood	449594	1.29	3.31	1.72	0.89	53.52	0.00	0.00
Wood Pulp	281929	0.81	6.15	0.00	19.88	20.73	0.00	0.00
Textiles	1058811	3.03	6.20	4.92	20.40	29.12	22.99	0.00
Clothing	5639833	16.15	12.56	11.49	0.02	0.02	90.20	89.88
Footwear etc	2142287	6.13	10.09	9.14	0.55	0.55	34.49	34.49
Stone, Cement etc	503909	1.44	6.45	5.61	1.70	7.19	17.28	17.28
Iron and Steel	987910	2.83	4.02	2.81	0.12	9.63	0.00	0.00
Base Metals	1116828	3.20	5.00	3.84	13.03	16.05	16.75	0.00
Non-electrical Machinery	3440671	9.85	2.80	1.39	3.62	58.28	0.06	0.00
Electrical Machinery	6129641	17.55	5.43	4.36	3.86	12.88	16.48	12.90
Motor Vehicles	217889	0.62	4.87	3.81	0.00	1.32	0.57	0.51
Other Transport Equipment	148468	0.43	0.36	0.27	88.96	89.79	0.00	0.00
Precision Instruments	1872625	5.36	4.87	3.93	0.36	6.44	0.00	0.00
Miscellaneous Manufactures	5070191	14.52	4.57	2.97	0.00	24.13	0.41	0.00
Total Industrial Products	34924813		6.44	5.26	3.60	16.41	22.53	19.15

Table 4 The Importance of Industrial Products & Technical Regulations in EU Trade				
	Share of Industrial Products		Share of Products Subject to EU Technical Regulations	
	EU Imports	EU Exports	EU Imports	EU Exports
INTRA-EUR15	85,54	86,10	70,77	71,30
EXTRA-EUR15	80,66	90,86	60,77	77,29
EFTA (4)	77,23	90,55	65,07	68,71
SWITZERLAND	96,86	89,93	45,84	72,71
ACP (70)	40,21	82,29	67,46	68,85
TURKEY	83,62	95,24	65,75	78,09
CEEC10	91,25	92,26	58,02	72,55
Balkans	91,16	84,77	39,50	70,63
CIS	57,19	81,62	52,98	71,10
MED	41,60	85,57	61,56	72,74
SOUTH AFRICA	68,28	94,58	33,20	77,56
UNITED STATES	92,29	93,09	71,64	79,48
CANADA	78,01	89,92	61,13	80,48
MEXICO	71,93	94,51	65,63	79,29
CACM	21,48	91,24	9,26	87,69
Andean	24,71	89,67	28,59	81,50
Mercosur	38,83	93,63	37,74	79,36
CHILE	62,60	95,44	22,13	74,86
Indian SC	88,10	96,05	54,66	82,64
New Nics	85,68	94,41	42,95	85,91
CHINA	94,88	96,18	46,92	85,12
NICS	99,02	94,05	53,64	78,75
JAPAN	99,70	87,39	75,90	69,91
ASNZ	56,29	94,78	41,84	81,16

Table 5. Share of Trade in Products Covered by EU-US MRA and by All New Approach Directives

Products under US-EU MRA except GMP		Products under US-EU MRA except GMP		All products under NA		All products under NA	
EU Imports		EU Exports		EU Imports		EU Exports	
TURKEY	1.50	TURKEY	5.43	TURKEY	2.66	TURKEY	15.67
POLAND	3.38	POLAND	5.89	POLAND	5.21	POLAND	14.14
CZECH REP.	7.00	CZECH REP.	8.01	CZECH REP.	11.04	CZECH REP.	14.17
SLOVAKIA	2.73	SLOVAKIA	8.35	SLOVAKIA	5.01	SLOVAKIA	14.57
HUNGARY	6.11	HUNGARY	8.06	HUNGARY	7.72	HUNGARY	12.72
ROMANIA	0.77	ROMANIA	5.63	ROMANIA	2.04	ROMANIA	14.68
BULGARIA	1.53	BULGARIA	4.52	BULGARIA	2.86	BULGARIA	9.73
UKRAINE	0.27	UKRAINE	4.89	UKRAINE	0.69	UKRAINE	11.29
RUSSIA	0.16	RUSSIA	7.72	RUSSIA	0.36	RUSSIA	14.11
US	12.62	US	6.88	US	15.71	US	12.08
CANADA	5.68	CANADA	4.48	CANADA	8.10	CANADA	10.61
S.KOREA	14.22	S.KOREA	6.23	S.KOREA	15.37	S.KOREA	15.62
JAPAN	9.99	JAPAN	6.80	JAPAN	15.06	JAPAN	11.13
TAIWAN	17.74	TAIWAN	10.47	TAIWAN	20.76	TAIWAN	18.69
INTEU12	5.15	INTEU12	5.62	INTEU12	7.76	INTEU12	8.53
EXTEU12	7.45	EXTEU12	6.84	EXTEU12	10.03	EXTEU12	12.80

