

COMMISSION OF THE EUROPEAN COMMUNITIES

SEC(95) 322 final

Brussels, 08.03.1995

COMMUNICATION FROM THE COMMISSION

FREE TRADE AREAS : AN APPRAISAL

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Summary and Conclusions

Free Trade Areas in various forms and guises are proliferating world-wide. The European Union has concluded and is currently negotiating a number of preferential/free trade agreements.

This paper examines FTAs in the light of 2 key factors :

- (a) The new obligations and the reinforcement of existing obligations undertaken by the Union in the GATT/WTO have important implications for FTAs. An FTA must cover substantially all trade. The exclusion of a major component of bilateral trade would result in the agreement being in contravention of WTO rules. The WTO's substantive obligations are, furthermore, reinforced by strengthened procedural requirements. The possibility of panel litigation against FTAs will require all WTO members to respect scrupulously these obligations.
- (b) Economic gains arise out of FTAs from, in the shorter run, trade creation and in the longer term dynamic effects arising from a larger market, greater potential investment and improved competitiveness. Conveying a clear political message to a country regarding its importance for the Union also remains a motivation for proposing an FTA. The nature and magnitude of the benefits will depend upon the individual FTA and upon the place of that agreement in the EU's overall external relations policy.

Conclusions

1. The EU has consistently favoured open regionalism. The Union, as a matter of principle, welcomes all FTAs which respect WTO rules.
2. Possible FTAs, whether concluded by the EU or by others, must be assessed in the light of their impact on EU interests and international obligations.
3. Decisions to negotiate an FTA need to be made on the basis of a case by case analysis of the mutual benefits for the EU and its partners. This has to be done in full awareness of the new WTO conditions (coverage, full reciprocity, transition arrangements, the possibility of referral of such agreements to WTO dispute settlement, etc.) and of the overall costs and benefits. These considerations also apply to FTAs currently being negotiated.
4. Such an analysis should take into account not only direct costs and benefits but also wider strategic considerations of an economic and political nature. It remains important, for the conduct of the subsequent negotiation as well as for other internal Union policies, for a serious analysis to be made of the economic costs and benefits involved and of the implications for our relations with other partners. They can then be weighed in the balance with the other relevant considerations.
5. Where we envisage regional or bilateral liberalisation, we should satisfy ourselves before proposing a negotiation that an ambitious FTA, covering the full range of obstacles to trade and meeting fully our international obligations, is a politically realistic objective. Otherwise, the EU risks finding itself bogged down in long-drawn and, perhaps ultimately fruitless, negotiations with third countries, with negative political consequences.

I. Current state of play.

1. A Free Trade Area is created when a group of two or more customs territories eliminate the duties and other broader restrictions on trade between them in products originating in those customs territories, in respect of "substantially all the trade". This definition, drawn from GATT, is the subject of widespread interpretative statements, some of them finalised as recently as last year's Marrakech agreement. The key element in an FTA is tariff elimination. As the definition makes clear, FTAs may include tariff elimination and other forms of economic deregulation. Equally, agreements to increase trade opportunities may include economic co-operation measures but not include tariff elimination, and so not be FTAs. For the purposes of this paper, FTAs are defined as all agreements which include tariff elimination provisions.
2. The European Union currently has concluded various types of preferential agreements which incorporate a tariff elimination component. These include agreements with the Baltics, the (residual) EEA, the CEECs, Israel, Switzerland, Cyprus, Malta, the Faroe Islands, San Marino and Andorra, the latter two being Custom Unions. Non reciprocal agreements exist with the Maghreb and Mashreq countries and the signatories of the Lomé convention. (see Table III in annex).
3. At the same time, the Union is negotiating new agreements with Morocco and Tunisia, while talks with the Gulf Co-operation Council on a FTA are still open. With regards to Turkey, negotiations on the implementation of the Customs Union are currently underway. The partnership agreement with Russia and the Ukraine provide for the possibility of a FTA when the agreement is reviewed in 1998. Similar provisions are likely to be included in some, at least, of the agreements currently being negotiated with the NIS.
4. The Council has before it Commission communications concerning bilateral liberalisation in the Mediterranean, with MERCOSUR and with Mexico. The Commission must shortly propose to the Council ideas for developing the bilateral relationship with South Africa.
5. The Union is not alone in undertaking such initiatives. Indeed, there is a proliferation of such regional agreements, proposed or actual, across the world. For example, the Australia-New Zealand Closer Economic Relations Trade Area (ANZCERTA) and the MERCOSUR Customs Union are in operation, the North American Free Trade Area (NAFTA) is now a reality, while ASEAN, the Group of Three (see Table IV in

annex for membership and coverage), have all set themselves the target of tariff-free trade, with timetables of varying degrees of ambition. Though there are important differences in the interpretation of the initiative, leaders of the APEC member economies agreed in Bogor last November to establish "free and open trade and investment" in the Asia-Pacific area. More recently, in December, leaders of 34 of the 35 countries of the Western Hemisphere agreed in Miami to create the Free Trade Area of the Americas (FTAA) for which negotiations should be concluded no later than 2005. Finally, the Canadian Prime Minister has suggested that the EU consider the idea of trans-Atlantic free trade, although USTR Kantor has reacted coolly to the idea.

II. FTAs in the WTO

1. The new obligations in the GATT/WTO have important implications for FTAs, whether concluded by the Union or by others. This requires increased vigilance by the Commission, not least to ensure that our trading partners respect WTO rules as we do.
2. To date, the free trade agreements concluded by the Union have been restricted in terms of product coverage. In particular, they have generally excluded all or most agricultural trade. The GATT examination of EU agreements in terms of both product coverage and other aspects of GATT conformity, notably non-reciprocity, has not in practice constrained our room for manoeuvre.
3. The Uruguay Round Understanding on the Interpretation of Article XXIV of the GATT clarifies further the conditions under which FTAs may be concluded and imposes additional obligations on WTO members. The exclusion of a major component of bilateral trade would result in the agreement being in contravention of WTO rules¹. Furthermore, the Understanding specifies that the transition period envisaged by the parties to such an agreement should exceed ten years only in exceptional circumstances. In addition an FTA once fully implemented should result in reciprocal and symmetrical trade liberalisation. FTAs must be notified for scrutiny without delay and periodic reports have to be given by the parties involved on the functioning of the agreement. Differences between WTO members concerning an FTA can be referred to WTO dispute settlement, so that in future the constraints of WTO will apply more consistently than in the past. A detailed analysis of the new conditions is to be found in Annex 1 of this paper.

¹ This test is applied to trade in industrial, primary and agricultural goods as a whole.

4. Regarding services, the GATS agreement permits the conclusion of preferential agreements on services, subject to the provisions of Article V. This stipulates that the agreement should have substantial sectoral coverage and should be based on national treatment among the parties involved. The former condition is understood in terms of the number of sectors, volume of trade affected and modes of supply. In order to meet this condition agreements should not exclude a priori any mode of supply. (see Annex 2).
5. It is clearly in our interest that FTAs respect fully these obligations. Others, not least the United States, are also pursuing their own regionalisation strategies with APEC, NAFTA, etc. Any move which would undermine WTO rules on regional initiatives, persistent demands for derogations on transition periods etc. would weaken a set of rules whose respect is in the long term interest of the Union.
6. The spread of FTAs also raises the important question of rules of origin. Rules of origin are an essential element of any FTA and without adequate workable rules it is unlikely that an FTA can succeed. One of the major problems the Union will face is developing rules which take into account its various trading relationships and which are acceptable to its partners. It has already become apparent that the numerous sets of origin rules resulting from the proliferation of trade agreements have made the full exploitation of such agreements by economic operators questionable. Careful consideration needs to be given to the existing approach towards rules of origin in order to ensure that the rules remain workable and that burdens such as compliance costs are kept to an acceptable level.
7. The strategy towards unification of rules of origin in trade between the Community, the CEEC and the EFTA countries, endorsed at Essen, shows that this difficult issue is already being tackled. Following the Uruguay Round, multilateral discussions on common non-preferential rules have begun, but no WTO work programme is yet envisaged for preferential rules.

