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## 4 What future for EU trade policy and free trade agreements?

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Trade policy has never been uncontroversial. Yet in recent years it has come back in full spotlight with (fears of) globalisation seeming to reshape politics in developed economies, principles of the post 1945 multilateral trade system being put into question and (threats of) trade wars spreading.

For the European Union (EU), trade policy has been one of its successes, having managed to position the bloc as a true global actor. Yet, EU trade policy faces multiple challenges. These include conducting trade policy successfully in a more uncertain and confrontational international environment; dealing with the changing nature of trade, i.e. broadening beyond goods and being transformed by technology; and maintaining domestic support for its trade policy strategy and actions.

### **The EU's trade position and Free Trade Agreements**

The EU is the world's largest trading bloc, covering 16.7% of global goods and services trade,<sup>2</sup> and the top trading partner for about 80 countries. The bloc ranks 2nd as an exporter of manufactured goods and leads globally as an exporter of services and for in- and outbound investment.<sup>3</sup> A wide-ranging network of free trade agreements (FTAs) underpins its position in world trade and form a key element of the Union's trade strategy. FTAs open up markets for exporters and help to create a more predictable rule-based business environment, thereby also incentivising investment.

FTAs can vary considerably in terms of scope and ambition. Traditionally about reducing tariffs, trade agreements have broadened their scope, including provisions to tackle behind the border non-tariff barriers.

1 The opinions expressed are the author's only. This essay should not be reported as representing the views of the European Investment Bank.

2 For 2017. See European Commission (2018, 2018a) and DG trade website.

3 For 2017. Ibid. Investment position refers to global FDI shares (stocks) for 2016.

Services have increasingly become part, and FTAs have been including elements that are only partly or not at all, covered by WTO rules. Additional areas forming part of FTAs are for instance rules to foster free and fair trade, related to competition or intellectual property, but also on labour rights or the environment.

Historically, EU trade agreements have served as a policy instrument to strengthen bilateral ties between partners, as well as to promote policy principles or values such as labour standards or protection of natural resources.<sup>4</sup> However, EU agreements to foster trade (and investment) have also sparked mixed feelings given the backlash against globalisation as well as EU-internal controversies over the power of the EU on behalf of its member states to strike comprehensive trade deals in recent years. In particular, controversies about the EU-Canada Comprehensive Economic and Trade Agreement (CETA) and the later abandoned Transatlantic Trade and Investment Partnership (TTIP) with the US had put EU trade policymaking to a test.<sup>5</sup>

At present, the EU has close to 40 agreements with more than 80 countries across the globe.<sup>6</sup> Out of total EU trade with third countries, the share of FTA-covered trade amounted to 32% in 2017 and could soon exceed the 40% mark, with new agreements entering into force, e.g. with Singapore, Vietnam, Canada and Japan.<sup>7</sup>

The EU's FTAs vary substantially, depending on partners and policy priorities. They can be classified into four types:

- “First generation” trade agreements, i.e. focused on trade in goods and tariff elimination, negotiated before 2006;
- Economic partnerships agreements with Africa, Caribbean and Pacific countries focusing on development needs and fostering gradual liberalisation in partner countries while the EU grants market access;
- Deep and comprehensive free trade areas (DCFTAs) deepening political association and preparing for economic integration with the EU; and
- New or “second generation” free trade agreements, i.e. comprehensive FTA's negotiated after 2006 with selected third countries that go beyond trade in goods, also covering services and potentially other aspects such as procurement, intellectual property rights and/or some investment related issues.

4 For the EU, this is reflected in the Trade for all strategy. See European Commission (2015).

5 See Wruuck (2017) for further discussion.

6 Source: European Commission (2018) and DG Trade website. Includes agreements in place and partly in place.

7 For trade in goods.

While the first two categories still make up the majority of existing FTAs, as commercial exchanges become increasingly dominated by services and shaped by digital technologies, new generation FTAs are also becoming more relevant. Furthermore, they can also play a role in helping to advance global trade rules and standards in certain areas.

### **“New generation trade agreements” with new challenges**

The emergence of new generation FTA partly reflects the rise of global value chains and multilateral disciplines in some of these areas being less advanced.<sup>8</sup> Arguably, these issues are particularly relevant for the EU given its position in world trade but the new type of trade accords also come with new challenges from a European perspective. These include controversies on the EU’s (exclusive) competency to strike comprehensive deals as well as opposition within the EU to the inclusion of some of the new issues, reflecting concerns about potential weakening of standards, e.g. for consumer protection, or trade agreements limiting the ability to regulate domestically.