Figure 1. The Geographical Structure of EU15 Imports, 1965-1998

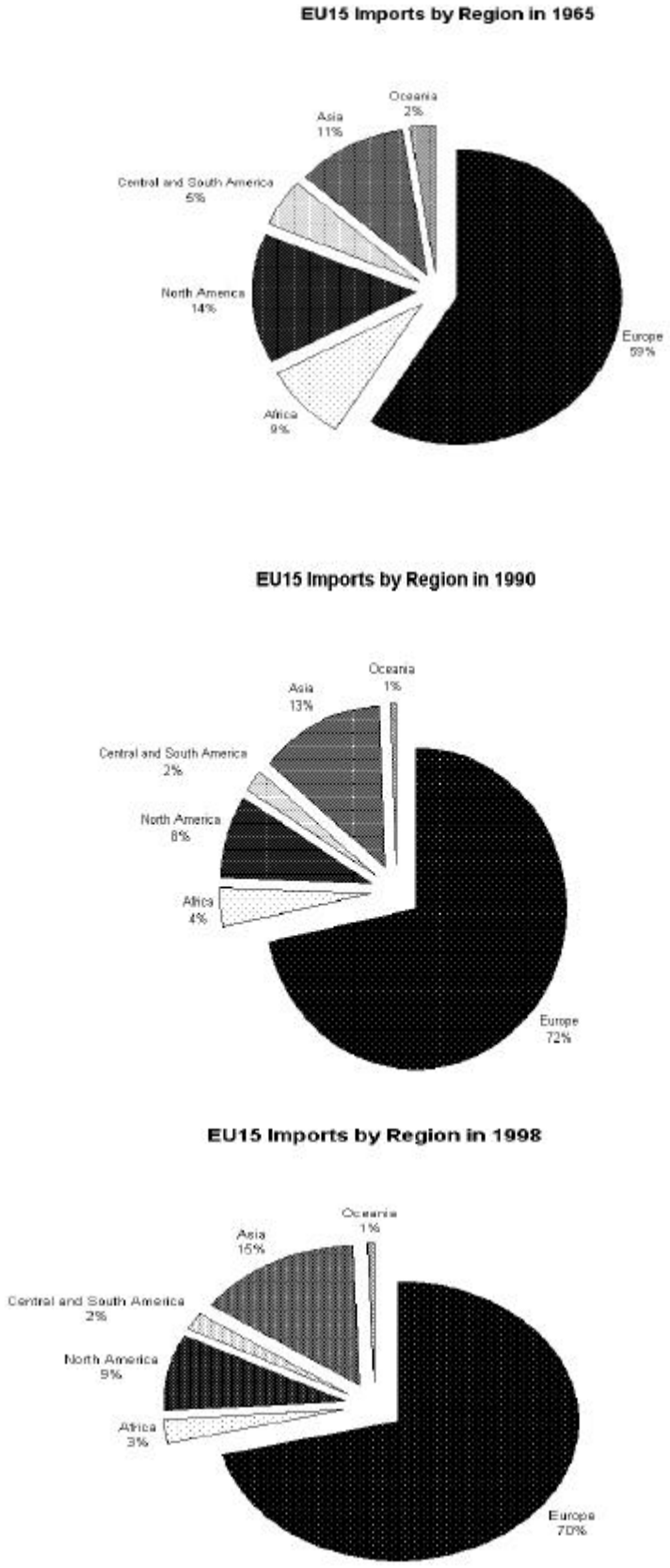


Figure 2. The