III Why FTAs?

1. FTAs are economically beneficial, especially where they help the EU to bolster its presence in the faster growing economies of the world, which is our overriding interest. Much attention has been focused on whether regional free trade arrangements are likely to result in trade creation or trade diversion. FTAs are usually trade creating. The statistical evidence shows that the growth of inter-regional trade world-wide over the last decade has been about as strong as that of intra-regional trade. There is considerable agreement among economists that preferential trade agreements between countries forming a "natural trade bloc", i.e. countries with strong reciprocal trade links, are less likely to have detrimental trade diversion effects on global trade, than similar arrangements between countries which are not already close trading partners. (see Annex 3).
2. More recently, this direct economic justification has also been supplemented by strategic considerations regarding the need to reinforce our presence in particular markets and to attenuate the potential threat of others establishing privileged relations with countries which are economically important to us.
3. Political considerations are as important as the potential economic benefits and in some cases may be the primary motivation. FTAs are coming to be seen as an indicator of the strength of our relationship with a country or region. They promote the principle of open regionalism and can generate trade liberalisation that subsequently spreads to the multilateral field. It is also important to be able to deliver the FTA once it is proposed. It would be counterproductive to take FTA initiatives without being reasonably sure that the negotiations can succeed.
4. However, the greater the number of FTAs which are concluded the smaller the economic preference effect. This is why it is necessary to establish EU priorities in the light of an overall vision, although particular arrangements must be defined in a selective way on a case by case basis.
5. Multilateral tariff negotiations have done much to reduce the levels of tariffs world wide. Nevertheless, the level of tariffs in many of our partner countries, particularly the newly industrialised and developing countries, remains high. Tariff averages of 30-40% are not uncommon (EU trade weighted tariff average for all products 4.6%, UNCTAD calculation). It, therefore, can seem obviously in our interest to persuade such countries to enter into FTAs with the Union, enabling us to encourage both tariff elimination and deregulation.

6. While prohibitive tariffs may be the determining factor in EU trade in certain specific products and specific countries, international trade is affected by other influences, many of which may in fact be more important than tariffs. The Union's exports increasingly include services as well as industrial goods and are, in any case, often hindered more by non-tariff barriers, whether intentional or not, than by tariff rates. Regulatory obstacles, subsidies, customs procedures etc. can be crucial in determining the ease with which we can trade with our partners. Equally important, the investment policies of the latter can prevent EU firms from establishing a physical presence in third country markets through foreign direct investment thereby depriving the Union of the trade gains which often accompany FDI. The more economic globalisation proceeds, the more such factors will gain in importance.
7. This analysis also makes clear that FTAs should include provisions for forms of economic co-operation, in the sphere of investment regulation, standards and certification, industry dialogue, administrative practices and so on, if the Union's relations with third countries or regions are to be reinforced in the most effective manner. Failure on our part to engage in this type of wider economic co-operation may well result in important economic regions developing a regulatory framework which will potentially hurt the Union's interests. The example of APEC illustrates this point particularly well. If the countries of East Asia were, as a result of regulatory co-operation within APEC, to align their regulatory systems practices to those of the United States, this would place the EU at a competitive disadvantage, at least to the extent that a large and dynamic part of the world economy developed as a result a system which diverged significantly from that of the Union. Tariff-free trade and trade facilitation are therefore two complementary tools of export enhancement.

IV. Third Country Initiatives

1. The trend towards regional co-operation initiatives is intensifying world-wide. Many, if not all such initiatives include tariff liberalisation, and ultimately tariff elimination, between the actual or emerging groupings. Most go beyond this and envisage the setting up of customs unions and/or regulatory and economic co-operation. The Union supports such initiatives, provided they are in accord with GATT/WTO rules and hence do not undermine the working of the multilateral system. While these initiatives generally seem to comply with multilateral rules, not all have submitted them to GATT. Some contain provisions or have set themselves objectives which cause concern in the Union (e.g. NAFTA: origin rules; APEC: potential harmonisation of telecom and other industrial standards, investment rules

etc.).

2. Enhancing the Union's relations with third countries and regional sub-groups is one way of ensuring that EU approaches to trade liberalisation are consistent with developments on key export markets. The EU has an interest in helping to consolidate independent initiatives such as MERCOSUR. Reinforcing links with ASEAN, for example, or with individual countries of the Asian region, would also help to ensure that Asian regional integration occurs in a way compatible to EU interests. The EU also has an interest in supporting deeper integration in southern Africa, with the full involvement of South Africa.
3. There may however be cases where our trading partners do not at present favour FTAs. The apparent reluctance of many of the East Asian countries to establish free trade even within the region, witness the vacillation over the ASEAN FTA, as well as the cool reception given to the Eminent Persons Group proposals for a target date in the APEC setting, suggests that the alternative forms of economic and regulatory (and political) co-operation being discussed with ASEAN, are likely to be more fruitful. It would also be more effective in countering possible adverse regional developments in the regulatory area.
4. The Copenhagen European Council of June 1993 agreed that the associated countries of Central and Eastern Europe (the countries with whom the EU has concluded Europe Agreements) can accede to the European Union as soon as they meet the conditions of membership. The Europe Agreements will lead to eventual free trade in industrial products between the EU and the CEECs. Most industrial products exported by the CEECs enter duty-free, and all remaining EU protection against sensitive sectors will be removed within two years.
5. The more FTAs the Union concludes in the next few years, the more rapidly the CEEC economies will have to adjust their economies if they are to meet the challenge. In the longer term, it is not clear to what extent the relative tariff preferences enjoyed by the associated countries are important, compared to other factors such as the underlying competitiveness of industry. The situation with respect to agricultural products is more difficult.

V. Future Options

1. The key question is whether, on both the economic and the political fronts the benefits for the Union of duty-free access to deregulated third country markets are greater than the adjustment costs of the EU concessions needed to produce a WTO-compatible FTA.

The Multilateral Option

2. It is in any case in EU interests to pursue sustained multilateral liberalisation. On the trade front the implementation of multilateral liberalisation is simple (no requirements for special origin rules) and flexible (no WTO limit on tariff transition periods). However, further generalised multilateral tariff elimination cannot be for immediate action, but would be a subject for discussion only when it is clear that the UR outcome is being implemented in a satisfactory manner. This will take time.

The FTA option

3. Alongside the multilateral option, we should keep the bilateral option, which, as described in detail in this paper, can contribute over time to the multilateral process, as well as securing immediate gains for EU exporters. The above analysis sets out the considerations which should be the basis for our judgement in each case of the interest of the EU and our partners for bilateral tariff elimination agreements. This judgement must give full weight to the non-tariff as well as the tariff benefits.

Other options

4. Where detailed analysis suggests that tariff elimination in conformity with our WTO obligations is not feasible between the EU and a third country, this does not mean that no form of bilateral economic rapprochement is possible. As this paper underlines, there are other useful bilateral steps that can be taken to ease economic regulations, with the result of increased trade. It may be possible to construct useful bilateral economic packages without tariff elimination, and without breaching the WTO's non-discrimination requirements. Such policies can help pave the way to further bilateral and multilateral liberalisation, as well as being complements to liberalisation, in an FTA proper.

