Deutsche Bank
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EU Monitor

European integration

July 27, 2012

Looking for partners

The EU's free trade agreements in perspective

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The European Union (EU) is looking to sign deep and comprehensive free trade agreements with attractive trading partners. This has been its official strategy since 2006. The EU is attempting to boost trade and welfare and aims to secure favourable market access conditions in growth regions. Implementation of this strategy is likely to last until 2020, and its success is by no means certain.

The EU's free trade agreement with Korea is the only one to date. This is the first time ever that major technical trade barriers have been dismantled in a Northeast Asian country and its markets for services and public contracts have been opened. This will boost trade. The European Parliament ratified this agreement by a large majority.

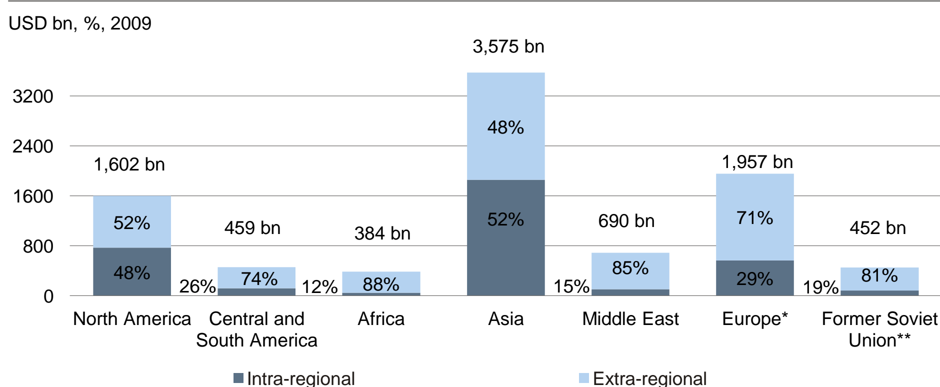
Great hopes are being pinned on a trade agreement with India. Bilateral economic relations are characterised by high barriers to access in the Indian market and by restrictive practices applied in the EU to Indian skilled (IT) workers. Much progress still needs to be made.

The EU is also keen to sign deep and comprehensive trade agreements with Canada, Mercosur, Ukraine, almost all Southern Mediterranean countries, and many ASEAN states. The economic impact of such agreements would generally be substantial for the partners concerned and moderately beneficial for the EU.

Fundamental decisions on the United States and Japan have yet to be made. Although a trade agreement with the United States in particular would offer a number of bilateral opportunities, it would also pose a significant risk of friction between the transatlantic and Asian regional integration areas. A deal with Japan would be broadly beneficial and pose less risk for the system.

Intra-regional and extra-regional trade in goods

USD bn, %, 2009



* Excluding intra-EU trade
** Former Soviet Union (Armenia, Azerbaijan, Belarus, Georgia (until 2009), Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan)

Source: WTO 2011, p. 69

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Acknowledgements

The author wishes to thank Jay Pocklington and Woldemar Walter for their valuable research assistance; Eric Heymann, Maria-Laura Lanzeni, Bernhard Speyer and Annette Sell for their comments and suggestions; and numerous employees of the European institutions and various national and international trade associations for their willingness to be interviewed about the topics discussed in this survey.

The trade policy winds are blowing eastwards

Crisis of multilateral trade liberalisation

Far from merely being shaken by the crisis in the euro zone over the past four years, the European Union has finally been forced onto the defensive in the global economic and political arena. Only a decade ago, the world's largest trade and investment power made no secret of its ambitions to assume leadership of the global trading system.[1] At that time no other country was willing to follow it in the wake of the fiasco of the World Trade Organization (WTO) meeting in Seattle in 1999. But with the momentum of security policy behind it – after the terrorist attacks of 11 September 2001 and the subsequent efforts to provide the developing nations with greater economic opportunities – the international community even managed to get the EU-sponsored Millennium Round on track at the WTO meeting of ministers in Doha in 2001.[2] Today – one decade and a huge financial and economic crisis later – the situation looks totally different. The Doha Round talks are stalling and stumbling along, and hardly anything seems to be working out as planned. Although good headway was briefly made in Geneva in 2008, any further progress at the time was thwarted by Indian domestic politics. Europe's flagship project of multilateral trade liberalisation was scuppered by conflicts between China and the United States in 2011.[3] This pattern is familiar from climate-change negotiations, currency squabbles and many other economic policy issues. The outlook for multilateral trade policy is decidedly gloomy.

China continues its regional integration

China, on the other hand, has integrated itself extensively within the Asia region in recent years, notably by signing a free trade agreement with ASEAN in 2010. Over the last decade it has continued its rise as a world trade power unchecked despite huge obstacles. China currently has few options in terms of additional bilateral trade agreements. It will start negotiating a free trade zone with Japan and South Korea with uncertain prospects. However, the current status of trade policy should be sufficiently robust to ensure that China becomes the world's leading foreign-trade power in the next few years (a position still occupied by the EU). This trend is unlikely to be affected by the moderate appreciation of the renminbi in real terms – if historical experience of long periods of sharp real revaluations in Germany and Japan is anything to go by.[4]

US trade policy showing moderate forward momentum

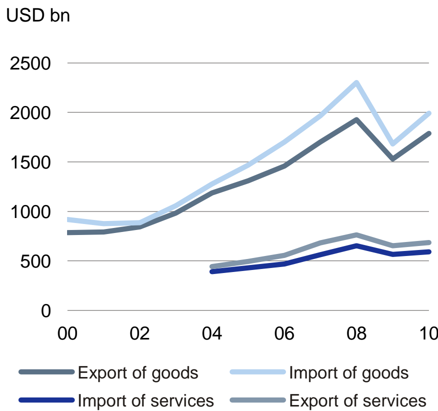
Under the presidency of George W. Bush the United States (unsuccessfully) tried its hand at foreign trade in both American subcontinents. Having signed the North American Free Trade Agreement (NAFTA) with Canada and Mexico in the early 1990s, however, the US has in recent years only managed to conclude trade agreements with Peru, Colombia and Panama, which remained controversial over a period of four years. Under President Obama the US is now looking towards Asia[5] and – most recently – has switched some of its attention back to the EU. The Trans-Pacific Partnership (TPP) initiative, which President Obama has chosen as his preferred trade policy project, is intended to combine many of the major Pacific Rim countries – excluding China – into a highly ambitious free trade zone. Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, the United States and Vietnam have already committed themselves to the venture; Japan signalled its interest, Mexico and Canada announced joining the talks on the eve of the G20 summit of June 18-19, 2012, and the Philippines, Thailand, Taiwan and South Korea are discussing the possibility of joining.

Asia's preferential trade agreements are blossoming

The 23 APEC nations (which include China), on the other hand, aim to dismantle various economic barriers but do not specifically aspire to achieve deep integration. India was a late starter in the process of signing trade

[1] Deutsch (2000).
[2] Deutsch and Speyer (2001) on the agenda.
[3] Deutsch (2011a) and Mattoo, Ng and Subramanian (2011).
[4] Ferguson and Schularick (2009).
[5] Deutsch (2011b).

Extra-EU foreign trade 1



Source: WTO

agreements with the ASEAN countries in particular. Although Japan was fairly passive in this respect, it agreed free trade in goods with ASEAN back in 2009. South Korea, by contrast, recently concluded two trade agreements with the United States and the EU. South America, the Middle East and Africa are not very actively involved in trade diplomacy at present. Competition for the best economic conditions governing trade, foreign direct investment, and business regulation centres mainly on the Asian markets, which already account for half of the global economy – a proportion that is set to increase.

The current trade policy activities are not only redistributing markets and opportunities for companies and consumers alike; they are also fundamentally reorganising power structures within the global economy. China's rapid rise as a world trade power is radically transforming these market parameters. The EU – still the leader in global trade – is attempting to use bilateral and interregional trade diplomacy towards selected countries and regions to secure lasting advantages.

New topics = new difficulties

Extra-EU trade by country (goods) 2

%, 2010

Exports		Imports	
US	17.5	China	18.7
Switzerland	8.3	US	11.0
China	8.1	Russia	10.4
Russia	6.3	Switzerland	5.1
Turkey	4.5	Norway	4.8
Norway	3.2	Japan	4.3
Japan	3.2	Turkey	2.8
India	2.5	South Korea	2.5

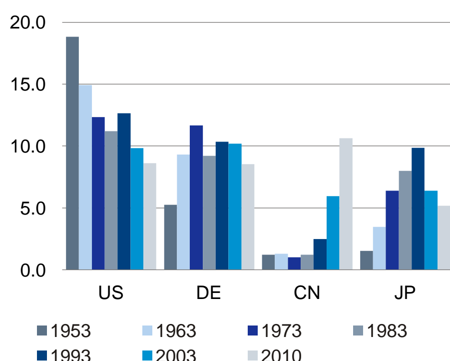
Source: WTO

Similar to the United States, the European Union therefore always needs to consider when examining these issues how Europe's long-term foreign-policy interests can best be protected in a world that is increasingly being shaped by Asian economies. The topics now included in the economic policy framework governing foreign trade relations already go well beyond what had been considered as innovative during the Doha Round. The traditional market access issues around tariffs, duties, technical trade barriers, the opening of government procurement markets, investment restrictions and the compulsory involvement of domestic companies in foreign direct investment have been joined by efforts to protect intellectual property rights, trade customs clearance, security precautions in freight transport, and electronic commerce. Practical questions of supply chain optimisation throughout worldwide production networks and compliance with complex trade policy legislation – especially rules of origin – have become more important. The latter is an unfortunate side-effect of the many preferential trade agreements.

An increasingly important issue in the context of competition with some East Asian and Russian companies is the need for a level playing field, especially where state-owned enterprises and government funding of foreign trade activities are concerned. China has not yet signed up to the OECD consensus on export finance and subsidises Chinese companies' access to foreign markets – especially in the case of commodities – in the form of development aid and the provision of infrastructure by affiliated suppliers.

Export of goods by country 3

% of the world, 1953 to 2010



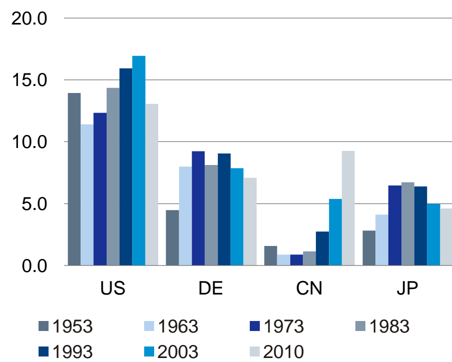
Source: WTO

A key role is also played by sectoral issues such as the timely removal of tariffs on the remote selling of products online and the signing of the WTO Information Technology Agreement in 1996, the cross-border use of data records by multinational corporations, the treatment of environmentally preferential goods and services ('environmental goods') or of products with a large environmental footprint (border taxes[6]), and the setting of trade policy rules for industrial and energy commodities which, in addition to foodstuffs, have become the main target of protectionist actions by countries such as China, Russia, Brazil and India since the outbreak of the financial and economic crisis.[7]

[6] Border tax adjustments on imports produced outside emissions trading schemes.
[7] WTO, UNCTAD, OECD (2011)

Imports of goods by country 4

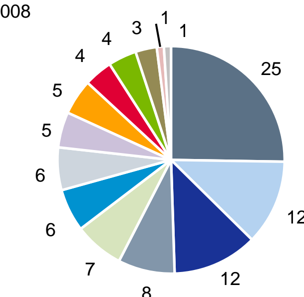
% of the world, 1953 to 2010



Source: WTO

Selected PAs* as a share of total global exports between PA signatories** 5

%, 2008



* Preferential agreements
** Excluding intra-EU trade
*** Asia-Pacific Trade Agreement

Source: WTO 2011

One aspect that, although by no means new, has become increasingly important is the issue of regulatory barriers 'behind' national borders – primarily in the extensive fields of trade in services such as telecommunications, finance and transport – which countries have been trying to dismantle multilaterally since the Tokyo Round of the GATT in the 1970s, but which they have failed to significantly reduce either then or during the Uruguay or Doha rounds or in the majority of bilateral agreements. Nonetheless, the European Union maintains overarching and sector-specific regulatory dialogues with key non-EU countries such as the United States, Japan and China. In addition, the EU also attempts to reach bilateral agreements to ease restrictions on the international secondment of skilled workers for service providers that operate beyond the EU's external borders (WTO mode 4).

The EU's preferential trade agreements

The EU was the first ever major preferential agreement signed by the GATT in the area of trade policy. But the Europeans didn't just stop there. They concluded a whole range of trade agreements over the course of several decades. The agreements signed by the European Community or the European Union in recent decades alone include:

— Customs unions with Andorra, San Marino and Turkey (1995);

— Free trade agreements with Norway, Iceland and Switzerland in the early 1970s; with Mexico and South Africa (2000); with the Balkan states (Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia) in the first decade of this century; with Central American CARIFORUM states (replacing the trade provisions of the Cotonou Agreement), further former Cotonou countries from the Caribbean, Africa and the Pacific Ocean and other individual African states (Côte d'Ivoire and Cameroon) in recent years; and with Peru, Colombia and Central American states (2011); and an agreement containing free trade provisions with Chile (2003/2005);

— and association agreements with Southern Mediterranean countries (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria and Tunisia).

The existing agreements already cover more than a quarter of the EU's total imports and exports of goods and agricultural produce.

Given the uniquely close economic integration within the single European market, however, the EU has a low proportion of non-preferential trade compared with other regional trade agreements because two-thirds of its 'foreign' trade takes place within the single market (these proportions have remained constant since 1990).[8] If trade within the EU's internal market is stripped out, NAFTA has the largest share of preferential trade in the world (25 per cent), followed by the EU (24 per cent); these figures relate to exports of goods in both cases. The respective figures are also roughly a quarter each in the case of commercial services. However, 70 per cent of the goods imported into the EU are subject either to no tariffs at all or to most-favoured-nation (MFN) tariff rates of less than five per cent. Only five per cent of imports are subject to preferential margins of at least five per cent. The respective figures for exports are similar except for the fact that there are slightly more MFN tariff rates above five per cent.

[8] All figures in this paragraph come from the WTO (2011).