Geographical Structure of EU15 Exports, 1965-1998

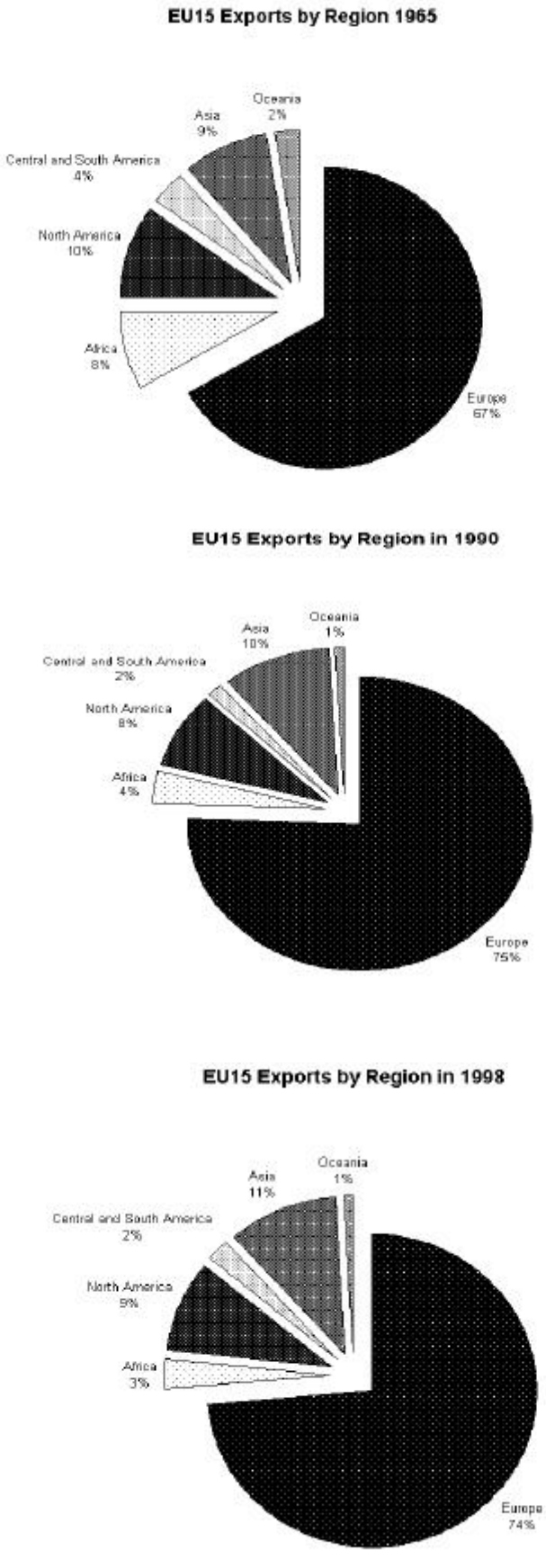
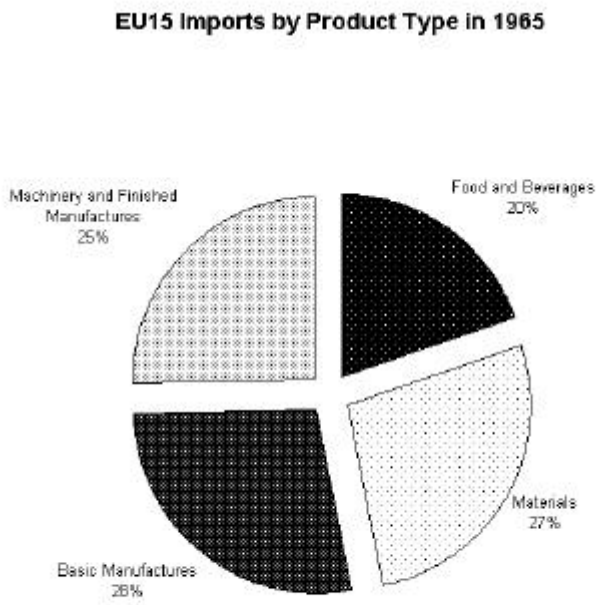