IMPLICATIONS OF ARTICLE XXIV

This note deals with the obligations relating to trade in goods (GATT rules will apply to trade in services but are no less strict, the reverse in fact). The distinction between free trade area (FTA) and customs union will not be drawn at every opportunity but the working party should bear the differences between the two types of agreement in mind, especially as regards methods for fixing the duties applicable to third countries (Art. XXIV:5(c)). Our purpose here is not to review existing agreements or the Commission's draft proposals or services under the GATT/WTO rules, but simply to identify the criteria for assessing the compatibility of FTAs with the multilateral system.

No objections

The existence of regional free trade agreements is compatible with the multilateral system in theory and results in practice in the obligation on FTAs to comply with the procedures and substance of the GATT/WTO. If a free trade agreement or customs union is found to conform to GATT/WTO rules and obligations, no criticism can be made against such an agreement on account of any supposed intention contrary to the spirit of the GATT/WTO (cf. the "hubs and spokes" model, however).

This is not only the current position of the EC, and has been for decades, but it is also actively supported by practically every country and GATT itself (Sutherland speech). More significantly, this interpretation of the role of FTAs is now enshrined in the text of the 'Understanding on the Interpretation of Article XXIV' (second recital), which recognises that "the contribution to the expansion of world trade that may be made by closer integration between the economies of the parties to such agreements".

Provided they conform to GATT/WTO rules

The obligation to conform to GATT/WTO rules cannot be underestimated. True, the review of free trade agreements and customs unions thus far has not resulted on the whole in actual constraints on the countries that implemented them. Nevertheless, despite this degree of flexibility, the EEC has suffered under the system on account of the Lomé Convention which does not include reciprocal preferences. Following the conclusions of the panel on bananas, the Community asked for, and was given at the end of 1994, a derogation (Art. XXV:5) from the MFN clause granting preferential treatment to the ACP products included in Lomé IV. In future, under the WTO, the relative tolerance shown by the Contracting Parties until now is likely to be considerably diminished.

This change of attitude is reflected in the 'Understanding on the Interpretation of Art. XXIV' which deliberately spelt out the criteria which had been unspecified in the text of GATT and at the same time introduced additional obligations.

The rules or scope for action in the WTO

1. According to Article XXIV:8(b) a Free Trade Zone (FTA) is defined as "group of two or more customs territories in which the duties and other restrictive regulations of commerce (...) are eliminated on substantially all the trade between the constituent territories in products originating in such territories". It has always been controversial what constitutes "substantially all the trade". Within GATT Working Parties on FTA's various quantitative thresholds have been mentioned ranging from 80% to 90% of trade between the partners, but the qualitative aspect of the notion has also been stressed; the exclusion of whole sectors, such as agriculture, has been deplored. Working parties have never been able, however, to reach clear conclusions on these questions. The Understanding on the Interpretation of Article XXIV sheds a little additional light on the question, even if it does not cover paragraph 8 of Article XXIV. In a preambular paragraph it states that the contribution of FTA's to the expansion of world trade will be "increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded". At best one could say that it may be taken into account when the multilateral assessment of an FTA under article XXIV:5 (which is interpreted in the Understanding) is made, but it does not go much beyond the statements on qualitative aspects of trade coverage which have been made in Working Parties at earlier occasions"
2. Notification of the decision to enter into a free trade agreement, customs union or interim agreement concluded with a view to establishing either of the former must be "without delay". The agreement or "plan and schedule included in an interim agreement" will be examined by a GATT/WTO working party which may make "recommendations". Where a plan and schedule are not included, the GATT/WTO can ask the parties to provide one. Finally, "the parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations" (Art. XXIV:7(b)). "Provision shall be made for subsequent review of the implementation of the recommendations" (paragraph 10 of the Understanding). In other words, reviews will be more specific and less formal.
3. The "reasonable length of time" allowed for an interim agreement to establish a customs union or FTA is given as ten years except in "exceptional cases" for which a "full explanation" must be provided to the Council of Trade. We already have an example of this in relation to our possible future agreements with Morocco, Tunisia and Egypt (?). The EC must give careful thought to use of the "exception" argument which must only be allowed where clear justification exists.
4. A further obligation is imposed on customs union and FTAs which "shall report periodically on the operation of the relevant agreement" (Understanding, paragraph 11; i.e. biennial reporting). Mr Sutherland also envisaged a "periodic collective monitoring exercise" which "would have the advantage of revealing the simultaneous status of most contracting parties as both third parties and members of agreements, shoring up the collective interest in sustaining the credibility of the multilateral rules" (speech given in Sao Paulo, July 1994).

5. Trade liberalisation must be reciprocal and symmetrical. The end result must be achieved by both partners although the programme may allow longer transitional periods to take account of different levels of development.
6. "Any matters arising from the application of Art. XXIV" may be invoked to initiate dispute settlement proceedings (Understanding, paragraph 12). The dispute settlement system has been strengthened and made automatic, in particular the adoption of a panel report can no longer be blocked by a veto. This provision backs up the instruments described in the preceding points by giving them real teeth.

Should services be covered?

Should an FTA also cover trade in services? The question does not arise in the WTO Agreement, therefore it follows that there is no written obligation to that effect. A free trade agreement covering goods or services alone should be formally acceptable. However, recent history provides no cases of agreements which do not include services in part at least (ANCZERTA, US/CAN, NAFTA, MERCOSUR?, ASEAN, Europe Agreements, co-operation agreements with Russia/Ukraine, etc.) as well as other sectors (investment, etc.) This tallies with the changing basic concept of what constitutes trade today.

In addition to the arguments advanced in the reference document and in meetings, the following point should be borne in mind. The conviction that FTAs are the "building blocks" (rather than the "stumbling blocks") of the multilateral system is based not only on the tariff argument (if tariff concessions have been negotiated at bilateral or regional level, it will not be so difficult to achieve the same level multinationally) but also (perhaps more so) on negotiations in other sectors (standards, public procurement, services). It could be argued that any agreement today amounting merely to an exchange of tariff concessions (even covering all sectors of trade in goods) could not fully constitute a "building block" of the multilateral system.

The Community's interest

- a robust and effective monitoring system, because our trading partners have discovered the advantages of regional agreements and most of the new FTAs will not include the Community amongst their ranks. For the self-same reason, we should be in a position to undertake a far-reaching review of our own free trade agreements and customs unions.

FREE TRADE AREAS AND SERVICES

Should a FTA also cover services?

There is no requirement in the WTO that a free trade area in goods should also cover trade in services. The inclusion of services would reinforce the economic effect of the agreement; however, this has to be done in full conformity with the rules of the GATS.

The GATS agreement envisages that the parties may conclude preferential agreement on services, but only where the conditions laid down in Article V are met, that is that the agreement:

- (a) has substantial sectoral coverage², and
- (b) provides for the absence or elimination of substantially all discrimination, in the sense of article XVII³, between or among the parties, in the sectors covered under subparagraph (a), through:
 - (i) "elimination of existing discriminatory measures, and/or
 - (ii) prohibition of new or more discriminatory measures,
 either at the entry into force of that agreement or on the basis of a reasonable time frame".

The additional conditions under the GATS as compared to those of the GATT will render the conclusion of a preferential agreement covering goods and services difficult. In particular, when the economies of the contracting Parties are at too different a level of development, the exercise requires a real effort by the parties. Equally, eliminating all restrictions to investment from the Community is often a sensitive issue for developing countries. Preferential agreements in services should be avoided, unless economic advantages for both sides are sufficiently strong to overcome these difficulties, and unless problems of prudential regulation can be dealt with.

With the exception of the EEA, the only preferential agreements concluded by the Community covering both goods and services are the Europe agreements. However, the specificity of the central and eastern European countries, both in terms of geography and history, should preclude the use of the Europe agreements as a model for future relationships with other partners. This is most likely true as far as concessions in terms of movement of persons are concerned.

2 This condition is understood in terms of number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the a priori exclusion of any mode of supply.