New approaches to trade policy

Status of EU FTAs* and their share of EU trade — 6

%

	Industrial products		Agricultural produce	
	Imports	Exports	Imports	Exports
Existing FTAs	22.3	27.7	24.3	29.1
FTA negotiations started	21.8	25.6	56.2	26.2
No FTAs	55.8	46.7	19.5	44.7

* Free trade agreements

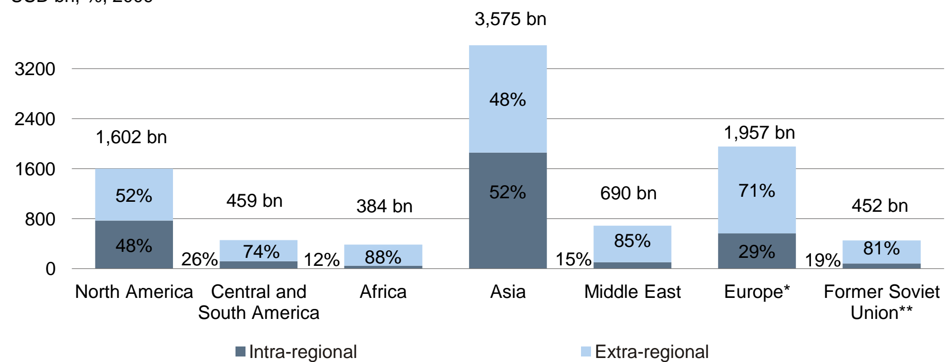
Source: EU Commission

Economic and demographic factors will ensure that Europe's share of world trade will gradually decline over the next few decades. In just the last ten years we have seen how the EU's foreign trade (extra-EU trade only) has grown by only around three per cent a year, while China's has expanded at double-digit rates (its exports of goods and services increasing at 17 per cent p.a. and its imports at 15 per cent p.a.) and India's exports and imports have boomed, growing fourfold and sixfold respectively. The EU is still the world's leading trader in goods and services (ahead of the United States and China in both cases); in 2009 the EU accounted for 17.4 per cent of global imports of goods, 16.2 per cent of exports of goods, 23.6 per cent of imports of services and 26 per cent of exports of services. However, five of the ten leading countries exporting goods and six of the ten leading nations importing goods are in Asia. These proportions are identical in the case of services.

As the world's premier trading power, the EU is still in the comfortable position of being able to shape much of the political and trade policy architecture. This means that decisions made today can improve the fortunes of European companies engaged in international trade over the long term. This naturally raises the question of how the European Union – as the leading trading bloc at present – intends to react to these new global economic and political trends. This is not merely an issue of narrow commercial interests. It also concerns the medium- and long-term framework within which trade and investment with other regions of the world can be expanded; the associated opportunities for growth, welfare and employment; and – much more fundamentally – the question of how international economic relations can actually be politically coordinated over the next two or three decades as multilateral rules and agreements are gradually eroded.

Intra-regional and extra-regional trade in goods — 7

USD bn, %, 2009



* Excluding intra-EU trade
** Former Soviet Union (Armenia, Azerbaijan, Belarus, Georgia (until 2009), Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan)

Source: WTO 2011, p. 69

EU pursuing a new trade strategy since 2006

Given the difficulties that they were facing in the multilateral arena, the EU institutions started in the middle of the last decade to move away from the strategy of essentially multilateral world trade liberalisation that it had been pursuing since 1999 under the umbrella of the WTO and, instead, set out on a path of new bilateral and interregional negotiations on trade agreements. Back in 2006, Peter Mandelson, the EU Trade Commissioner at the time, was given a comprehensive mandate to launch a new strategy for a 'Global Europe'[9] (2006),

[9] European Commission (2006) and (2010d).

which was continued and deepened in 2010 under the strategy for trade, growth and world affairs[10] as part of the Europe 2020 strategy[11] under the leadership of Commissioner Karel De Gucht.

Objective of deep integration

This strategy aims to prevent the EU's potential marginalisation within world trade and to achieve deep integration, which the WTO had set as an objective but had not pursued any further.[12] Right from the outset the EU was therefore at pains to address the topics of national border barriers and rule-based market access problems in areas such as government procurement, services, investment, and issues around resources and energy; strengthen the protection of intellectual property; raise questions of competition; and place these themes in the context of global development. This approach follows a trend that has shaped EU trade policy for some time now, namely to enshrine in trade agreements a number of obligations that go beyond the WTO's remit, even if many of these partial agreements cannot be legally implemented in the strict sense and merely constitute political declarations of intent.[13]

Growth stimulus is desirable

However, one of the objectives has been and still is to increase the competitiveness of EU companies by opening markets both inside and outside the EU, thereby stimulating growth. The EU's basic approach was therefore, at least initially, to negotiate with those trading partners that account for a significant proportion of the EU's foreign trade and which, at the same time, maintain substantial trade barriers against the EU. Consequently, the EU started negotiations with South Korea, India and ASEAN in 2007 and with Canada in 2009 and it resuscitated talks with the Gulf Cooperation Council states and with the Mercosur countries (Argentina, Brazil, Paraguay, Uruguay and Venezuela) in 2010. The ASEAN mandate was subsequently converted into sub-mandates for some of the ASEAN states, and negotiations were initiated with Singapore, Malaysia and Vietnam while talks with Indonesia were subjected to initial scrutiny. Although negotiations on a trade agreement with Ukraine have been completed, the deal still needs to be signed by politicians. The EU is currently considering starting negotiations with the United States and Japan. If preferential trade agreements were signed with these two heavyweights, the lion's share of the EU's foreign trade would then be governed by preferential agreements, which would fortunately but paradoxically bring the ultimate goal of general trade liberalisation within much closer reach.[14] It would also mean that only a few major trading nations would then continue to have most-favoured-nation status (Australia, China, Hong Kong, New Zealand, Russia and Taiwan). In addition, the Commission intends to launch negotiations with China and other countries on the subject of EU-wide investment. Furthermore, the EU is looking to gain better access to other countries' procurement markets both within the scope of the relevant WTO agreement and beyond.

Free trade agreements offer substantial economic opportunities

The Commission itself estimates that if the 2010 trade policy agenda were fully implemented, roughly half of the EU's foreign trade would be barrier free, the average tariff rate on exports would be halved to 1.7 per cent, the corresponding rate on imports would be reduced by almost one fifth, and gross domestic product (GDP) could grow by 0.5 per cent overall. These calculations do not include the major players. Since more than 40 per cent of the European Union's foreign trade is conducted with the United States, China, Russia and Japan, it would certainly be desirable for the EU to clarify its trade policies and strategy towards these countries. Trade agreements with the United States and Japan could possibly significantly increase the beneficial economic effects of these

[10] European Commission (2010a).
[11] European Commission (2010b).
[12] See also Koopmann and Wilhelm (2010).
[13] Horn et al. (2009).
[14] WTO (2011).

policies. This would also boost employment, raise labour productivity and real wages, improve consumer welfare and dampen inflationary pressures.[15]

EU cannot offer much more liberalisation

However, these negotiations generally presented the problem that although the EU was able to articulate specific offensive interests, beyond the issue of agriculture – where it had already made substantial concessions in the WTO in 2008 – it did not really know how to maximise its negotiating position, especially as many trading partners' offensive interests included agricultural produce, mobility of service providers – i.e. the granting of visas and temporary work permits – and other issues. However, the EU's internal market for industrial products is already largely open, which severely limits the potential for making specific concessions to trade partners. Although agriculture still offers some latitude in this respect, only in very few cases do the benefits available to trading partners in absolute terms constitute a sufficient reward. The EU's ten per cent tariff on car imports plays an important role as a bargaining chip in some negotiations.

Some critics therefore perceived a lack of clear priorities, strategic planning and willingness to make concessions on the part of the EU.[16] But there is also a further fundamental question: are many of the developing countries and emerging markets with which the EU is entering into talks actually structurally in a position to negotiate what are essentially free trade agreements with the EU and, if necessary, able to sustain such a free trade regime economically? After all, many of these trading partners have not been asked to implement sweeping deregulation and liberalisation in the form of regulatory reforms during the course of the Doha Round to date – and there are good reasons why this is the case. The next section discusses the trade agreement with South Korea and a few other key negotiations.

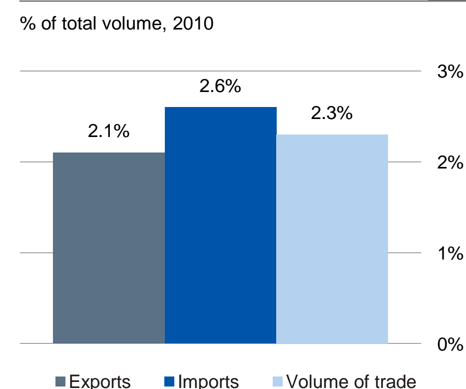
Key data South Korea 8

Population	48.9 m
GDP	759,7 EUR bn
Per-capita GDP	15,532.10 EUR
Exports as %age of GDP	41.6%
Imports as %age of GDP	40.1%
Gross value added	
Agriculture as %age of GDP	2.6%
Industry as %age of GDP	36.5%
Services as %age of GDP	60.9%

Source: Eurostat

EU's trade with South Korea 9

% of total volume, 2010



Source: Eurostat

Korea: deep and comprehensive

The European Union's free trade agreement with South Korea (EUKOR) – which was applied as from 1 July 2011, before it even officially came into effect – constitutes a unique case in the EU's new trade policy. A deep and comprehensive agreement was signed and received political approval after less than three years of negotiations (2007 to 2009). Although the United States had entered into an agreement with Korea back in 2007, it was not ratified until 2011. Apart from bringing about a significant liberalisation of the Korean market, EUKOR commits Korea to extensive regulatory collaboration in key industrial sectors. The agreements on services and government procurement were also extraordinarily wide-ranging and even went beyond US standards.[17] Korea meets nearly all the criteria set by the EU because it is a country with considerable economic potential as well as high barriers to EU trade. The negotiations were marked by Korea's keen interest in forging strong bilateral relations as part of a widely diversified portfolio of trade agreements and by Europe's attempts to ensure that it was not put at a disadvantage compared with the United States or other Asian economies that were also negotiating trade agreements with Korea or are still in the process of doing so. Unlike in some ongoing or forthcoming negotiations, these talks with Korea did not try to resolve complex development or foreign-policy issues.

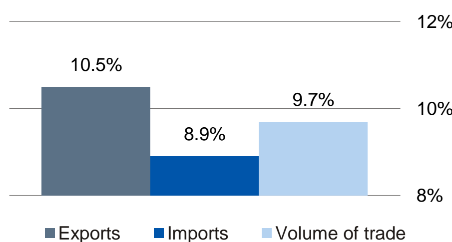
Bilateral economic relations

The volume of bilateral trade in goods and services between the EU and Korea totalled EUR 76 billion in 2010. In 2010 the EU accounted for some ten

[15] European Commission (2010c).
[16] Evenett (2010).
[17] For a summary of the agreement see European Commission (2011).

South Korea's trade with the EU | 10

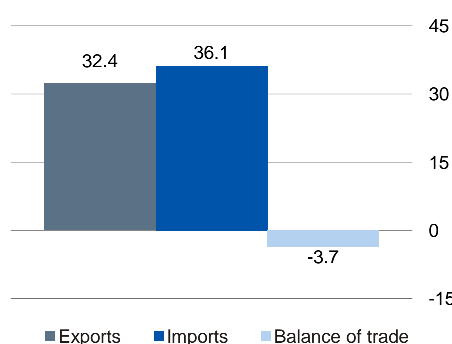
% of total volume, 2010



Source: Eurostat

EU's trade in goods with South Korea | 11

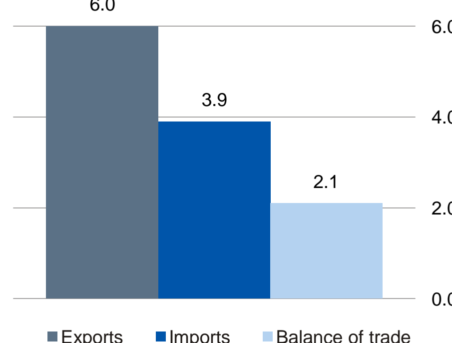
EUR bn, 2011



Source: Eurostat

EU's trade in services with South Korea | 12

EUR bn, 2010



Source: Eurostat

per cent of Korea's foreign trade (having achieved an all-time high of 14 per cent in 1994; it is third worldwide in terms of exports and fourth for imports), while just over two per cent of the EU's foreign trade takes place with Korea (making the latter eighth in terms of imports and tenth for exports). Most of Korea's exports consist of electronics, cars and industrial products, whereas the EU's exports largely comprise engineering, chemicals and electronics. Although the EU has a slight trade deficit, EU companies have invested significantly more in Korea (almost EUR 39 billion as of 2010) than the other way round (Korean companies have invested some EUR 14 billion in the EU).

Economic impact

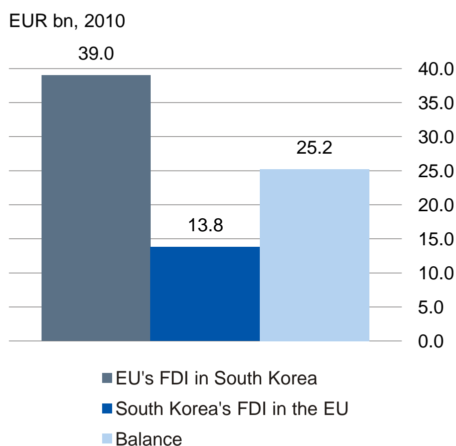
It is estimated[18] that this trade agreement will increase Korea's trade with the EU by up to 38 per cent and the EU's trade with Korea by up to 82 per cent. While economic growth and welfare in Korea are likely to improve by roughly one percent over the long term, the growth effect in the EU will probably be only 0.1 percent and static welfare effects are likely to be negligible. This trade agreement should have an especially significant impact on the EU's exports of cars, meat, dairy produce, chemicals and engineering products and on Korean exports of clothing, textiles, cars, chemicals and industrial products. The general liberalisation timetable is fairly strict. The vast majority of the agreement already applies. In the sensitive area of cars, the EU has agreed to reduce its ten per cent tariff in three to five years (depending on category), while Korea has insisted on being allowed a little more time to lower its tariffs on pork, whisky and some industrial goods and has won a blanket exemption for rice. Decisive progress in the form of wide-ranging market deregulation obligations and cooperation requirements was also made on the issue of dismantling technical trade barriers that apply to electrical goods, motor vehicles and related parts, pharmaceuticals, medical products and chemicals. The agreement especially improved the conditions for foreign direct investment in Korea by banks, insurers, law firms, corporate and trade service providers, telecommunications firms, shipping companies and express delivery service providers. Specific market access barriers are being largely abolished and the principle of national treatment is being applied to EU companies. However, the extent of this liberalisation is limited because Korea will maintain a high level of protection for financial, telecom and transport services owing to the structure of its domestic economy (government ownership, monopolies); the EU has also exempted certain areas from market deregulation. In the field of procurement, Korea is now keen to enter into build-operate-transfer agreements, which are particularly useful for large-scale infrastructure projects. The EU has also managed to enforce the protection of geographical indications of origin. A competition agreement is designed to improve practices on subsidies and antitrust activities.