Figure 3. The Commodity Structure of EU15 Imports, 1965 and 1998



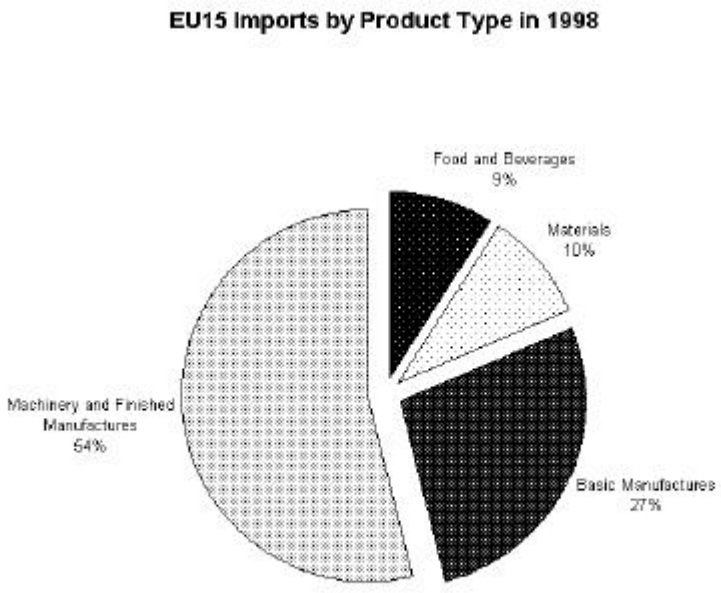
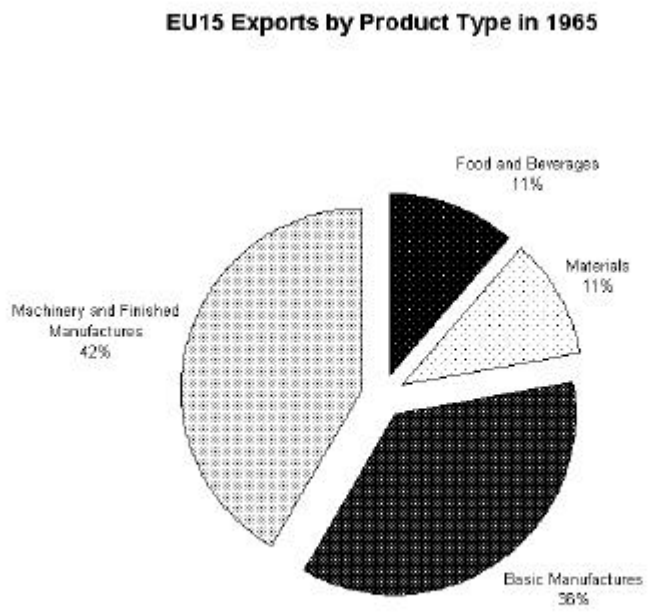