The modes of supply of a service are the supply:

- (a) from the territory of one Member into the territory of any other Member (cross-border);
- (b) in the territory of one Member to the service consumer of any other Member (consumption abroad);
- (c) by a service supplier of one Member, through commercial presence in the territory of any other Member (commercial presence);
- (d) by a service supplier of one Member, through commercial presence of natural persons of a member in the territory of any other Member (movement of natural persons).

3 National treatment

This was confirmed by the negotiations for association agreements with Mediterranean countries conducted during 1994. These negotiations clearly show that a political decision to conclude a free trade area may not be followed by the necessary concessions for a preferential agreement in services.

In any case, according to European service industries, the approximation of laws and the recognition of qualifications, standards and licensing procedures would be more useful than a preferential agreement.

THE ECONOMIC IMPACT OF TARIFF LIBERALISATION

1. The economic costs and benefits of a FTA for the participants (and the remaining countries outside the FTA) depend very much on the individual circumstances of the trade partners. An assessment of the net impact (short and long term) therefore requires a rather detailed and dynamic economic analysis of the sectoral/product structure of trade and production of the partners involved; in the light of the specific sectors which are covered in the FTA agreement.
2. EU trade is reasonably well diversified in geographic terms (see Fig. I in annex). About a quarter of total EU(15) exports are destined for NAFTA; one fifth is directed towards the Asian Pacific (including Japan); one tenth goes to Russia and the NIS plus the CEECs; a further tenth to the Mediterranean Basin, and 4% to Latin America. The picture for EU(15) imports is essentially the same. Trade with the CEECs and ASEAN has been growing particularly rapidly in recent years, as has trade with NAFTA and MERCOSUR, albeit at a lower rate. On the grounds of geographic distribution of trade, there is no overwhelming argument in favour of concluding an FTA with one or another partner.
3. The EU does, however, have an overriding economic interest in increasing its trade, and its economic presence in general, in the fast growing newly industrialised or industrialising economies while, at the same time, maintaining its position in the mature industrialised countries. An important yardstick for assessing a proposed FTA is the extent to which it contributes to the achievement of this objective. The expected trade creation effects of an FTA are particularly important in this respect, more so than the trade diversion effects, although the latter are not without value if they result in a declining reliance on stagnant or slow-growing markets. In general, one might expect that in view of its relatively low tariff rates, the EU stands a good chance of achieving an improvement in its balance of trade with the FTA partner, particularly if the latter has significantly higher tariffs on products which are of interest to EU exporters. As a general rule trade creation is most likely to occur when the partners in an FTA are major trading partners with similar trade/economic structures.
4. The longer-term dynamic effects of trade liberalising measures are, however, more important than the short term trade effects. To the extent that FTAs create additional trade flows, they will promote world economic growth, with generalised benefits both for the FTA partners and others. Further benefits can arise from the strategic use of FTAs; intended to secure market share in a globalising economy.
5. Various techniques and models exist for forecasting the likely outcome of an FTA, gravity models and general computable equilibrium models being particularly favoured in recent years. Opinions may differ over whether these give better results than a more qualitative assessment based on a careful examination of the specifics associated with a particular FTA proposal, in any event it is always reassuring if the results of both qualitative and quantitative analysis coincide.

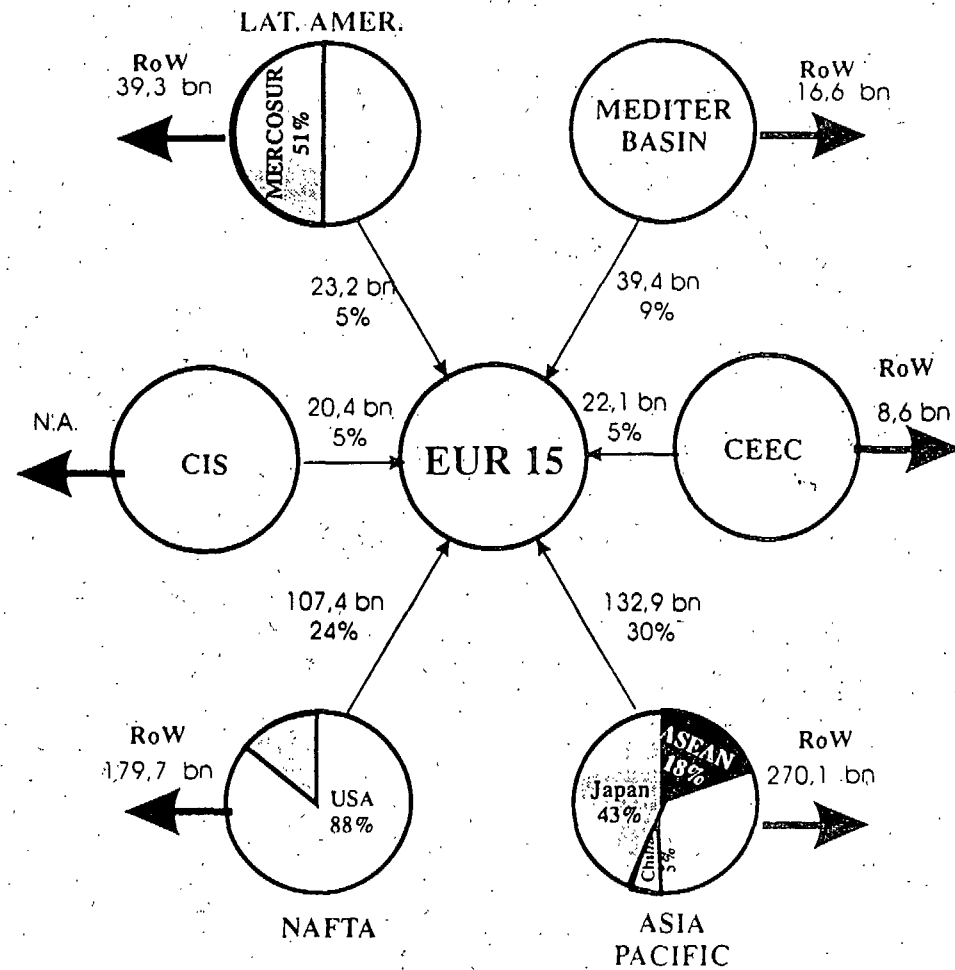
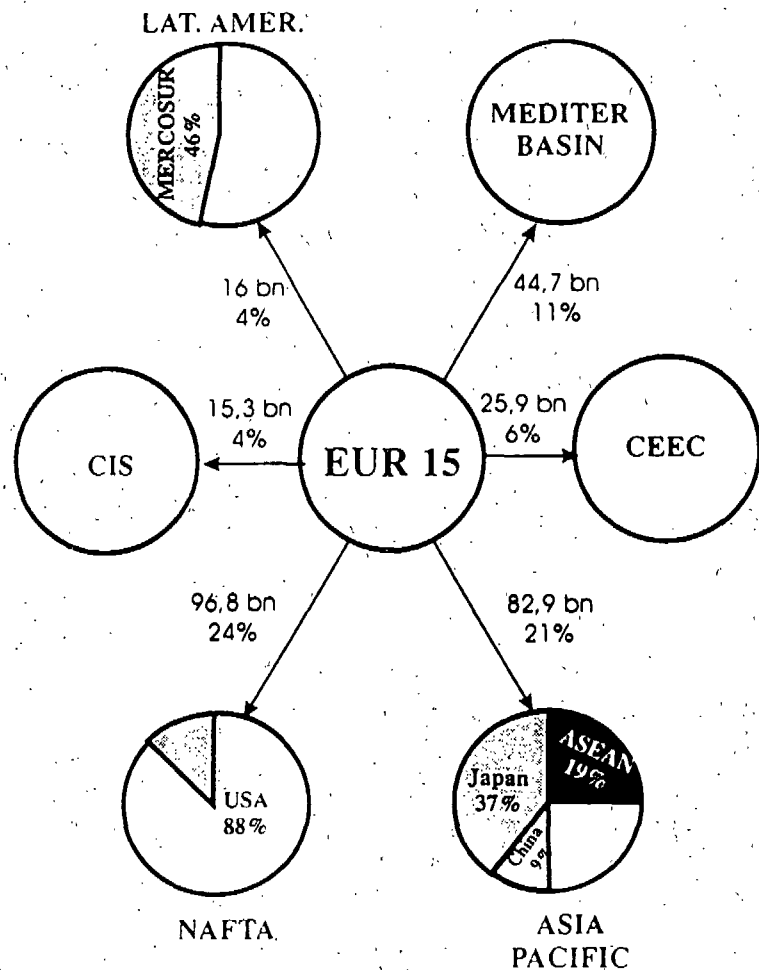
6. The argument that the EU, with its relatively low tariff rates stands to gain directly from an FTA with countries or regions with relatively higher tariff rates applies principally to industrial products. The question is much more problematic for agricultural products, where, even after the reductions agreed in the Uruguay Round, the Union will maintain high levels of protection. For example, tariffication of our existing system with respect to agricultural products will, it is estimated, result in tariff rates of around 100% on beef, more than 100% on pigmeat and poultry and between 50 and 100% on cereals.
7. In the future, FTAs are likely to have major implications for the CAP. Are the economic benefits for the Union of reduced tariffs in a given third market greater than the cost of tariff reductions in our own agricultural sector that are needed to meet WTO rules? Even if we can meet the WTO minimum, will third countries, particularly those for whom agricultural trade is important, agree to other types of economic co-operation without the prospect of substantive agricultural tariff liberalisation? These questions would have to be analysed case by case, bearing in mind that an FTA must cover substantially all trade. The exclusion of a major component of bilateral trade would result in the agreement being in contravention of WTO rules.
8. As figure II demonstrates, agricultural trade as a whole frequently represents a substantial component of overall flows between the EU and many partner countries. A far more detailed analysis of product coverage by country or region concerned, as well as a detailed assessment of the dynamic impact of the Uruguay Round outcome on agricultural trade flows in general needs to be carried out before the potential effects on EU imports of free trade can be estimated with any degree of confidence.
9. Accordingly, due attention should be given to the actual and potential structure of trade with any prospective free trade partners. Unless the type of exports are such as to pose few additional burdens on the Union, then it would be difficult to envisage an early implementation of a free trade agreement. Indeed, this is likely to be an important criterion for setting priorities in the negotiation of WTO-compatible free trade areas.
10. Given the large and growing importance of services in total EU output and trade, the sector should also be studied when considering bilateral economic initiatives. (This is yet another reason why investment regimes in third countries are of critical importance for the overall trade prospects of the EU.) Nevertheless, the GATS conditions for preferential agreements on services, notably the requirement that markets have to be more open to natural persons in order to permit trade in services by all modes of delivery, represent a problem for the Union. This is amply illustrated by the negotiations with the Mediterranean countries, where it is proving very difficult to deliver the necessary concessions to permit the inclusion of services.