Trade and investment in the new framework expanded strongly. Overall bilateral trade grew by six per cent in 2011, and investment from EU companies in South Korea increased by 60 per cent over the three quarters since the provisional application. Trade growth was strongest in liberalized sectors, strong in partly liberalized areas and more modest in still protected ones (46% vs. 36% vs. 23%). However, EU car exports increased 70 per cent (or some EUR 670 m in new sales). Korea also started importing Brent Oil for the first time. In the EU, imports of Korean cars increased sharply, too. It seems that business develops as expected by economic analysis so far but these are early days, of course.

[18] See the excellent study based on the negotiation outcome of CEPII/ATLASS (2010) and – with similar assessments – CEPS and KIEP (2007), Copenhagen Economics (2007), IBM (2008), Constant et al. (2010), Hilpert (2009) and Erixon and Lee-Makiyama (2010).

South Korea: total foreign direct investment (FDI) 13

EUR bn, 2010



Source: Eurostat

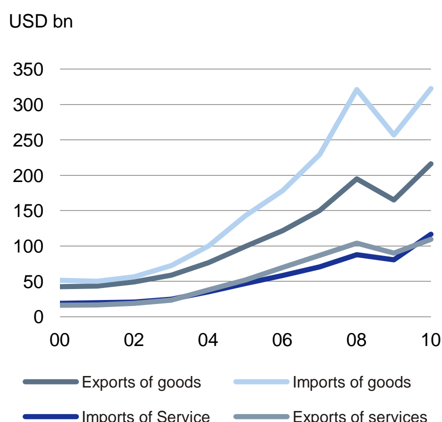
Key data on India 14

Population	1,215.9 m
GDP	1,160 EUR bn
Per-capita GDP	954.1 EUR
Exports as %age of GDP	13.5%
Imports as %age of GDP	21.3%
Gross value added	
Agriculture as %age of GDP	17.8%
Industry as %age of GDP	27.0%
Services as %age of GDP	55.3%

Source: Eurostat

India's foreign trade 15

USD bn



Source: WTO

Evaluation

Three points are worth emphasising here. First, this is probably the first time that technical trade barriers in a Northeast Asian country have been brought under control with a reasonable prospect of success. This would not have been possible without the Korean government's valuable leadership on the issue of foreign trade. Hilpert points out that the country's oligopolistic industries were unable to prevent the Korean government either from trying to promote Korea as a transnational business and logistics hub for Northeast Asia or from attempting to strengthen the position of Korean exporters and investors relative to other Northeast Asian economies in the single European market. In this respect Korea has shown itself willing to open its markets.

Secondly, the EU has managed not only to assert its offensive interests as part of a well-coordinated strategy but also ultimately to strike the right balance between the highly complex fields of offensive and defensive interests in the automotive sector. Export opportunities in the hermetically sealed Korean market are mainly available to the primarily German premium producers, whereas the competition and import rivalry from Korean vehicles that are produced in the EU are set to increase – not only, but principally – in the market for small cars. This chiefly affects the high-volume producers from the three major countries of France, Italy and Spain.[19] Given the severe crisis in the Italian automotive industry, Italy hesitated for some time before giving its consent, but finally agreed. The EU will not be fully opening its mass-market segment for another five years, whereas it will be liberalising its premium segment in just three years' time. What's more, Korea is opening its hermetically sealed market. Although the EU has accepted Korea's duty drawback (mostly from China) on imports of intermediate goods from non-EU countries it has stipulated stringent rules on the origin of such goods.[20] Nonetheless, the European Union has demonstrated that it is able to accept losses of output and employment in the EU automotive industry in order to reach a trade agreement that is beneficial on the whole.

And thirdly, the European Parliament showed itself to be a constructive force rather than a stumbling block during the initial ratification process under the Lisbon Treaty. EUKOR was ratified on 17 February 2011 by 465 votes to 128, with 19 abstentions. The European Parliament also adopted the regulation on a bilateral protection clause. The government MPs in the Korean parliament passed the trade agreement, while the opposition complained of inadequate protection mechanisms and rejected the agreement.

India: hopes for the future

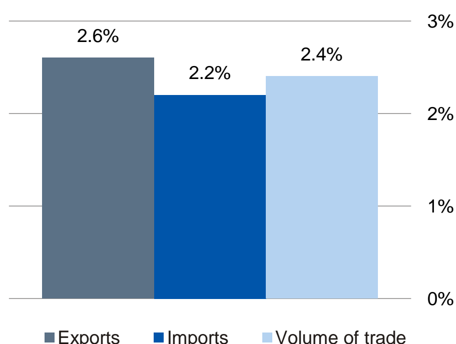
India has achieved very high rates of growth in its national economy, foreign trade and inward investment over the past decade. Nonetheless, the GDP generated by the 1.2 billion Indians is just slightly above the level of Spain. Since 1990, exports have grown 13-fold and imports have increased by a factor of 14. India's share of world trade has risen to between 1.3 per cent (imports of goods) and 2.7 per cent (exports of services). Despite all the liberalisation that this formerly closely sealed economy has achieved since 1991, India is still only integrated to a very small extent into the international division of labour and reveals considerable weaknesses in its physical infrastructure and manu-

[19] Hyundai and Kia had a market share of 4.8 per cent of all EU vehicle registrations in 2011 and are generating the strongest growth of all producers. Fiat and Peugeot-Citroën have posted the sharpest losses of market share; see The Economist (2012). Hyundai also produces in the Czech Republic, while Kia makes cars in Slovakia. See also Lee-Makiyama (2012) on the state of the EU automotive industry.

[20] Korea insisted on being able to keep the refunds of import tariffs on intermediate products for export goods.

EU's trade with India 16

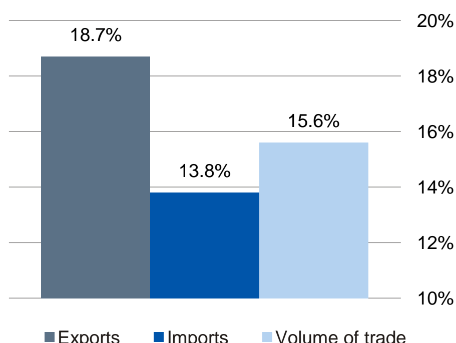
% of total volume, 2010



Source: Eurostat

India's trade with the EU 17

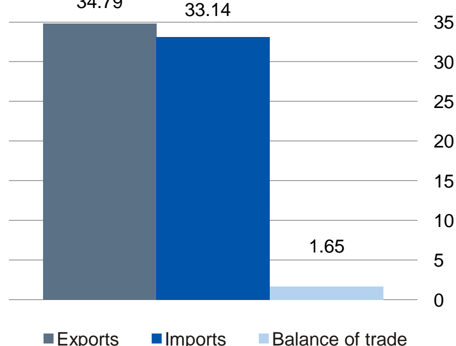
% of total volume, 2010



Source: Eurostat

EU's trade in goods with India 18

EUR bn, 2010



Source: Eurostat

facturing industry. It is a paradox that although India as a country has a surplus of low-skilled workers, its export profile is dominated by capital- and skill-intensive goods and services. This is because of a large number of development and labour-market policy decisions taken in India's past.[21] Only its IT exports are truly competitive. It should also be noted that the relative composition of the value added to India's economy has shifted by twelve percentage points since 1990 from agriculture towards services (2009: 55 per cent), while the proportion attributable to industry has remained unchanged at around 27 per cent. Under normal circumstances one would have expected industrial employment to have increased substantially – especially at the labour-intensive end of the market – in order to absorb surplus agricultural workers. Instead, these people have been fairly smoothly integrated into the informal trade and local services sector in particular, which has not exactly helped attempts to fight poverty.

Bilateral economic relations

When viewed over the long term, Europe's share of India's foreign trade is falling. India currently ranks ninth and eighth in terms of the EU's imports and exports respectively, while the EU still comes top in both categories for India. The same applies to foreign direct investment: the EU is the largest investor in India. However, trade with the EU is low in absolute terms. Only 2.4 per cent of the European Union's trade with non-EU countries is attributable to India, whereas almost 16 per cent of India's foreign trade is with the EU. Trade in goods totals just under EUR 69 billion (2010), while trade in services amounts to almost EUR 18 billion. The EU runs surpluses in both cases. India's exports to the EU consist largely of labour-intensive goods such as textiles, foodstuffs and leather, while Europe's exports to India mainly comprise industrial goods. The level of production integration in the form of foreign direct investment also remains minimal, with total EU capital spending in India coming to roughly EUR 27 billion and India's direct investment in the EU amounting to a paltry EUR 5 billion. Nonetheless, all categories of trade have posted high growth rates over the past decade.

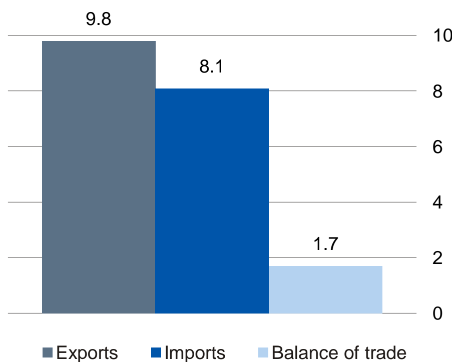
Barriers to market access

Foreign companies are still faced with considerable barriers when trying to access the Indian market. The weighted average tariff rates applied in the manufacturing and agriculture sectors are still fairly high at 7.8 per cent and 60 per cent respectively.[22] Especially high tariffs are still imposed on foodstuffs, beverages, tobacco, animal and vegetable fat, motor vehicles, cotton, plastic and certain chemicals. What's more, studies reveal that India's non-tariff trade barriers amount to an average tariff equivalent of around 18 per cent, are highly product specific and, above all, are used as an alternative to tariffs.[23] They affect roughly ten per cent of the EU's exports. In the field of foreign direct investment there are still substantial restrictions on acquisitions. For example, purchases of shareholdings by foreign investors are limited to 26 per cent in the case of insurance companies, 74 per cent in the case of banks, 51 per cent for retailers' single-brand stores, and 74 per cent for retailers' multi-brand stores, wholesalers and telecommunications companies. The IT industry and telecoms are fairly open services sectors; a moderate degree of liberalisation exists in construction, healthcare, banking, insurance, education and courier services; and the markets for legal advice, accountancy and postal services are essentially closed to foreign investors.

[21] For further general information on India see Panagariya (2008) and Subramanian (2008).
[22] Figures from Hufbauer, Schott and Wong (2010).
[23] CARIS (2011), CEPII-CIREM (2007), Khorana and Perdikis (2010).

EU's trade in services with India 19

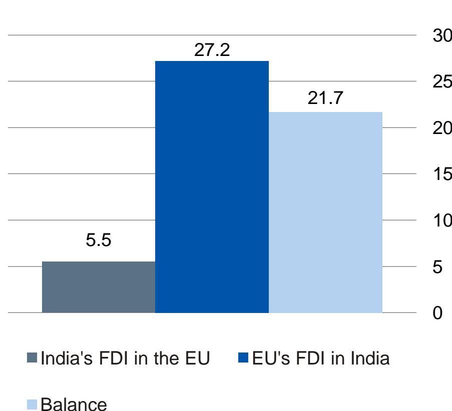
EUR bn, 2010



Source: Eurostat

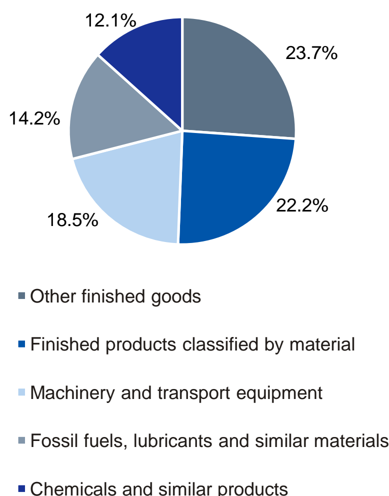
India: total foreign direct investment (FDI) 20

EUR bn, 2009



Quelle: Eurostat

Goods imported from India 21



Source: Eurostat

The EU's strategy in this area is therefore aimed at dismantling India's protective tariffs and non-tariff trade barriers and at promoting the deregulation of the aforementioned service sectors. India, on the other hand, is trying to strengthen the exports of its IT industry by improving the legal framework and conditions for the international secondment of skilled workers. It is indeed the case that the welfare effects for India depend largely on the EU opening its markets to services from India under mode 1 (such as call centres) and mode 4 (business visas, international secondment of highly qualified workers) and on the deregulation of some Indian services.

Economic impact

Previous studies have shown that India could benefit especially by increasing its exports of labour-intensive products – such as textiles, clothing and leather goods – and some services and that the EU might benefit primarily by raising its exports of industrial products (such as cars). However, there are some Indian industrial sectors whose output could decrease as the result of a trade agreement. India's tough stance during the Doha Round (NAMA negotiations) has ultimately stemmed from these concerns.

The bilateral dismantling of high protective tariffs and non-tariff barriers – especially in the manufacturing and agricultural sectors – can sometimes have the remarkable effect of diverting trade from what are actually more efficient providers to the preferred partner. Another factor that needs to be taken into account – as in other major emerging markets – is the policy of promoting certain domestic industries (particularly the automotive sector and its suppliers), which often takes the form of very high tariffs and non-tariff barriers as protection against foreign competition. This situation is preventing the swift general deregulation of such sectors and the abolition of tariffs within just a few years. A major sticking point in recent negotiations was the question of whether India should be allowed to maintain a tariff rate of 30 per cent over the long term (instead of the existing rates of up to 60 per cent). The EU rightly rejected this. Depending on what is actually agreed in the chapter on trade in goods, this could have a generally adverse impact on industrial output and employment in India.