Figure 4. The Commodity Structure of EU15 Exports, 1965 and 1998



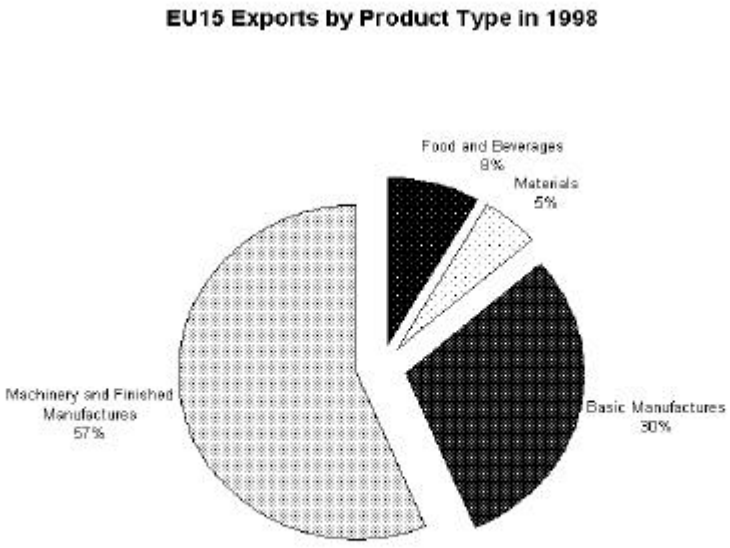
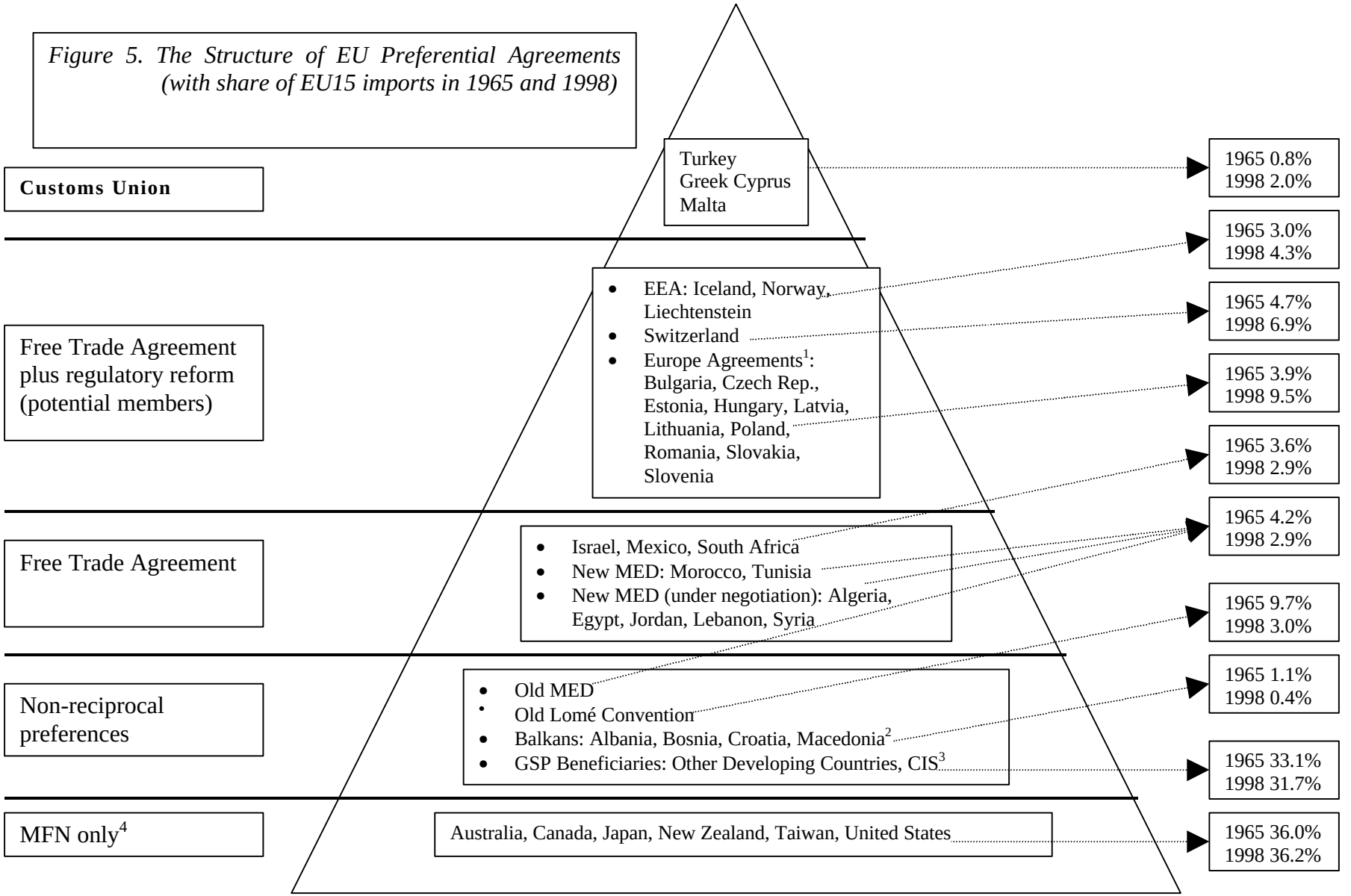


Figure 5. The Structure of EU Preferential Agreements (with share of EU15 imports in 1965 and 1998)



Notes: 1. The Data for 1965 do not include Estonia, Latvia and Lithuania. 2. The data for the Balkans includes data for Yugoslavia (Serbia and Montenegro), but all trade preferences are currently suspended. 3. The data for 1965 include Estonia, Latvia and Lithuania. 4. The EU has signed an MRA with the US and is negotiating similar agreements with other MFN partners. MRAs form part of the customs union with Turkey. This issue is discussed more fully in the text.