Fig. I Total Merchandise Trade, 1992

EU Exports

(Value in bn ECU)

EU Imports



Note: % on arrow indicates the share in total EU exports (or imports)
 % in balloon indicates share of country(ies) in exports (or imports) to (from) that region
 RoW: Rest of the World ← Estimated values

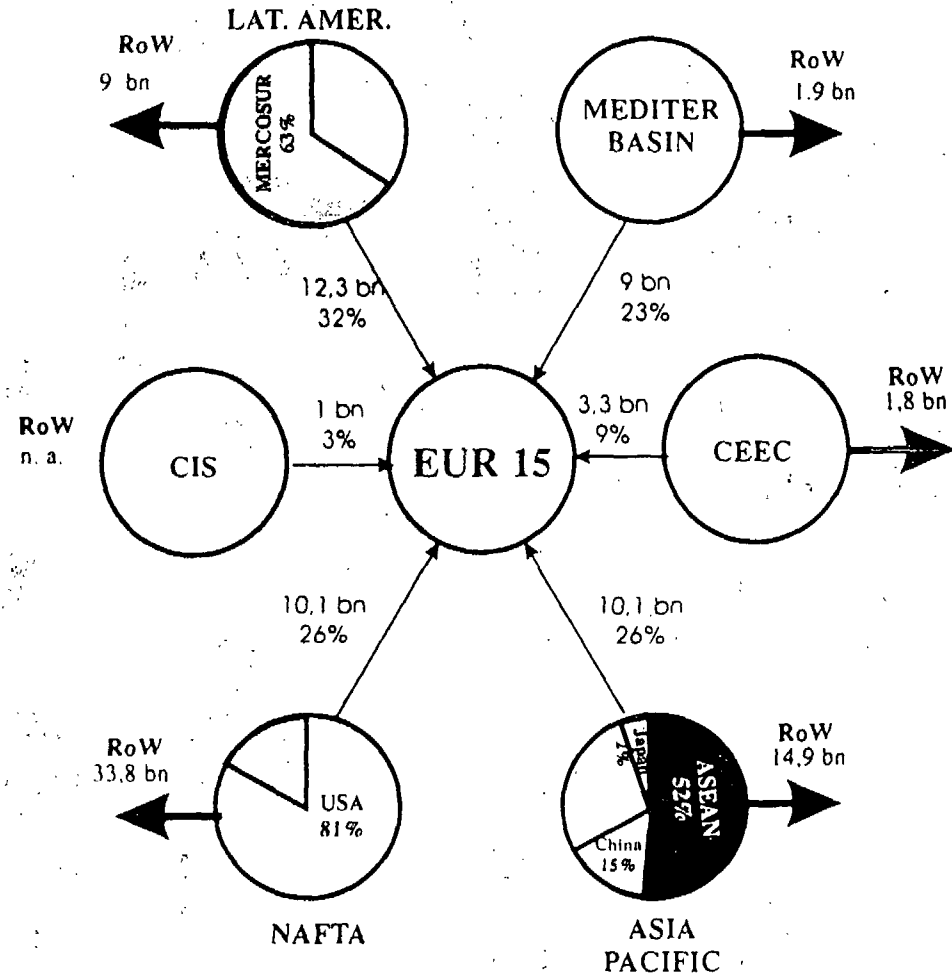
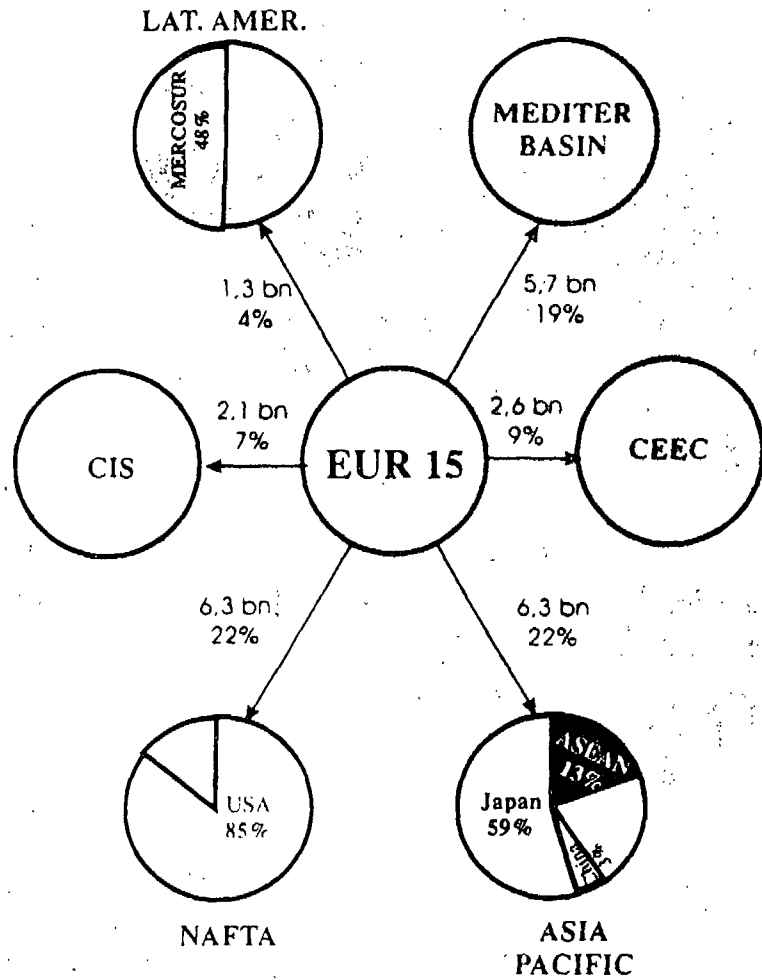
LAT. AMER.: Central and South America, Mexico excluded
 PACIFIC ASIA: East Asia, South Asia, South East Asia, Australia, N. Zealand
 MEDITER BASIN: Mashreb, Mashrek, Turkey, Albania, Ceuta and Melilla, Gibraltar, Malta, Ex-Yugoslavia, Libya, Cyprus, Israel
 CEEC: Poland, Czechoslovakia, Hungary, Romania, Bulgaria, Albania