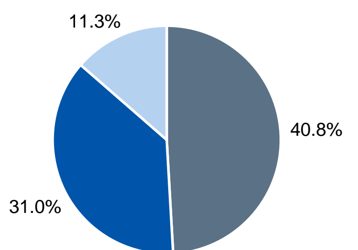
Negotiations hit a stumbling block

Negotiations started in 2007 and were originally scheduled to be completed in 2009. After a few delays, the talks are now due to be completed by the end of 2012. Both sides claimed to have made progress at the EU-India summit on 10 February 2012. Most of the tariff issues appear to have been resolved, although there are ongoing conflicts about the tariff rates that India imposes on cars, wines and spirits (currently up to 150 per cent). Protective tariffs on most products are generally to be dismantled in three to five years, or in seven years in some sensitive sectors. It has been agreed that 3 per cent of tariff lines can be entirely exempted. The potentially critical issues of trade in textiles, clothing and car parts appear to have been defused. An agreement fixing India's tariff rates would also be beneficial for the EU. However, it is clear that the labour-intensive automotive and car-parts industries are likely to come under severe pressure as a result of higher imports of new cars and used vehicles, while Indian consumers can finally look forward to the prospect of better foreign products at lower prices.

Foodstuffs

There are plans for both sides to dismantle their barriers to market access in the food industry, and an escape clause is being discussed. The concerns voiced

Goods imported to India 22



■ Machinery and transport equipment

■ Finished products classified by material

■ Chemicals and similar products

Source: Eurostat

by some non-governmental organisations (NGOs)[24] that the planned reduction of tariffs in the dairy sector (tariffs of up to 60 per cent) could have a serious impact on the cooperative, smallholder-dominated Indian dairy industry – which is estimated to potentially employ some 15 million dairy farmers – and might have adverse consequences for employment and the prevention of poverty certainly need to be put into perspective, given the EU's minimal market share and the complex logistical requirements involved in the export of milk and dairy produce; there are a few local joint ventures to date. This logic also applies to similar concerns about the poultry industry.

Services

The pertinent issues being discussed in relation to India's market liberalisation are the legal and regulatory upper limits on foreign direct investment, tax legislation on the appropriation of profits, and a number of other administrative restrictions. Apart from industry, this primarily affects service providers. No offers of market liberalisation have yet been made by either side on the issue of services. Nonetheless, there are signs that India might be willing to take further steps towards moderate deregulation of financial services[25], retailing[26] and other services. The main issues for negotiation in the banking sector are the upper limit of 74 per cent on acquisitions and the central bank's permission for EU banks to open a larger number of branches; the key issue for investment firms is stringent capital allocation requirements.

Retailing

Retailing is one of the most politically controversial issues in the EU's negotiations with India. Having finally decided in the summer of 2011 to reform its retail sector, India then delayed implementation. However, renewed momentum in this direction now seems possible and could lead to the signing of a trade agreement. Concerns occasionally voiced by NGOs and development organisations[27] to the effect that EU multi-brand wholesalers and retailers would simply corner the Indian market at the expense of street traders (some 35 m people) should not be regarded as an inevitable threat to India's inefficient informal retail sector (which accounts for well over 80 per cent of the market[28]), given the practical obstacles to market access (especially the availability and purchase of retail space in central locations of major towns and cities as well as the associated approvals and permits needed) and the ability of India's administrative authorities to exert political influence. Consequently, it is likely to be some time before Indian consumers reap the potential welfare gains. Nonetheless, structural change in this area is bound to be only gradual and, in any case, is likely to be largely driven by Indian retailers. Any agreement on improved market access for EU companies should not cause any particular problems.

Procurement markets

The European Union is also trying to gain better access to India's procurement market, which is estimated to be worth over ten per cent of GDP. The EU is still negotiating on transparent tendering procedures and relevant threshold values for contracts that are put out to tender, while India would like to retain the ability to promote domestic small and medium-sized firms as part of its economic policies. India is not a member of the pertinent WTO agreement. Given the foreseeable obstacles to the implementation of any ambitious agreement,

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[24] Misereor et al. (2011).
[25] See Unkelbach (2011).
[26] There has been open access to the wholesaling market since 1997.
[27] See, for example, Sharma (2009) or Powell (2008).
[28] See Panagariya (2008), p. 308.

deregulation is only likely to become a reality in the medium term. The opening of this market will also be of interest to all service providers looking to participate in the upgrading and expansion of India's physical infrastructure (transport networks, water, telecommunication networks). Closer inspection reveals that India's large-scale transport infrastructure construction projects require practically the full gamut of services, and foreign companies could be very useful here. It remains to be seen whether market liberalisation of legal advice, accountancy and postal, courier and express delivery services can be agreed.

Outlook

If both sides were to accommodate each other on the still unresolved issues over the course of 2012, they could reach an agreement which would then have to be ratified by the European Parliament on behalf of the EU; India's parliament would not be required to ratify the agreement. Although an agreement could potentially boost India's trade and economic output, any such stimulus would be moderate. More important than these immediate effects, however, would be the general legal and regulatory framework and the long-term opportunities for European companies to undertake direct investment in the expanding Indian market. A commitment by India to greater liberalisation of services would send a clear signal that trade over the next few decades could be made more effective for India and lucrative for Europe. On the other hand, the EU might well benefit from more generous rules (higher quotas, longer periods) on the international secondment of Indian IT professionals if, in turn, India were to ease restrictions on the secondment of business personnel from the EU. The liberalisation of India's foreign trade requires supplementary adjustments to be made to many aspects of the country's economic policies in order to remove the obstacles to a normal industrialisation strategy and to drive private and public investment in the physical infrastructure needed to expand India's trade with the world (ports, airports, road and rail networks, logistics services etc.). At a recent EU-India meeting, both sides reaffirmed their commitment to solve the outstanding issues in 2012. Much progress still needs to be achieved.

Key data Japan 23

Population	127,5 m
GDP	4,117.7 EUR bn
Per-capita GDP	32,300.20 EUR
Exports as %age of GDP	13.2%
Imports as %age of GDP	12.3%
Gross value added	
Agriculture as %age of GDP	1.5%
Industry as %age of GDP	28.0%
Services as %age of GDP	70.6%

Source: Eurostat

Gaiatsu: a few highlights 24

In 1985, president Reagan and prime minister Nakasone launched the market-oriented, sector-specific (MOSS) talks, which actually achieved a certain liberalisation of Japan's markets in telecommunications, pharmaceuticals, micro-electronics, wood products, beef and citrus products for US companies, but were unable to prevent a huge conflict over semiconductor dumping and sanctions (1986 to 1991). The Structural Impediments Initiative subsequently pursued by president Bush and premier Kaifu between 1989 and 1993, which was intended to address further regulatory problems in the Japanese market, produced very mixed levels of success. Although Japan opened its retail market (for large stores) and increased its public investment, it made hardly any concessions on land use reforms (which were meant to make the purchase of industrial estates more affordable) and refused to give any ground at all on antitrust policy and the regulation of keiretsu supply relationships, which were the two most controversial issues.

In 1993, president Clinton and Japanese premiers Miyazawa and Hosokawa launched a new attempt to bring about quantifiable market liberalisation ('voluntary import expansions'). Although this goal was not achieved as such, in 1994 it did lead to some degree of progress on government procurement of medical and telecoms equipment and a certain liberalisation of the insurance market. However, 1995 saw the escalation of a conflict over imports of cars and automobile parts, which was finally resolved by an agreement on import targets.

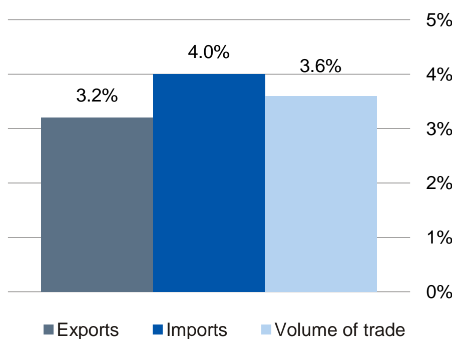
Japan: opportunities of market liberalisation?

The opening of the Japanese market to foreign suppliers of goods and services has been a constant theme of trade diplomacy for more than 150 years now. Ever since Matthew Perry, a commander in the US Navy, arrived in the port of Nagasaki in July 1853 with the aim of signing a trade agreement between the United States and Japan and breaking the monopoly that the Netherlands had on foreign trade at the time, the US and the EU have made a number of attempts – mainly since the mid-1980s – to achieve further liberalisation of Japan's markets in agricultural produce, industrial goods and services either multilaterally, bilaterally or through 'aggressive unilateralism'. At a time when Japan's status as a global trading power was at its peak, the Reagan and Clinton US administrations made particularly strenuous efforts to dismantle structural trade barriers in the Japanese market and achieved widely varying levels of success, depending on the sector concerned and the restrictions imposed by domestic politics. Although the EU too can now look back on more than ten years of bilateral negotiations as part of its strategic dialogue with Japan on a broad spectrum of market access barriers, Europe's business organisations still have a long list of grievances and very little tangible progress has been made. The West therefore has plenty of experience of 'gaiatsu',[29] i.e. external pressure exerted on Japan to try to persuade it to mend its ways (see box on the left).

[29] See Schoppa (1993) and (2008).

EU's trade with Japan 25

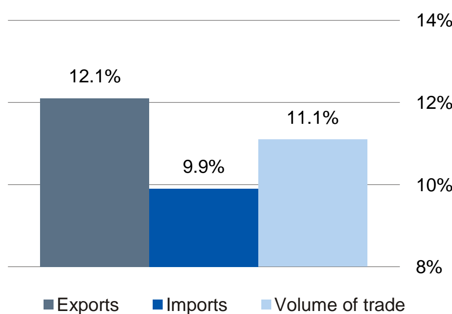
% of total volume, 2011



Source: Eurostat

Japan's trade with the EU 26

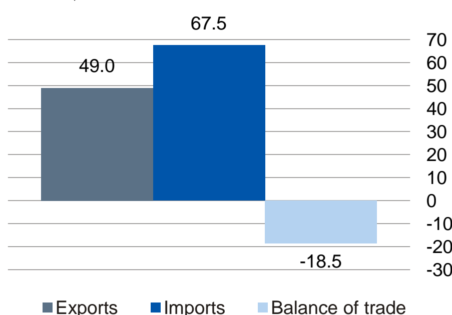
% of total volume, 2010



Source: Eurostat

EU's trade in goods with Japan 27

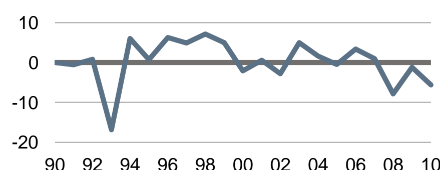
EUR bn, 2011



Source: Eurostat

Passenger-car registrations in the EU 28

% yoy



Source: ACEA

Japan's foreign trade policies on a path of liberalisation?

Although Japan has been gradually changing, it remains to be seen whether this change will be sufficient to benefit its external relations. After more than 70 years of pursuing economic policies[30] which were largely based on an industrial strategy, deliberately restricted and controlled competition from foreign market participants and ensured that Japan accounted for 10 per cent of global exports by 1993, the country gradually adopted a new approach 15 years ago. Over the course of the 1990s the liberalisation paradigm won out over the interventionist tendencies in Japan's foreign trade strategy. This was reflected in the country's strong support for the WTO, in several waves of liberalisation and deregulation of its domestic market and, finally, in its trade policy. By the end of the 1990s Japan was transitioning to a bilateral free trade strategy,[31] signing its first agreement with Singapore in 2002. This was followed by agreements with Mexico, Malaysia, Chile, Thailand, Brunei, Indonesia, ASEAN, the Philippines, Switzerland, Vietnam, India and Peru. Negotiations with Korea (bilateral), China and Korea (trilateral), Australia and the countries of the Gulf Cooperation Council are ongoing. However, only 18 per cent of Japan's imports (18.4 per cent of its exports) are currently attributable to preferential agreements,[32] partly because Japanese companies don't even use many of the preferential rules:[33] they evidently need the incentive of a sizeable foreign market before they will do so.

In general, however, the level of protective national border barriers is no longer very high. Although weighted average protective tariffs in agriculture still amount to 13.7 per cent, they are only four per cent on industrial products. Nonetheless, Japan still has the lowest proportion of imports among all OECD countries (measured as a percentage of total demand) and maintains many technical barriers to market access. In addition, the country has lost more than half of its share of global exports over the past 20 years and now accounts for around five per cent of the world market. Its share of global imports has also fallen from seven per cent to five per cent. Japan's foreign trade fared very poorly over the past decade, growing by only between one per cent and two per cent a year in terms of volume. Its policies on foreign trade also failed to provide adequate stimulus. What's more, 2011 was the first year since 1963 in which Japan reported a balance-of-trade deficit. Although this was attributable to several factors (high oil prices, loss of output and exports owing to the nuclear disaster), there are no signs that things will improve any time soon because structural changes in people's saving and investment behaviour are hitting the country's external balances and some of its key export industries are deeply mired in crisis – especially electronics, which is its second most important export sector.[34]

Bilateral economic relations

For some years now the Japanese government has been hoping that a free trade agreement with the EU would help to drive its domestic economic reforms and open the country to more foreign trade. The volume of bilateral trade in goods and services totalled EUR 143 billion in 2010. While Japan was the EU's seventh-largest trading partner in that year, the EU was Japan's third-largest partner after China and the United States. Japan accounts for some four per cent of the European Union's foreign trade, whereas more than eleven per cent

[30] See the debate unleashed by Johnson (1982) on Japan's industrial policies, which now fills entire libraries.
[31] Hiratsuka, Isono and Sato (2010).
[32] Figures from JETRO (2011).
[33] Hiratsuka et al. (2010) find that far more than half of Japanese companies did not use the preferential rules for 2006/07.
[34] Economist (2012).

Key data on automotive sector for 2010 — 29

Share of global vehicle production	22%
Share of global pass. Car production	26%
Trade surplus	57 EUR bn
EU employees / sector	12.6 m

Number of factories

Germany	47
France	38
UK	31
Italy	20
Poland	16
Spain	15

Vehicle production in 2010 (millions)

Germany	5.91
Spain	2.39
France	2.23
UK	1.39
Czech Republic	1.08

Passenger-car registration in 2010 (millions)

	Pass. cars only	Total
EU	13.36	15.135
Germany	2.90	3.198
France	2.25	2.708
UK	2.03	2.295
Italy	1.96	2.168
Spain	0.98	1.114

Trade in vehicles in the EU in 2010 (EUR bn)

	Imports	Exports	Balance
Passenger cars	22.006	76.46	54.454
Other	4.177	6.836	2.659

Imports of passenger cars in 2010 (EUR bn)

	Imports
Total	22.6
Japan	7.3
US	3.5
Turkey	3.4
South Korea	2.4
Mexico	1.6

Source: ACEA

of Japan's foreign trade is with the EU. Japan's importance as a foreign trade partner to the EU was already declining significantly before global trade fell sharply in 2009/10, while Russia, China and Turkey moved up into second, third and fourth places respectively among the EU's main target markets. Although the EU reports a balance-of-trade deficit in goods, it has a surplus in terms of services. The EU mainly imports machinery, equipment and cars; it exports these items as well as chemicals and other products. Trade with Japanese production plants in China is not included in this analysis. Cars are the single most important item in bilateral trade. The most recently available statistics reveal that Japanese suppliers sold roughly 550,000 units in the EU (generating revenue of approximately EUR 11 billion), while EU car makers sold 150,000 units in Japan (earning revenue of around EUR 3.5 billion). Foreign producers account for only five per cent of the Japanese market, whereas Japanese producers have a market share of 15 per cent in the EU. Although Japan does not impose any tariffs on cars (unlike the EU's ten per cent), its technical barriers to trade are very high. Japan accounted for 36 per cent of the EU's car imports in 2009 but only six per cent of its car exports.