Fig. II Agricultural Trade (incl. processed products), 1992

EU Exports

(Value in bn ECU)

EU Imports



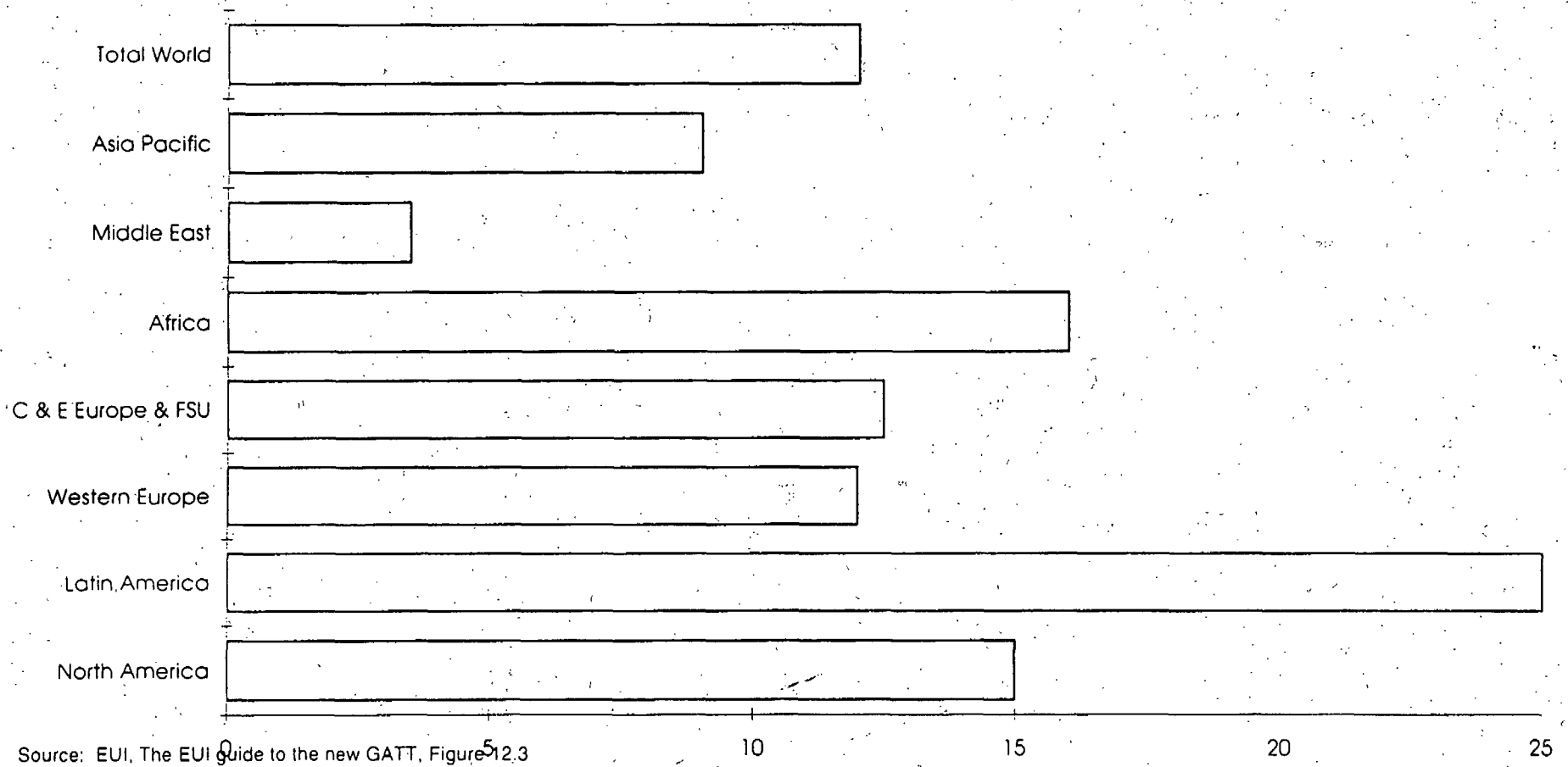
Note: % on arrow indicates the share in total EU exports (or imports)
 % in balloon indicates share of country(ies) in exports (or imports) to (from) that region
 RoW: Rest of the World
 ← Estimated values

LAT. AMER.: Central and South America, Mexico excluded
 PACIFIC ASIA: East Asia, South Asia, South East Asia, Australia, N. Zealand
 MEDITER BASIN: Mashreb, Mashrek, Turkey, Albania, Ceuta and Melilla, Gibraltar, Malta, Ex-Yugoslavia, Libya, Cyprus, Israel
 CEE C: Poland, Czechoslovakia, Hungary, Romania, Bulgaria, Albania

Fig. III

IMPORTANCE OF AGRICULTURAL TRADE 1992

(Agricultural exports as % of total merchandise exports)



Source: EUI, The EUI Guide to the new GATT, Figure 12.3

18

Table I - Regional trade :