Japanese companies have a much higher level of direct investment in the EU than EU companies do in Japan (EUR 129 billion in 2011 compared with EUR 94 billion in 2009). Five per cent of all foreign direct investment in the EU comes from Japanese sources, whereas only just over two per cent of EU foreign direct investment has been undertaken in Japan. Out of all the OECD economies, Japan has the lowest amount of foreign direct investment as a proportion of GDP. The relative importance of bilateral trade decreased overall as a result of the deeper regional integration in Europe and Asia.

Nonetheless, bilateral economic relations no doubt offer plenty of potential for furthering the integration of European-Japanese trade and investment. After all, diplomatic efforts in this direction would not exactly be starting from scratch. The EU and Japan have been discussing trade issues bilaterally since 1995; an agreement on the reciprocal recognition of standards in four sectors (radio and telephony, electrical products, safe practices in chemical laboratories and the production of pharmaceuticals) has been in force since 2002; and the EU has been engaged in an intensive dialogue on foreign direct investment, intellectual property and other issues since 2004. Furthermore, Japan has been trying with ever-greater intensity over the past decade to deepen its bilateral relations with the EU. Japan's interest in forging stronger economic relations with the EU, the United States (in the TPP) and the East Asian heavyweights (China and South Korea), which it has been articulating even more forcefully since the tragedy of early March 2011 (earthquake, tsunami and nuclear accident), should also be seen against the backdrop of its lacklustre foreign trade. The EU-Japan summit held in April 2010 set up a working group to examine the options available for deepening relations. The summit held in 2011 decided to start the process of parallel negotiations on a deep and comprehensive free trade agreement or economic partnership agreement and on political, global and sectoral cooperation. The results of the scoping exercise were published recently. Commissioner De Gucht called for the opening of negotiations.

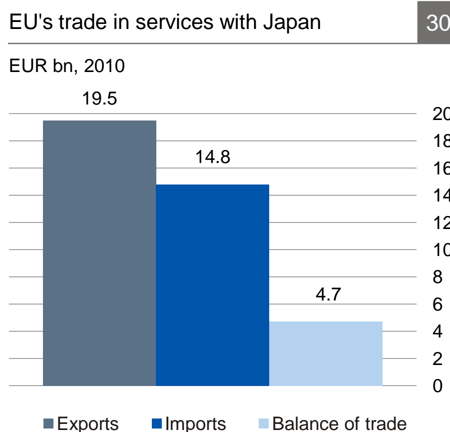
Potential for negotiations

Academic studies as well as statements provided by companies and their trade associations suggest that there are still a large number of barriers to market access, especially in the Japanese market. The EU could also facilitate trade by dismantling the barriers that it maintains.

In the scoping exercise, the potential benefits of a deal were looked at in various scenarios.[35] An ambitious agreement with substantially stronger reductions of the market barriers in Japan as compared to in the EU would raise EU GDP until 2020 by 0.8 per cent and Japanese GDP by 0.7 per cent. Exports to Japan would grow by some 33 per cent, and imports from Japan by almost 24 per cent. Most EU industries would benefit, with the important exception of the car industry which might see a broadly neutral impact, whereas in Japan several export industries would clearly benefit while the chemical industry would face a drop in production of some 11%.

EU's trade in services with Japan 30

EUR bn, 2010

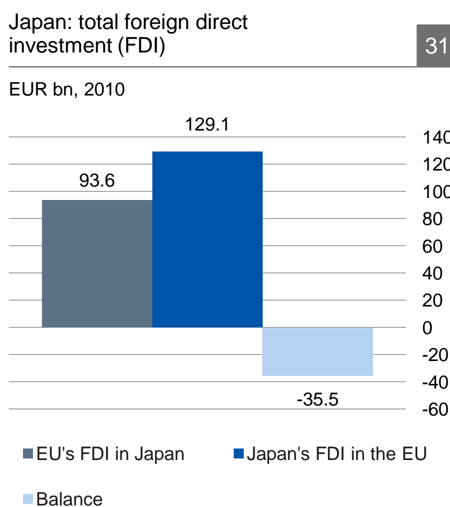


Source: Eurostat

An important prior study[36] commissioned by the EC concluded that the EU's exports could be raised by up to 23 per cent purely through the reduction of tariffs and that they could even be increased by a further 20 per cent to 40 per cent if the most important technical barriers were removed. The study found that the greatest opportunities lay in the dismantling of barriers applied to pharmaceuticals, medical equipment, processed foods, cars and other motor vehicles. The scoping exercise added IT, consumer electronics, telecommunications and textiles to the list of potential winners on the EU side. As far as services were concerned, the study concluded that the EU and Japan could improve on the very low current level of bilateral trade. However, state ownership, weak competition and other factors play a key role in service industries. For example, the postal and telecommunications markets are firmly in the grip of Japanese providers, and the barriers to market access in the energy and transport sectors are also well above the OECD average. Regulations governing the financial services industry prevent foreign companies from offering products belonging to different segments from a single entity.

Japan: total foreign direct investment (FDI) 31

EUR bn, 2010



Source: Eurostat

The liberalisation of Japan's government procurement market beyond the current level[37] would also be an attractive proposition. In order to boost inward investment, Japan would need to dismantle structural barriers around corporate takeovers and company management and in certain sectors, but *keiretsu* relationships in industry between end-producers and suppliers are likely to remain a permanent problem. Nonetheless, a government commission has been trying for years to enhance Japan's appeal as a place to do business.

Japan, in turn, could expand its own exports by up to 30 per cent by dismantling tariffs, with cars accounting for two-thirds of this increase. Further growth of between 10 per cent and 30 per cent could be achieved through the reduction of technical barriers in the EU, primarily in relation to cars, chemicals and electronics. Both economies would benefit from noticeable welfare effects. However, the impact on key macroeconomic variables such as output and employment would be negligibly small on both sides.

Widespread scepticism

Comments by companies, trade associations and chambers of commerce contain many references to these opportunities, which are particularly emphasised in respect of chemicals as well as producers of foodstuffs and spirits.[38] And yet there are also misgivings on both sides. Many EU trade associations reckon there is only a limited chance that the negotiation of a deep

[35] European Commission (2012).
[36] Copenhagen Economics (2009).
[37] The total volume of this market amounts to some 18 per cent of GDP (EU: 19 per cent). 83 per cent of the market falls within the threshold values of the WTO agreement, only four per cent is truly open and a further 13 per cent could be liberalised if Japan were to remove its exemptions from the WTO agreement. This amounts to a total of more than EUR 70 billion; see Copenhagen Economics (2009), p. 89 f.
[38] See, for example, the evaluation of the consultation by the Commission (European Commission 2011) or the European Business Council in Japan and the European (EU) Chamber of Commerce in Japan (2010).

free trade agreement will bring about a substantial reduction of the complex barriers to market access in Japan. Many market participants are therefore demanding that Japan should give a firm undertaking to dismantle a large number of barriers to market access even before or while such talks take place. In order to reduce such barriers, however, Japan has since 2009 taken numerous measures that had been demanded by EU trade associations, such as the publication of English-language tender documents for government contracts awarded by virtually all relevant public-sector entities, the easing of restrictions on the sale of alcohol, and safety procedures for cars.

The next political decision is likely to be a formal opening of the negotiations, coupled with EU demands for prompt actions by the Japanese government on dismantling several important trade and investment barriers. The economic case for deepening the bilateral relationship has been well put forward, and the focus will shift to political delivery. This will remain quite difficult as market opening would have to be pretty asymmetric. Japan would have to dismantle more barriers than the EU. If this becomes politically viable in Tokyo, the outlook for the bilateral relationship will clearly improve, and an agreement will come into reach.

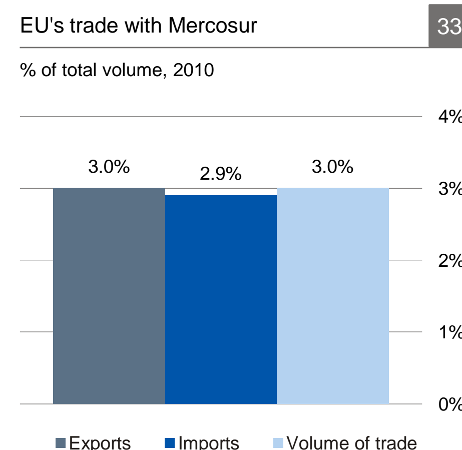
Key data on Mercosur 32

Population	244 m
GDP	1.658 EUR tr
Per-capita GDP	6,800 EUR

Source: Eurostat

EU's trade with Mercosur 33

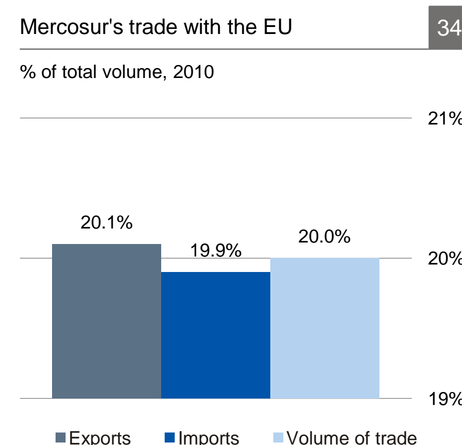
% of total volume, 2010



Source: Eurostat

Mercosur's trade with the EU 34

% of total volume, 2010



Source: Eurostat

Mercosur: pronounced sectoral effects

Over the past two years the EU's trade policy has again started to focus more sharply on economic relations with Latin America. The EU signed free trade agreements with Mexico and Chile many years ago, and similar agreements have recently been concluded with Peru, Colombia and the Central American states. Although the main focus is currently on Mercosur, the EU is also considering forging partnerships with Bolivia and Ecuador. It would then have signed preferential agreements with virtually all Latin American economies.

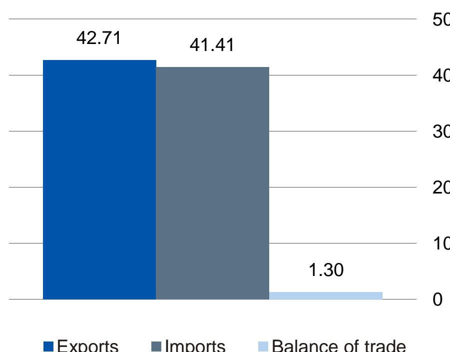
The 'Common Market of the South' (Mercosur), which was set up in 1991, comprises the four countries of Brazil, Argentina, Uruguay and Paraguay and was intended to be an ambitious customs union, although it had not fully achieved this objective by 2011 because many internal barriers within the single market and various national foreign-trade regulations and tariff rates continued to exist. Nonetheless, 85 per cent of tariffs have now been standardised, and this integration process is due to be completed by the end of 2012. Venezuela was accepted as the fifth partner country in 2006 and will become a full member in August 2012 while Paraguay's membership was suspended end of June 2012 until the next elections in April 2013. Mercosur (the four founding members) has a population of 244 million people, a combined GDP of just under EUR 1.7 trillion and an average per-capita income of EUR 6,800. 80 per cent of its economic output is attributable to Brazil.

Bilateral economic relations

Since 2004 (with the exception of the crisis year of 2009) bilateral economic relations between these two regional integration areas have generated double-digit growth rates in trade in goods and achieved sharp increases in foreign direct investment. The bilateral volumes of trade in 2010 amounted to EUR 84 billion in goods and EUR 21.5 billion in services. Mercosur currently accounts for some three per cent of the EU's foreign trade (and this proportion has been growing slightly over the past decade), while exactly one fifth of Mercosur's foreign trade is with the EU (and this share has been declining). Mercosur is now the EU's seventh-largest trading partner, and the EU is Mercosur's top trading partner. The EU mainly imports commodities and foodstuffs and exports industrial products. The EU has a small trade deficit in goods and a small surplus in services.

EU's trade in goods with Mercosur 35

EUR bn, 2010



Source: Eurostat

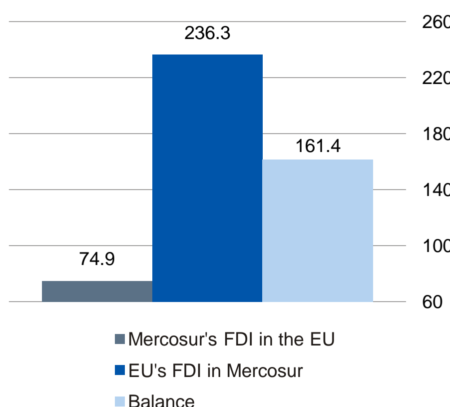
EU's trade in services with Mercosur 36

EUR bn, 2010

Source: Eurostat

Mercosur: total foreign direct investment (FDI) 37

EUR bn, 2010



Source: Eurostat

At just under EUR 236 billion, the relatively high level of foreign direct investment by EU companies in the Mercosur area points to a long history of exposure to this region – especially Brazil – and this investment grew by EUR 25 billion in 2010 alone. Foreign direct investment by Mercosur companies in the EU totals approximately EUR 75 billion, having amounted to less than EUR 20 billion as late as 2006. Over the past decade, however, Mercosur has slipped down the rankings as a destination for EU foreign direct investment compared with other emerging markets such as Russia, India and China.

Economic impact

Unsurprisingly, assessments of the economic impact[39] come to the conclusion that a free trade agreement could have a noticeable effect on trade and income in both regional integration areas given the substantial tariffs and non-tariff trade barriers that continue to be applied particularly to trade in goods in the Mercosur countries, the tariff-based and volume-related import restrictions especially on beef and other foodstuffs in the EU, and the high barriers to foreign direct investment in services in the Mercosur region.

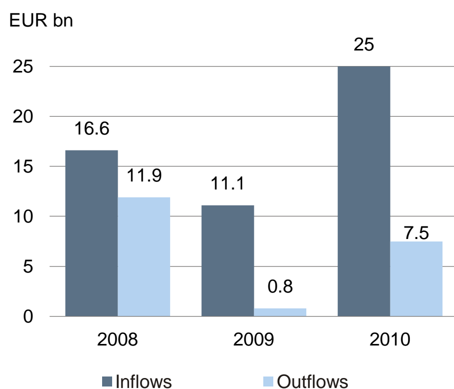
The potential income effects of an ambitious trade agreement are estimated to be increases of 0.2 per cent for the EU and 0.3 per cent for Mercosur. Assessments of various free trade agreement scenarios assume that, if comprehensive market liberalisation were agreed, the EU could potentially double its exports and increase its imports from the Mercosur region by as much as 40 per cent. These estimates suggest that Mercosur's agricultural and industrial exports would expand; the EU's exports of industrial products, processed foods and beverages would increase substantially; the EU's exports of services would rise slightly; and that the value added by Mercosur's manufacturing industry and by the EU's agriculture sector would decrease. As is to be expected, the liberalisation of trade would ensure that resources were genuinely reallocated away from the EU's less competitive meat production sector and Mercosur's industrial sector; the effects of this in absolute terms, however, would merely be in the low billions of euros. Nonetheless, concentrated local losses arising from what is generally a beneficial trade agreement always present a certain obstacle for reasons of political economy, domestic politics and development strategy.

Second attempt at negotiations

Since the summer of 2010 the EU has been making a second attempt to reach a trade agreement with Mercosur. The initial period of negotiations lasting from 1999 to 2004 ended without any tangible results having been achieved. Now that EU companies are becoming increasingly interested in foreign trade – especially in the Brazilian market – and the Chinese are stepping up their activities in this region. However, the Mercosur countries and the EU decided in May 2010 to launch another attempt at bilateral negotiations. Although eight rounds of negotiations have taken place since then, no actual offers of market liberalisation have yet been made by either side.

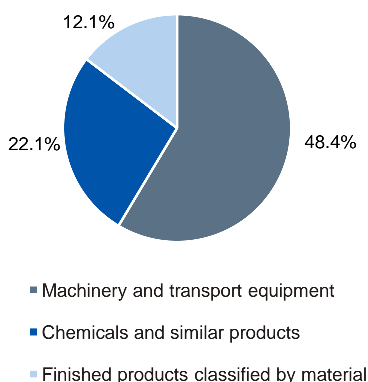
[39] There are many studies on this subject. My figures are mainly taken from the study that the EC commissioned from Copenhagen Economics (2011). However, please also refer to the Joint Research Center (2011) and the University of Manchester (2009).

Mercosur's FDI flows 38



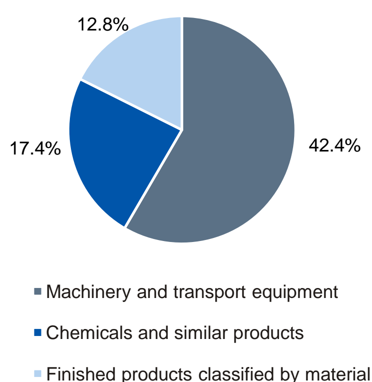
Source: Eurostat

Goods imported from Mercosur 39



Source: Eurostat

Goods exported to Mercosur 40



Source: Eurostat

Tariffs are still important

The negotiations conducted to date have focused on barriers to market access for trade in agricultural and industrial goods. The main issues being discussed in respect of Mercosur are the high tariffs imposed on many industrial goods,[40] the top tariff rates applied to foodstuffs, the incomplete integration of national customs systems,[41] taxation problems, inefficient customs clearance procedures, high logistics costs, technical trade barriers, Argentina's import licensing and minimum pricing regime, and the generally huge market access barriers to services and foreign direct investment. In addition, the automotive sector is posing particular problems because the Mercosur countries apply different rules on production and subsidies which, in effect, constitute substantial barriers within Mercosur.

The EU, on the other hand, imposes especially high tariffs or tight quotas on imports of foodstuffs (particularly beef). Both sides will have to agree to exempt certain sensitive products from full liberalisation of tariffs and quotas. During the Doha Round talks held in 2008 the EU made substantial offers to Latin American producers and others in the all-important meat industry. The main problems encountered during negotiations on agriculture to date have centred on securing access for processed foods and other products (alcohol, dairy, tobacco) to the Mercosur market.

The downturn in the Brazilian economy, the country's growing current account deficits (a consequence of the significantly overvalued real effective exchange rate of the *real*) and the problems that Argentina is encountering in its economic policies and foreign trade will not exactly make it easier to negotiate a free trade agreement, especially in the industrial sector. The liberalisation of trade in industrial goods would put additional pressure on Brazilian industry especially and benefit the EU countries, which are strong exporters. This would be likely to pose particular problems for producers of chemicals, rubber and plastics – industries that are highly capital intensive but very weak in terms of human capital – and for the engineering and automotive sectors. However, there would be adjustment costs for Europe as well. The local losses suffered in agriculture would hit the politically well-organised French meat industry particularly hard, and it does not take too much imagination to work out that any final agreement would at least have to be able to deliver substantial benefits in the form of access to the Mercosur market for other French providers.

Many different technical barriers

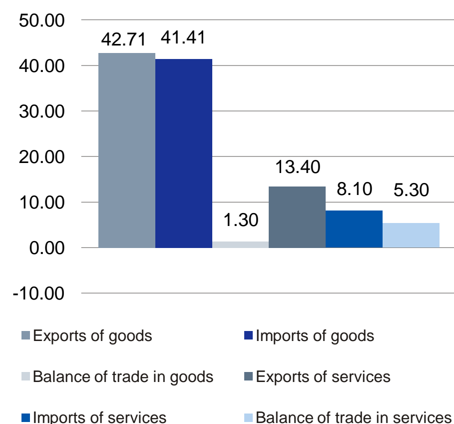
A trickier and more urgent issue to tackle, however, will be the dismantling of technical barriers in Mercosur, because this involves a large number of complicated obstacles that have an enormous impact on prices and trade. Negotiations on services are also likely to prove challenging because Brazil, among others, has reversed some market liberalisation processes in the past few years. Nonetheless, services would offer excellent medium-term opportunities for Brazil in particular. Transport, financial and communications services will need to play a more important role in the development of Brazil's

[40] Hufbauer et al. (2010) estimate that the trade-weighted tariffs applied by Brazil in 2006 were 7 per cent on industrial goods and 4.1 per cent on agricultural produce, while Argentina imposed tariffs of 5.1 per cent on industrial goods and 2.9 per cent on agricultural produce. However, these fairly modest average rates conceal high tariffs on individual product groups which, for example, amount to tariffs of 34 per cent on clothing, 22 per cent on textiles, 18.4 per cent on vehicles, and 17 per cent on beverages and tobacco (all trade-weighted averages for the Mercosur countries); see Copenhagen Economics (2011), p. 27.

[41] This can result in a situation whereby customs tariffs are charged on goods imported into one Mercosur country and then, when the goods are re-exported to another Mercosur state, tariffs are charged again.

Trade in goods and services with Mercosur — 41

EUR bn, 2010



Sources: Eurostat, Copenhagen Economics

economy and infrastructure, and foreign companies could use their expertise to boost employment and value creation.

The protection of intellectual property is also posing especially tough challenges. This is an issue that the EU considers to be increasingly important but which Mercosur is treating as a defensive interest. The opening of Mercosur's procurement market might prove to be an easier task.

Services offer benefits for both sides

On the other hand, there would certainly be economic scope for resolute market liberalisation, especially in Brazilian services, which would no doubt boost competition, employment and value creation in Brazil. During the Doha Round to date, however, Brazil has been highly reluctant to make any concessions on services and has proved unwilling to offer much more than an agreement on the existing level of market access. A free trade agreement would make at least strong sectoral aspects of market liberalisation unavoidable, although even a legally binding agreement on the current extent of market access would bring benefits for some industries.

Political resistance within Mercosur needs to be overcome

Although the bigger picture here is that negotiations between the EU and Mercosur offer many opportunities to substantially deepen bilateral economic relations, the obstacles still to be overcome are considerable and – even if there is strong political commitment to this process on both sides – will probably require the Mercosur countries to make huge efforts to abolish non-tariff trade barriers and open their services markets to investment by foreign companies. The EU would be able to accept losses on a local level. However, the prospects for this trade agreement are not especially promising. It takes two to tango – and that includes Buenos Aires.

Key data on Canada — 42

Population	34,4 m
GDP	1,263.4 EUR bn
Per-capita GDP	36,743.90 EUR
Exports as %age of GDP	24.5%
Imports as %age of GDP	27.1%
Gross value added	
Agriculture as %age of GDP	1.7%
Industry as %age of GDP	31.5%
Services as %age of GDP	66.8%

Source: Eurostat

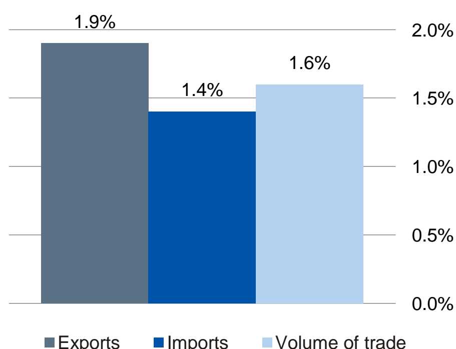
Canada: the EU as a counterweight to the United States

Canada was not initially included in the list of prospective partners for free trade agreements under the Global Europe strategy in 2006 because it did not meet the usual criteria. The first attempt to reach agreement in 2006 failed because the EU wanted to discuss the issue of regulatory and market access barriers, which fall within the remit of the provinces, but Canada was reluctant to do so at the time.

Although Canada appeared to be slightly peeved, it was soon pulling out all the stops to get back on the EU's radar screen. Key roles were played here by prime minister Stephen Harper and by the premier of Quebec province, Jean Charest, who organised a coalition of provinces that sensed an opportunity to secure jobs and exports. Encouraged by strong leadership from then French president Nicolas Sarkozy (the EU Council president at the time), Commission president José Manuel Barroso and Trade Commissioner Peter Mandelson, the EU decided in 2007 to launch a renewed attempt to reach an agreement.[42] The bilateral summit in 2007 commissioned a study into the potential offered by a free trade agreement, which in the autumn of 2008 led to the adoption of a resolution on preparations for trade negotiations. The EU and Canada started talks on a Comprehensive Economic and Trade Agreement (CETA) in 2009. Negotiations were aimed at achieving a deep agreement that included Canada's provinces and territories.[43] Trade associations on both sides eventually

EU's trade with Canada — 43

% of total volume, 2011

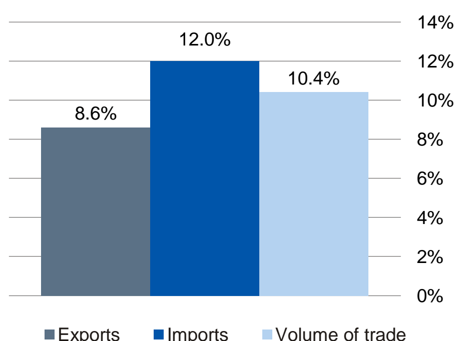


Source: Eurostat

[42] For the political backstory see Woolcock (2011), Woll (2011), Drache and Trew (2011).
[43] Joint Report (2009).

Canada's trade with the EU — 44

% of total volume, 2010



Source: Eurostat

welcomed this political initiative and, even later in the process, Canadian trade unions and NGOs voiced their concerns. The project is a controversial issue in Canadian politics because it is opposed by the New Democratic Party (NDP), which is the main opposition force in parliament.[44] It has not yet unleashed any controversial debates within the EU, although there have been minor disagreements on the subject of oil sand mining.

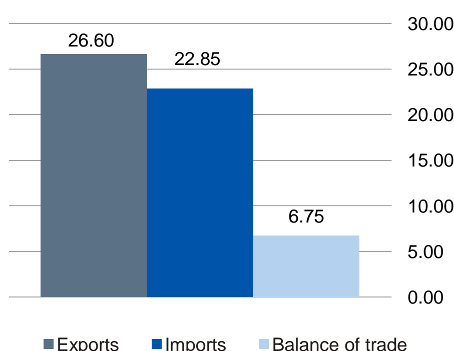
Canada therefore constitutes one of the few cases where the EU has been selected by its trading partner rather than the other way round. This is partly because Canada's economy and trade have been increasingly strongly influenced by the United States ever since the country signed a bilateral agreement with the US in 1989, and Canada is now once again starting to look for opportunities to diversify by forging closer relations with its second most important partner, the EU. In doing so, Canada will no doubt have taken on board the fact that it would have to open its markets more than the EU could in return, which has fuelled an ongoing debate in Canadian domestic politics.[45]

Bilateral economic relations

Economic relations between the European countries (the EU more recently) and Canada have been fairly harmonious for centuries. Since a framework agreement was signed in 1976, the EU and Canada have also concluded a few sectoral agreements, which include agreements on reciprocal recognition (1998). However, no major trade agreements have been signed.

EU's trade in goods with Canada — 45

EUR bn, 2011



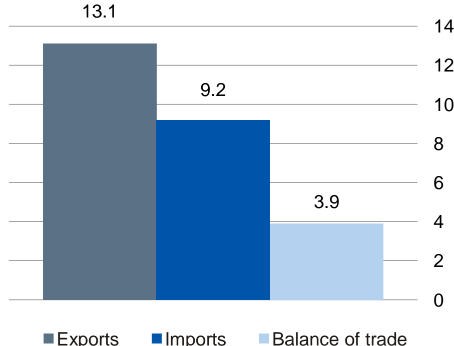
Source: Eurostat

The volume of bilateral trade in goods and services amounted to just under EUR 70 billion in 2010. Although Canada accounts for only 1.6 per cent of the EU's foreign trade, 10.4 per cent of Canada's trade is with the EU. Canada is the EU's twelfth-largest trading partner, while the EU is Canada's second-largest partner. These relative weightings have changed only marginally over the past decade. The EU runs small trade surpluses. The EU's main exports are high-value finished goods and energy commodities, although the EU is also increasingly importing uranium, metals and mineral commodities (iron ore, nickel and aluminium) from Canada. Trade in services is dominated by transport and tourism, followed by corporate and financial services.