EUR 15

EUROPEAN UNION

11-Jan-95

Page : 2

Product : ALL PRODUCTS

	IMPORTS				EXPORTS				BALANCES			
	1983	1984	1991	1992	1983	1984	1991	1992	1983	1984	1991	1992
	VALUES (in billion ECU)											
WORLD	2121.9	2547.4	2911.1	2679.9	2065.8	2470.1	2829.3	2583.2	56.2	77.3	-83.9	-96.7
EUROPEAN UNION												
TOTAL	772.3	881.3	1298.5	1303.9	734.1	851.0	1212.8	1233.3	38.1	32.4	-85.7	-70.6
INTRA	436.5	499.7	825.4	838.1	437.2	504.1	808.8	818.1	0.7	4.4	-16.6	-20.0
EXTRA	335.1	382.4	470.4	462.2	292.9	342.7	399.2	410.9	-42.2	39.7	-71.2	-51.3
MISCELLAN	0.7	1.1	2.7	3.6	0.0	4.2	4.8	4.3	3.4	3.0	2.1	0.7
EUROPEAN UNION <--> REGION(S)												
AMLAT-MEXI	21.3	24.9	24.5	22.9	11.6	13.7	14.2	15.7	9.7	11.2	10.2	7.2
ASEAN	8.7	10.5	21.0	23.5	10.4	11.1	18.9	20.8	1.7	0.6	-2.1	2.7
ASIA PACIFIC	52.6	62.4	127.9	130.5	35.2	42.7	78.6	81.7	17.4	19.7	-49.2	48.8
CEEC	10.6	13.6	18.9	22.0	9.3	10.5	21.0	25.6	-1.3	3.1	2.1	3.6
CIS	24.7	28.8	21.1	20.1	17.1	17.0	16.1	15.2	7.6	11.9	-5.0	-4.9
MEDITERRAN	36.6	41.2	45.1	39.2	42.0	46.1	48.5	44.4	5.4	4.9	3.4	5.1
MERCOSUR	11.2	14.2	14.4	13.5	5.0	5.5	6.6	7.3	6.2	8.7	-7.8	-6.2
NAFTA	74.9	84.9	111.7	105.3	64.3	91.2	92.3	94.7	10.6	6.3	-19.5	10.6
EUROPEAN UNION <--> PARTNER(S)												
CHINA	2.9	3.5	16.0	18.0	3.1	4.1	6.2	7.6	0.2	0.6	-9.7	-10.4
JAPAN	24.6	28.9	56.9	56.3	8.5	10.3	23.9	22.2	16.1	18.6	-33.0	-34.1
UNITED STAT	62.7	71.5	98.2	92.8	56.0	80.1	76.9	79.3	-6.7	8.7	-21.3	13.4
	% SHARE											
										% GROWTH (1)		
										IMPORTS	EXPORTS	
WORLD	(2)	100	100	100	100	100	100	100	100	26	25	
EUROPEAN UNION												
TOTAL	(3)	36	35	45	49	36	34	43	48	69	68	
INTRA	(4)	57	57	64	64	60	59	67	66	92	87	
EXTRA	(5)	43	43	16	35	40	40	33	33	38	40	
MISCELLAN	(1)	0	0	0	0	1	0	0	0	445		
EUROPEAN UNION <--> REGION(S)												
AMLAT-MEXI	(6)	6	7	5	5	4	4	4	4	7	35	
ASEAN	(6)	3	3	4	5	4	3	5	5	171	100	
ASIA PACIFIC	(6)	16	16	27	28	12	12	20	20	148	132	
CEEC	(6)	3	4	4	5	3	3	5	6	107	175	
CIS	(6)	7	8	4	4	6	5	4	4	19	11	
MEDITERRAN	(6)	11	11	10	8	14	13	12	11	7	6	
MERCOSUR	(6)	3	4	3	3	2	2	2	2	20	45	
NAFTA	(6)	22	22	24	23	22	27	23	23	41	47	
EUROPEAN UNION <--> PARTNER(S)												
CHINA	(7)	1	1	3	4	1	1	2	2	512	143	
JAPAN	(7)	7	8	12	12	3	3	6	5	129	161	
UNITED STAT	(7)	19	19	21	20	19	23	19	19	48	42	

Sources : EUROSTAT, United Nation

(1) Growth rate, 1983-1992

(2) Intra EU included

(3) Total/World

(4) Intra/Total

(5) Extra/Total

(6) Region/Extra

(7) Partner/Extra

Table II - Regional trade : EUR 15 EUROPEAN UNION

11-Jan-95

Page : 1

Product : AGRICULTURAL PRODUCTS

	IMPORTS				EXPORTS				BALANCES			
	1983	1984	1991	1992	1983	1984	1991	1992	1983	1984	1991	1992
VALUES (in billion ECU)												
WORLD	302.2	357.4	341.4	345.9	302.2	357.4	341.4	345.9	0.0	-0.0	0.0	0.0
EUROPEAN UNION												
TOTAL	114.8	129.9	162.4	166.5	88.4	102.0	137.7	144.3	-26.4	27.9	-24.8	22.3
INTRA	61.4	68.3	122.5	126.3	60.3	68.8	108.1	114.2	-1.1	0.5	14.4	12.2
EXTRA	53.1	61.3	39.8	40.0	27.7	32.6	28.8	29.5	-25.3	28.7	-11.0	10.5
MISCELLAN.	0.3	0.3	0.2	0.2	0.4	0.6	0.8	0.6	0.1	0.3	0.6	0.4
EUROPEAN UNION <-> REGION(S):												
AMLAT-MEXI	11.3	13.7	12.7	12.1	0.8	0.9	1.2	1.2	-10.6	12.9	-11.5	10.9
ASEAN	4.2	5.1	4.7	5.2	0.6	0.6	1.0	1.1	-3.7	4.5	-3.7	4.1
ASIA PACIFIC	8.1	9.8	9.4	10.0	2.8	3.2	5.9	6.0	-5.3	6.7	-3.5	3.9
CEEC	2.0	2.4	3.4	3.3	1.0	1.1	2.3	2.6	-1.0	1.3	-1.1	0.7
CIS	1.1	1.2	1.5	0.9	2.3	2.1	2.2	2.1	-1.2	0.9	0.7	1.2
MEDITERRAN	3.6	4.1	9.3	8.9	4.9	6.0	5.8	5.6	1.3	1.9	-3.4	3.3
MERCOSUR	7.7	9.6	7.9	7.6	0.2	0.2	0.5	0.4	-7.5	9.4	-7.4	7.2
NAFTA	14.3	14.4	9.5	9.9	5.2	6.8	5.9	6.2	-9.2	7.6	3.5	3.7
EUROPEAN UNION <-> PARTNER(S):												
CHINA	1.0	1.2	1.5	1.5	0.2	0.0	0.3	0.2	-0.8	1.2	-1.2	-1.3
JAPAN	0.2	0.3	0.2	0.2	1.2	1.5	2.6	2.6	1.0	1.2	2.3	2.4
UNITED STAT	12.3	12.3	7.6	8.1	4.4	5.7	4.7	4.8	-7.9	-6.6	-2.9	-3.3
% SHARE												
									% GROWTH (1)			
									IMPORTS		EXPORTS	
WORLD	(2)	100	100	100	100	100	100	100	14		14	
EUROPEAN UNION												
TOTAL	(3)	38	36	48	48	29	29	40	45		61	
INTRA	(4)	54	53	75	76	68	67	79	106		89	
EXTRA	(5)	46	47	24	24	31	32	21	25		6	
MISCELLAN.	(6)	0	0	0	0	0	1	1	43		66	
EUROPEAN UNION <-> REGION(S):												
AMLAT-MEXI	(6)	21	22	32	30	3	3	4	7		55	
ASEAN	(6)	8	8	12	13	2	2	3	23		98	
ASIA PACIFIC	(6)	15	16	24	25	10	10	20	23		113	
CEEC	(6)	4	4	9	8	4	3	8	62		154	
CIS	(6)	2	2	4	2	8	7	7	21		9	
MEDITERRAN	(6)	7	7	23	22	18	18	20	145		15	
MERCOSUR	(6)	14	16	20	19	1	1	2	-1		147	
NAFTA	(6)	27	23	24	25	19	21	21	31		19	
EUROPEAN UNION <-> PARTNER(S):												
CHINA	(7)	2	2	4	4	1	0	1	42		13	
JAPAN	(7)	0	1	1	0	4	5	9	22		115	
UNITED STAT	(7)	23	20	19	20	16	17	16	34		10	

Sources : EUROSTAT, United Nation

(1) Growth rate, 1983-1992

(2) Intra EU included

(3) Total/World

(4) Intra/Total

(5) Extra/Total

(6) Region/Extra

(7) Partner/Extra

Table III: Free Trade Agreements of the EU with Third Countries (not including the EEA countries)