Foreign direct investment by both sides is fairly strong. Canada's capital spending in the EU totals roughly EUR 143.1 billion and has grown by a factor of 2.4 since it dipped in 2003. EU direct investment in Canada came to EUR 197.4 billion in 2011 and has increased by a factor of 2.5 since 2004. Having grown strongly between 2003 and 2006, capital expenditure has again been rising sharply since 2010. There are evidently good reasons for assuming that a growing number of EU companies are engaging in foreign direct investment in Canada, from where they are then supplying the NAFTA market.

EU's trade in services with Canada — 46

EUR bn, 2010



Source: Eurostat

Trade in goods

The vast majority of trade in goods is subject to very low customs tariffs; the weighted average tariff rate on imports into the EU was 2.2 per cent in 2007, while the corresponding tariff on Canada's imports was 3.5 per cent.[46] The EU continues to impose high tariffs on fish, marine products, grain and processed foods, while Canada levies high tariffs or quotas on foodstuffs (especially dairy and animal products), shoes, textiles and clothing. Trade in goods is impaired by factors such as differing technical standards and agricultural protection on both

[44] Since the elections on 2 May 2011 the Conservatives have had 167 of the 310 seats in the House of Commons, the NDP has 102 and other parties have 39; the latter group includes the Liberals, who have 34 seats and are generally in favour of free trade.
[45] Drache and Trew (2011).
[46] Joint Study (2008).

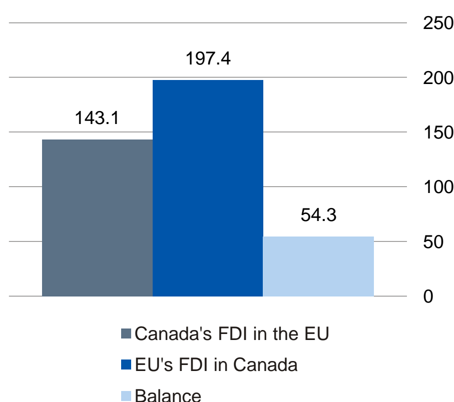
sides in general as well as Canada's support for producers in selected sectors – especially the dairy industry, which employs more than 200,000 people – and EU-specific rules on genetically modified organisms and hormone-treated beef in particular. These problems are exacerbated by differing marketing rules in all sectors. Rules on the origin of goods are fairly important under the CETA. Strict rules on origin need to be agreed in order to prevent US companies from indirectly being granted free access to the EU's internal market because they are covered by NAFTA. This is particularly relevant to the automotive sector.

Trade in services

Trade in services continues to be subject to substantial barriers, which increase the cost of their provision by between 20 per cent and 50 per cent. These barriers apply primarily to aviation services, the cross-border provision of insurance services, and in telecommunications, the latter being a sector in which Canada still imposes limits on ownership and the EU maintains barriers. Another important area is the liberal professions, for which the rules on reciprocal market access need to be relaxed. Financial services (especially investment companies) are also hampered by the regulatory authorities of the 13 provinces and territories and by the lack of reciprocal recognition among these entities. Many sectors are still generally subject to registration or nationality requirements for directors and managers. Nonetheless, the negotiators are trying to reach agreement on an approach based on a 'negative list' of services for the first three categories which are not to be liberalised, which then makes life easier for the other sectors. This approach has the added advantage that newly created services are initially treated liberally. However, this is not exactly easy to implement either, and exemptions will probably be granted for education, healthcare, utilities and waste disposal services. What's more, EU companies often have problems with visas and work permits issued by the provinces for employees on international secondments, while Canadian investors have to contend with numerous barriers to the movement of Canadian professionals between the various EU member states. Labour mobility is therefore one of the key issues being discussed in the negotiations, which seem to be progressing well.

Canada: total foreign direct investment (FDI) 47

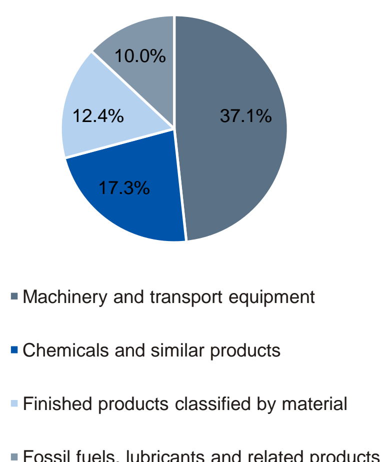
EUR bn, 2010



Source: Eurostat

Goods imported from Canada 48

2011



Source: Eurostat

Foreign direct investment

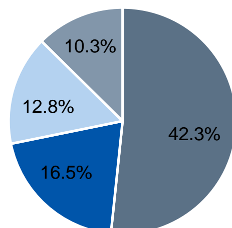
Although the barriers to foreign direct investment in the EU are not very high, Canada has quite a few such barriers. The main sectors affected are shipping, financial services, telecommunications and energy. Canada plans to open its telecoms[47] market, but this is likely to prove quite a task given the sizeable cross-shareholdings with other areas of the ICT industry and cultural protection regulations. Progress also seems to be possible in financial services. In the EU, on the other hand, one of the main issues is indirect barriers in the form of public-sector enterprises.

The protection of capital investment is very important for Canada. In the autumn of 2011 the European Council gave the Commission a mandate to negotiate an investment protection agreement with Canada in accordance with the Lisbon Treaty. This agreement will cover protection issues as well as market access.

[47] Canadian law stipulates that primary landline telecommunication services must be provided by Canadians, 80 per cent of the members of the relevant companies' management bodies must be Canadian, and at least 53.3 per cent of their shares must be held by Canadians; see Joint Study (2008), p. 48.

Goods exported to Canada 49

2011



- Machinery and transport equipment
- Chemicals and similar products
- Finished products classified by material
- Other finished goods

Source: Eurostat

Government procurement

One of the EU's key offensive interests is to gain better access to Canada's government procurement market, which accounts for almost three per cent of the country's GDP, and this total is split more or less equally between the federal government, the provinces and the local authorities. Although Canada is a signatory to the Government Procurement Agreement (GPA), it has not entered into any commitments on behalf of its provinces, local authorities or public-sector enterprises. The Joint Study therefore identified potential here for substantial welfare effects in Canada if there were greater competition because Canada had opened its market to European companies, whereas the open EU would derive hardly any such additional benefits because its internal market has already been deregulated; it could, however, benefit from increased exports. Comprehensive reciprocal offers of market liberalisation have already been made. Although the United States has already gained access to large parts of the Canadian market, what the EU is looking to achieve goes even further.

Intellectual property

Another crucial area in negotiations is the differences in the protection of intellectual property and the issue of protected geographical indications of origin – as in the case of Parma ham, for which there is no such protection in Canada – but also for cheeses and wines, both of which are highly protected products. Although the EU is expecting Canada to make material concessions on this issue (as Korea has already done), Canadian legislation is currently based on the principle of self-regulation for industry. Obstacles still need to be overcome with respect to patent law issues as well; Canadian pharmaceutical manufacturers, for example, oppose strict protection standards for intellectual property. Sanitary and phytosanitary standards are also controversial, although the EU maintains a number of barriers that are difficult to justify. Canada is generally keen to have binding arbitration procedures for regulatory issues, whereas the EU rejects such proposals.

Opportunities of liberalisation

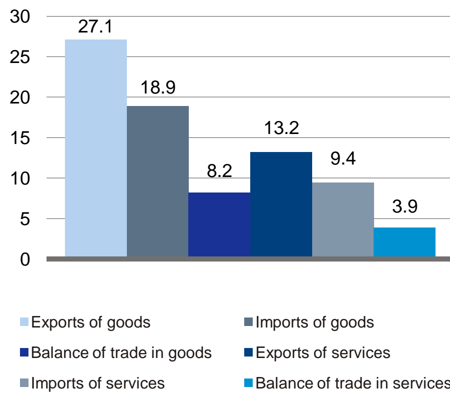
The Joint Study conducted by the EU and Canada concluded that bilateral trade could be increased by between 20 per cent and 25 per cent in both directions if a comprehensive agreement were signed. Half of the desired effect would come from the liberalisation of trade in services,[48] while roughly one quarter each would be attributable to tariffs and technical barriers. However, all of these figures are based on the assumption that the Doha Round will be completed. If it is not concluded, the desired effects on trade in goods are likely to be much greater. The Joint Study concluded that the EU's main export opportunities would come from processed foods, chemicals, capital goods and transport, construction and insurance services; the greatest opportunities for Canada are expected to stem from processed foods, agricultural commodities, metals, transport services and equipment, and capital goods. One of the decisive factors will, of course, be whether the parties concerned really manage to soften some of the hard protectionist edges around trade in goods and services.

It is easier to describe the EU's new trade strategy than it is to put it into practice. EUKOR has already broken new ground in many areas. The CETA will have to do likewise on several other issues. The CETA could act as a model if it manages to regulate new topics properly for the first time. There are signs of

[48] The Joint Study (2008) used the EU's internal market as a reference point in order to methodically calculate the potential for harmonising cost structures as a result of liberalising trade between the EU and Canada. This revealed sectoral trading cost reductions of between 24 per cent and 52 per cent for Canadian imports and between 18 per cent and 42 per cent for EU imports.

EU's trade in goods and services with Singapore 50

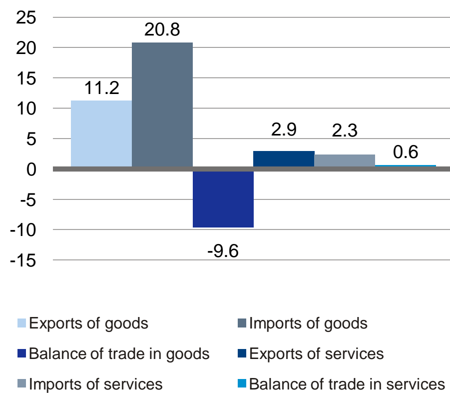
EUR million, 2010



Source: Eurostat

EU's trade in goods and services wirth Malaysia 51

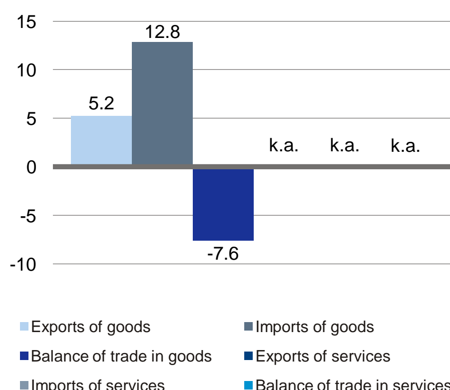
EUR million, 2010



Source: Eurostat

EU's trade in goods and services with Vietnam 52

EUR million, 2010



Source: Eurostat

such potential on the complex issue of labour mobility. This might also be achievable in respect of the reciprocal recognition of professional qualifications and university degrees, although possibly not in the trade agreement itself. It is equally true, however, that the EU could carry out some of the groundwork for its member states by using a negative list to liberalise some services sectors, and this work would then be beneficial for other trade agreements as well. The case of Canada could clearly illustrate the level of external competition that economies should be able to withstand. Canada would need to open its markets further. As the first of its kind, the planned agreement on foreign direct investment, on the other hand, might trigger an important learning process on the part of the EU because the Lisbon Treaty has transferred the relevant powers to the European Union; however, these powers now need to be put into operation. FDI agreements are hugely important for service providers. Nonetheless, we need to caution against drawing sweeping conclusions. Although academics may be keen on 'model' agreements, it is far from certain that bilateral solutions can simply be transferred to other bilateral relations in the form of WTO-plus or WTO-minus agreements.[49]

ASEAN countries: Europe's wild-goose chase

The more developed ASEAN countries meet the necessary criteria for trade agreements with the European Union because they are fast-growing economies with high barriers to EU trade and have undertaken market liberalisation measures both within Asia and in trade with the United States. However, they are all small national economies with correspondingly modest markets. The volume of bilateral trade in goods with the six largest economies in 2010 totalled EUR 145.1 billion, which represented 5.2 per cent of the EU's foreign trade. The EU's largest trading partners among this group are Singapore (ranking 12th overall), Malaysia (22nd), Thailand (24th), Indonesia (32nd), Vietnam (36th) and the Philippines (42nd). The ASEAN countries generally continue to apply very high protective barriers to industrial goods and to services. This is particularly true of the automotive sector.[50]

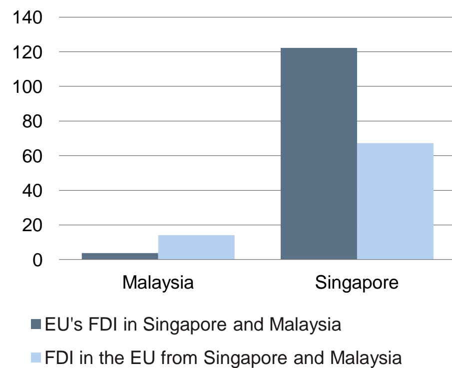
Singapore

The EU has been negotiating a trade agreement with Singapore since the spring of 2010. Bilateral trade recently totalled approximately EUR 60 billion. EU foreign direct investment in Singapore is in excess of EUR 100 billion, while Singaporean companies have invested more than EUR 60 billion in the EU. A trade agreement would have a highly beneficial impact[51] on growth, employment, wage levels and foreign trade in Singapore. The more agreements the EU signs with ASEAN countries, the greater these positive effects would be because Singapore acts as a regional hub. A trade agreement is also expected to have a beneficial impact on market access and trade in services – especially banking and insurance services – and the liberal professions. It could also have a benign effect on Singapore's exports of textiles, clothing and electronics. It remains to be seen whether the EU and Singapore can reach an accommodation on the issue of financial services. Singapore has already liberalised market access for US companies under a free trade agreement, and the EU is now demanding the same treatment.

[49] 'WTO-plus agreement' is the technical term used to describe agreements that deal with WTO regulation at a higher level, while 'WTO-minus agreements' are those covering issues that lie outside the WTO's legal remit.
[50] See the comprehensive study conducted by Heymann on this subject (2011).
[51] Country annexes to an impact assessment by the Commission are available on the website of the Directorate General for Trade of the European Commission.

EU's total foreign direct investment (FDI) 53

EUR bn, 2010



Source: Eurostat

Malaysia

The EU has been conducting negotiations with Malaysia since October 2010. The volume of bilateral trade totals approximately EUR 37 billion, although reciprocal foreign direct investment remains very low. Three-quarters of bilateral trade in goods is attributable to industrial goods (engineering, vehicle manufacturing, electronics). Malaysia's economy maintains a number of barriers primarily in services, foreign direct investment, and government procurement. Public-sector enterprises also play a crucial role. However, the government is making efforts to substantially liberalise many services and open them up to competition. Trade in goods is marked by the promotion of domestic carmakers. The Commission's impact assessment concludes that an ambitious trade agreement could have a particularly positive effect on Malaysia's level of output and exports, and that the EU could gain better market access in services and foreign direct investment.

Vietnam

At the beginning of April 2012 the EU and Vietnam reached agreement on the issues to be discussed in forthcoming negotiations. Formal talks began in July. The volume of bilateral trade remains low at EUR 18 billion. However, Vietnam has a balance-of-trade surplus of EUR 7.6 billion, which stems largely from the country's substantial exports of telecoms equipment, commodities, shoes, textiles, clothing, some foodstuffs (coffee, seafood) and furniture, while the EU supplies some industrial goods. Foreign direct investment in Vietnam is still very low. It is too early to say what chance there is of reaching a trade agreement.

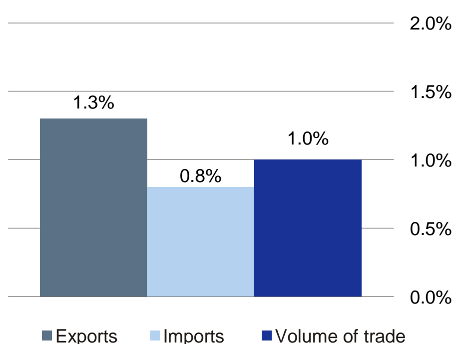
Key data Ukraine 54

Population	45.5 m
GDP	102.9 EUR bn
Per-capita GDP	2,262.70 EUR
Exports as %age of GDP	36.1%
Imports as %age of GDP	43.5%
Gross value added	
Agriculture as %age of GDP	8.2%
Industry as %age of GDP	29.4%
Services as %age of GDP	62.4%

Source: Eurostat

EU's trade with Ukraine 55

% of total volume, 2010



Source: Eurostat

Eastern Europe: Ukraine and others

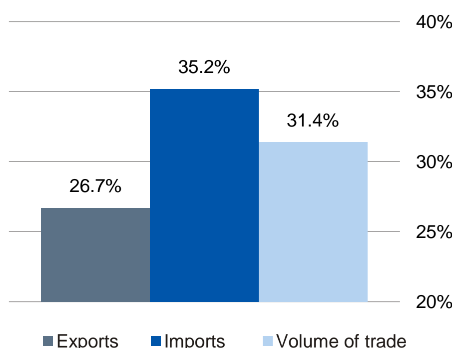
The EU is negotiating with a number of eastern European countries. It started free-trade talks with Georgia and Moldova in 2011. Russia is not considered to be a candidate for a free trade agreement at the moment because the country's trade policy schedule is already very busy given that Russia is due to join the WTO in the summer of 2012. However, the existing partnership and cooperation agreement has yet to be updated, and these negotiations could include trade issues.

Free trade agreement with Ukraine ready to be signed

Ukraine is the most important country in this region after Russia. Back in 2007 it was decided to start talks on an association agreement and, after Ukraine had joined the WTO in May 2008, the EU and Ukraine commenced negotiations on a new association agreement, including a free trade agreement. These negotiations were completed in December 2011. The EU is Ukraine's second-largest trading partner (just behind Russia) and accounts for 31 per cent of the country's foreign trade, whereas only one per cent of the EU's foreign trade is with Ukraine. The volume of bilateral trade came to EUR 56 billion in 2010, with the EU running moderate balance-of-trade surpluses in both goods and services. The EU principally imports agricultural produce, energy commodities, base chemicals, iron and steel, while the EU's main exports are industrial goods. Foreign direct investment by EU companies in Ukraine totals EUR 18 billion, while Ukrainian firms have invested just under EUR three billion in the EU. Ukraine's exports to the EU are already largely barrier free. The planned agreement would introduce extensive liberalisation of trade in goods and

Ukraine's trade with the EU 56

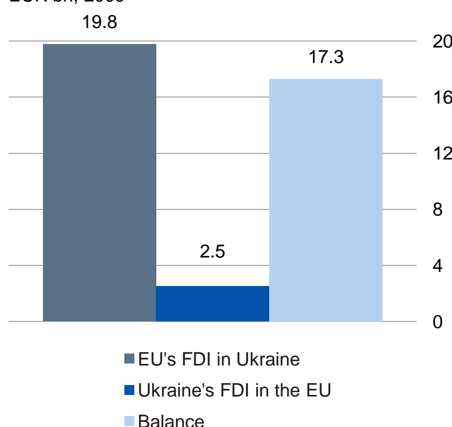
% of total volume, 2010



Source: Eurostat

Ukraine: total foreign investment (FDI) 57

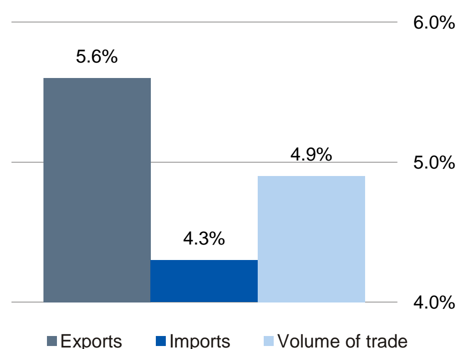
EUR bn, 2009



Source: Eurostat

EU's trade with die Euromed countries* 58

% of total volume, 2011



* Excluding the EU and Turkey; Euromed: Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria and Tunisia

Source: Eurostat

services.[52] The main exemptions likely to remain are the EU's protective barriers against grain imports and the restrictions on market access for Ukrainian transportation and logistics services, primarily for social and welfare reasons.[53] The agreement is likely to bring Ukraine into line with the EU's legal status in terms of competition, government procurement, industrial standards, conformity tests, sanitary and phytosanitary standards and other areas. In 2020 Ukraine could then largely adopt the legal status of the EU's internal market, thereby obtaining favourable market access on a permanent basis. This should benefit dairy and meat producers as well as most industrial manufacturers. In areas where Ukraine has adopted the EU's legal status there is already a certain degree of free movement for service providers; in other areas this freedom will apply in accordance with an implementation schedule.

The macroeconomic effects of the agreement are likely to be positive for both sides, and for Ukraine they should also be highly substantial. Consumer welfare, growth, exports and wages will all probably increase sharply despite the fact that Ukraine will have to shoulder a few transitional administrative costs in order to introduce the EU standards in key sectors. The main sectors to benefit in Ukraine will be engineering, electronics, textiles, clothing and the meat industry, while adjustments are primarily expected in the energy sector and in financial, transportation and business services. Ukrainian consumers are likely to benefit from better services and lower prices. EU exports of sugar and alcoholic beverages should also rise sharply.

The trade agreement will bring medium-term benefits for both sides in terms of foreign direct investment, providing that Ukraine manages to implement the EU legal status and resolve the other issues affecting domestic business activities (inadequate rule of law, corruption, ineffective judiciary).

However, the agreement is still waiting to be signed and then ratified by parliament because the EU and Ukraine are still involved in a foreign policy dispute over the Ukrainian judiciary's treatment of Yulia Tymoshenko, an opposition politician and former prime minister. Nonetheless, the Ukrainian government hopes to have ratified the agreement by the time parliamentary elections are held in October 2012. From the EU's side, the agreement needs to be ratified by the European Parliament (trade agreement) and by all 27 member states (association agreement).

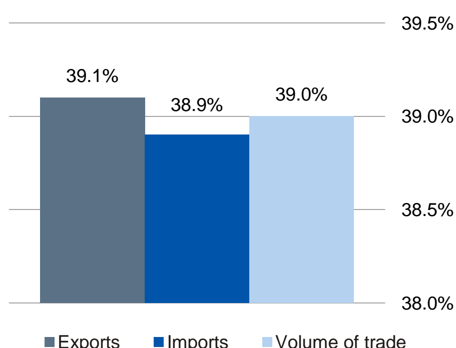
Southern Mediterranean countries: business location policy is key

The EU decided on 14 December 2011 to conclude new deep and comprehensive trade agreements with some of the Southern Mediterranean countries[54]. The idea is to start with negotiations on trade liberalisation between Egypt, Jordan, Morocco and Tunisia, which are the signatories to the Agadir Agreement. These talks are now under way. The agreements concluded to date generally only cover trade in industrial goods. They are now to be supplemented by agreements on issues such as agricultural produce, services, protection of investment, technical barriers, sanitary and phytosanitary standards, government procurement, competition, protection of intellectual property, easing of trade restrictions, and arbitration procedures. Parallel negotiations on services and foreign direct investment are already being conducted with some other Southern Mediterranean countries. The European Union is also examining to

[52] For general information on the impact of the agreement see ECORYS and CASE (2007) as well as Van de Water (2011).
[53] It is not yet possible to give a definitive evaluation because the text is not publicly available.
[54] Negotiations are not due to be held with Syria. Turkey is already linked to the EU through a customs union. The other Southern Mediterranean countries are potential candidates for trade agreements.

Euromed countries'* trade with the EU 59

% of total volume, 2010



* Excluding the EU and Turkey; Euromed: Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria and Tunisia

Source: Eurostat

what extent the partners with which it wishes to sign deep and comprehensive agreements could harmonise their legal systems with that of the EU. Trade with the Southern Mediterranean countries (excluding Turkey) totalled just under EUR 160 billion in 2011, with the EU running a small balance-of-trade surplus. The EU accounts for 39% of this region's foreign trade, making it by far the largest trading partner. The Southern Mediterranean countries account for just over 4% of the EU's imports and almost 6% of its exports so that, overall, they are the EU's fifth-largest trading partner with 4.9% of its foreign trade. Trade in agriculture represents only 10 per cent of bilateral trade (with the EU running a trade surplus!), while energy commodities generate 31% of trade. Services are virtually irrelevant. The EU's imports from the Southern Mediterranean countries remain strongly focused on commodities (54%) as well as machinery, chemicals and textiles/clothing, which each account for roughly 9% of the total. Trade between the Southern Mediterranean countries is extremely modest and the level of economic integration within this region is very low. It is therefore hardly surprising that these countries attract only one per cent of the EU's total foreign direct investment. Although deep trade agreements might reduce some of the EU's import barriers, the lion's share of the work needs to be focused on making the Southern Mediterranean countries more attractive places to do business and on gradually harmonising their legal systems. Only then will it be possible to substantially expand bilateral trade.

Conclusion

Seven years ago the EU shifted the focus of its trade strategy away from what were primarily multilateral policies and towards bilateral agreements with countries and regions. Since then it has started negotiations with several major industrialised countries and a number of emerging economies and developing nations. One trade agreement has already been signed (South Korea) and negotiations on another have been completed (Ukraine). The attempts to reach agreements with Mercosur, India and the ASEAN countries still have varying amounts of negotiations ahead of them. It is still too early to speculate on the political prospects and the potential economic success of these talks. There are a lot of obstacles in domestic politics that still need to be overcome, and many rounds of negotiations have yet to be completed.

The EU's strategy is flexible

The negotiations being conducted with Canada, for one, did not meet the usual criteria set by the EU when looking for trading partners. Negotiations with Japan and the United States would not fulfil these criteria either. However, this does not mean that the EU could not respond to its partners' wishes and preferences or that it would be unable to venture beyond its original strategic objectives. A certain flexibility is integral to its trade strategy.

Bilateral agreements require a strong sense of political purpose from both partners

One can rightly ask why there should be a realistic prospect of success in so many bilateral negotiations when multilateral talks – which should, in theory, be simpler – have so far proved fairly unproductive. There is no obvious answer to this question. As far as both South Korea and Ukraine are concerned, one of the main reasons why these countries were able to reach agreements was that their politicians had taken the fundamental decision to open their markets to foreign trade and strengthen their economic relations with the EU. It is not yet clear whether the other countries will be able to sustain such a strong sense of political purpose that proves resilient enough to overcome the many stumbling blocks on the path towards 'deep and comprehensive trade agreements'. Given recent events, observers would appear to have good reason for doubt. Concerns about overbearing Chinese competition played a large part in many emerging economies' lack of willingness to open their markets during the Doha Round. It remains to be seen whether it will really be easier to reach agreements without China.

Transatlantic agreements setting global standards?

The negotiations between the EU and the United States will reveal whether preferential agreements and multilateral efforts – which have recently been given a shot in the arm by Russia's forthcoming membership of the WTO, the strengthening of the plurilateral agreement on government procurement, and the arbitration in the Airbus-Boeing dispute – are compatible in the long term. If these two partners manage to use bilateral agreements on the most progressive dossiers in global trade to effectively set standards for the multilateral system and to ensure subsequent multilateralisation within the WTO or under plurilateral agreements, then those engaged in foreign trade around the world can relax a little more. At the same time, both of these players need to think long and hard about the extent to which these arrangements should be open to third parties.

Risk of tensions within global trade is growing nonetheless

However, the danger that Asia's regional integration in terms of production, trade, foreign direct investment, currency management and market regulation could evolve into an alternative regulatory model to rival the transatlantic one, thereby heightening tensions within the global trading system over the medium to long term, cannot simply be dismissed. This is also true of the growing risk of trade and capital protectionism in countries such as China, India, Brazil, Argentina and Russia, which have often either taken or intensified protectionist measures since the financial crisis. Given the ongoing macroeconomic turmoil worldwide, national development policy priorities in the widest sense, and the significant role played by governments in the economy, the EU's strategy of pursuing 'deep and comprehensive trade agreements' that go well beyond the WTO's remit and the obligations embedded in the multilateral system is faced with the challenging task of strengthening potential trading partners' willingness to forge closer relations with Europe. Only in very few cases will this strategy receive support from security policy considerations.

Are strong bilateral trade agreements and a functioning multilateral system compatible?

In the past, diplomacy was often driven by the transatlantic rivalry to secure better market access for US and EU firms. In future, such considerations will be determined to a greater extent by the rivalry between the East Asian and transatlantic economic models. Since the EU and the United States do not have the option of signing preferential trade agreements with China in the foreseeable future because of the political obstacles involved, and the multilateral system is failing to provide the necessary momentum, the focus of attention going forward needs to be fixed not just on the opportunities offered by individual preferential agreements but also on the growing risk of tensions within the international system. The huge task still facing those in Brussels and elsewhere is to avert a potentially lethal cocktail of incompatible regulatory frameworks and mounting protectionism.

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Printed by: HST Offsetdruck Schadt & Tetzlaff GbR, Dieburg

Print: ISSN 1612-0272 / Internet/E-mail: ISSN 1612-0280