Europe Agreements

	<u>Title of Agreement</u>	<u>Period of Validity</u>	<u>Type of Agreement</u>
HUNGARY	Europe (association) Agreement between the EC and their MS and the Republic of Hungary	Signed on 16 December 1991 Entered into force on 1 February 1994.	Association agreement and a fore runner to possible accession providing for a time-table and a phased approach
POLAND	Europe (association) Agreement between the EC and their MS and the Republic of Poland	Signed on 16 December 1991 Entered into force on 1 February 1994.	Association agreement and a fore runner to possible accession providing for a time-table and a phased approach
CZECH REPUBLIC	Europe (association) Agreement between the EC and their MS and the Czech Republic	Signed on 4 October 1993 (held up by the splitting of Czechoslovakia). Entered into Force 1 February 1995.	Association agreement and a fore runner to possible accession providing for a time-table and a phased approach
SLOVAK REPUBLIC	Europe (association) Agreement between the EC and their MS and the Slovak Republic	Signed on 4 October 1993 (held up by the splitting of Czechoslovakia). Entered into force 1 February 1995.	Association agreement and a fore runner to possible accession providing for a time-table and a phased approach
BULGARIA	Europe (association) Agreement between the EC and their MS and the Republic of Bulgaria	Signed on 8 March 1993. Entered into force 1 February 1995.	Association agreement and a fore runner to possible accession providing for a time-table and a phased approach
ROMANIA	Europe (association) Agreement between the EC and their MS and the Republic of Romania	Signed on 1 February 1993. Entered into force 1 February 1995.	Association agreement and a fore runner to possible accession providing for a time-table and a phased approach

Customs Unions

	<u>Title of Agreement</u>	<u>Period of Validity</u>	<u>Type of Agreement</u>
ANDORRA	Agreement between the EEC and the Principality of Andorra	Entered into force the 1 January 1991 for an unlimited period	Provides for the establishment of a customs union
CYPRUS	Protocol laying down the conditions and procedures for the implementation of the 2nd stage of the Agreement establishing the Association between the EC and the Republic of Cyprus	Signed on 19 October 1987. Entered into force on 1 January 1988 for an unlimited period.	Provides for the establishment of a customs union in two phases.

	<u>Title of Agreement</u>	<u>Period of Validity</u>	<u>Type of Agreement</u>
MALTA	Agreement establishing an Association between the European Economic Community and Malta.	Signed on December 1970. Entered into force on 1 April 1971 for an unlimited period.	Provides for two stages The first stage has been extended for an unlimited period through a protocol to the Agreement.
TURKEY	Agreement establishing an Association between the European Economic Community and Turkey	Signed on 12 September 1963. In force from 1 December for an unlimited period.	Establishes a customs union and in principle paves the way to accession, comprising three stages.

FTAs

	<u>Title of Agreement</u>	<u>Period of Validity</u>	<u>Type of Agreement</u>
ISRAEL	Agreement between the EEC and the State of Israel	Signed on 11 May 1975. Entered into force on 1 July for an unlimited period	Free trade and cooperation agreement
SWITZERLAND	Agreement between the ECC and the Swiss Confederation	Signed on 22 July 1972. In force for an unlimited period.	Preferential agreement creating a free-trade area

Free trade agreements were signed with the three Baltic states (ESTONIA, LATVIA and LITHUANIA) on 18 July 1994 and entered into force on 1 January 1995.

Agreements including a clause considering a future FTA

	<u>Title of Agreement</u>	<u>Period of Validity</u>	<u>Type of Agreement</u>
RUSSIA	Partnership and Cooperation Agreement	Signed on 28/6/94. Valid 10 years with tacit reconduction.	A non-preferential agreement covering inter alia trade in goods, establishment and operation of companies, trade in services, current payments and capital movements. The agreement mentions the objective of the creation of a free trade area as well as conditions bringing about freedom of establishment of companies, cross border trade in services and of capital movement. The parties will examine in 1998 whether the circumstances allow for the beginning of negotiations.

UKRAINE	Partnership and Cooperation Agreement	Signed on 14/6/94. Valid 10 years with tacit reconduction.	" "
BELARUS	Partnership and Cooperation Agreement	(1)	" "
MOLDOVA	Partnership and Cooperation Agreement	Initiated 26/7/94. Signature expected shortly. Same conditions.	" "
ASEAN	Cooperation Agreement between the EEC and Indonesia, Malaysia, the Philippines, Singapore and Thailand - member countries of ASEAN	Signed on 7 March 1980. In force for five years. Renewable thereafter for two-year periods. Still in force pending the outcome of the current negotiations, interrupted 'sine die'.	Framework agreement for commercial, economic and development cooperation. Under the heading of commercial cooperation, the parties undertake (among other items) to <u>study ways and means of eliminating trade barriers.</u>
GULF COOPERATION COUNCIL	Cooperation Agreement between the EEC and the countries parties to the Charter of the Cooperation Council for the Arab States of the Gulf	Signed on 15 June 1986, for an unlimited period. Entered into force on 1 January 1990.	Agreement providing for cooperation in an number of fields (economy, agriculture, fisheries, industry, etc.). <u>Dialogue has been resumed on a much broader basis, examining the possibility of developing a free-trade trade agreement.</u>

(1) Negotiations not yet complete

Sources: *Annotated Summary of Agreements Linking the Communities with Non-member Countries* (as at 31 December 1993 - Updated list June 1994) Treaties Office. Commission of the European Communities.
Data provided by DG I services.

Table IV: Examples of FTA membership and their coverage

FREE TRADE AREAS	MEMBERS	DATE OF CREATION	SECTORS							
			GOODS				SERVICES			
			Agriculture	Automobile	Energy	Textiles	Telecom	Transport	Financial	Business
NAFTA (1)	Canada, Mexico, US	1992	Provisions are included on rules of origin, national treatment, general market access conditions and safeguards and special provisions addressed in these four sectors				Included	Air transportation services excluded	Included	Included
MERCOSUR (2)	Argentina, Brazil, Paraguay, Uruguay	1991	Included	Included	Included	Included	Included	Included	Included	
ANDEAN PACT (3)	Bolivia, Colombia, Ecuador, Venezuela, Peru	1969	Yes, though still many sensitive and protected products.	No, political. Peru differs from the others.	No, not foreseen.	Included (4)	Still being negotiated, except for air transportation services where an agreement has already been reached.			
CENTRAL AMERICAN COMMON MARKET	Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua	1960	Yes, although there is a list of goods subject to a Special Regime	Not included	Not included	Included in the industrial sector	No, the treaty deals essentially with trade in goods			
G3	Venezuela, Colombia, Mexico	1994	Yes, with some temporary exceptions	A step by step implementation in ten years is envisaged.	Not specified	Venezuela excepted	Yes, especially in the use of networks	Included	Yes, with some exceptions on monetary and exchange policy	Included
ANZCERTA	Australia, New Zealand	1983	Included	Included	Included	Included	Excepted those inscribed in "negative lists"			
GULF COOPERATION COUNCIL	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates	1981	Included	Included	Included	Included	No	No	Included	Included
ASEAN/AFTA	Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand	1967/1993	The agriculture sector will be gradually included into the Scheme	Motor vehicles are in the exclusion list of all ASEAN member states	Mineral fuels excepted	Included	Negotiations are quite advanced they would initially cover telecoms and transportation			

(1) Rules, patterned on the TRIPS agreement, are set up committing each country to provide effective protection and enforcement of intellectual property rights. Furthermore, institutional, dispute-settlement, transparency, accession and duration provisions are included

(2) All these sectors are included in the Mercosur Treaty. However, the member states are still discussing the creation of a customs union whose field of action will not be defined before January 1995 and which could modify the FTA

(3) In the agreement signed in 1969, it was foreseen to create a free-trade area for the year 1994. This objective was not accomplished but there have been several bilateral agreements between the members (Agreement between Bolivia and Peru and Agreement between Colombia and Venezuela)

(4) Even though there are some products with a "0" tariff, most of them are strongly protected

Source: DG I services