Reconciling the European system of multi-level governance and internal sovereignty sharing with negotiating new generation FTAs is central for the EU to successfully negotiate accords. Yet, the EU’s ability to conclude trade deals is ultimately contingent on domestic political support. One lesson that can be learned from CETA is that EU negotiators need to be sensitive to domestic concerns about the (potential) effects of FTAs earlier in the negotiation process with a view to reduce the risk of agreements being called into question at a later stage and its credibility towards trading partners being put to the test.

### **EU trade policy: internal and external challenges**

Stable trade relations with its partners are key for an advanced economy like the EU, its consumers and companies and FTAs play a vital role in supporting ties. In fact, the certainty they can add is (all the more) valuable in times of high (political) uncertainty.

To reap these benefits, EU trade policy needs to navigate domestic and external challenges. The context of world trade has changed in recent years, marked by harsher competition with emerging markets and the breakdown of multilateralism.

8 While trade and investment are closely linked, it is worth recalling some distinctions between agreements on trade compared to investment. First, the basic goal of rules in the two areas differs. Rules for trade originally aimed at smoothing flows of goods by reducing protection at the border (thereby encouraging trade) whereas arrangements for FDI are about protecting property rights of foreigners within another country’s borders (thereby attracting investment). Second, the degree of multilateralisation and institutionalisation is more advanced for trade.

This affects the EU in particular because its policy approach to trade and international relations is rules-based and traditionally focused on a multilateral approach.<sup>9</sup> To the extent that rules and principles of global cooperation are ignored or undermined by other players, it also becomes more difficult for the EU to maintain its approach, because it can become harder to justify internally if other strategies are perceived as more successful in the short term.

Domestic challenges to EU trade policy and FTAs partly stem from traditional concerns about the distributional effects of trade, adjustment frictions and fears about job destruction. For the comprehensive agreements, concerns can also arise from fears that accords might lead to weakening of some European standards and protection of public services, as the controversies around the CETA agreement with Canada and the abandoned TTIP negotiations illustrate.

These experiences provide two major insights: first, negotiations about the comprehensive trade agreements can easily turn into wider and intense political debates about how to manage globalisation. Arguably, to the extent that the comprehensive agreements touch on areas that have traditionally been more in the realm of domestic politics, they also require greater trust in EU policymaking processes and EU trade negotiators. EU trade negotiators and policy-makers need to properly disseminate to the European citizens the objectives and outcomes of the EU's trade policy, as a way to mitigate rising mistrust towards EU institutions. Steps that can help to strengthen trust are for example the publication of negotiation mandates and the better information in the outcomes of FTAs. Strengthening continuous dialogue with different stakeholders and citizens at national and local level on trade policy is similarly an important element.

Public opinion on free trade and globalisation in the EU is mixed. However, EU citizens' overall views on globalisation have turned more positive again since 2011.<sup>10</sup> Views are more favourable among the young and those that place themselves higher in social class strata. Positive views about globalisation and the EU tend to be correlated. Respondents who have a positive image of the European Union are more likely to have positive views on globalisation (69% vs. 31% of respondents who have a negative image), as are those who tend to trust the EU (69% vs. 39% of respondents who tend not to trust in the EU). However, about 30% of Europeans do not see globalisation as an opportunity and another 10% are not sure about its effects despite the economic recovery in recent years.<sup>11</sup>

9 See for instance Art. 21 TEU, which states that the Union aims to "promote multilateral solutions to common problems".

10 See Eurobarometer 461 (2017).

11 See Eurobarometer. Views on trade tend to be more positive in times of economic recovery. Similarly, people who think that their economy is doing well tend to view globalisation more positively.

In addition, many Europeans doubt that trade increases employment or wages.<sup>12</sup> Similarly, opinions on whether the EU helps to protect its citizens from negative effects of globalisation are evenly split.

## **How to strengthen trust in the EU's capacity to manage globalisation?**

Survey results should be read as a 'work assignment' for EU policymakers both with regard to mixed views on trade among the EU public and the sociodemographic composition. What can be steps to strengthen trust in the EU's capacity to manage globalisation for the benefit of its citizens? First, this can involve dedicated instruments to facilitate adjustment to trade shocks. Second, facilitating adjustment of individuals, regions and countries to trade shocks requires a comprehensive set of sound economic policies. The EU can help to foster these through economic policy coordination.

The establishment of the globalisation adjustment fund in 2007, to facilitate reintegration to employment of workers who have lost their jobs as a result of globalisation with financial support, politically acknowledged that from the EU's exclusive competency over trade policy follows some budgetary responsibility to deal with adjustment frictions.<sup>13</sup> The Fund, together with the member states, supports for instance retraining of displaced workers or starting a new business. Over the years, it has also been used to cope with crisis-related redundancies. Looking ahead, some further adjustments to the programme may be worth considering. These include lower threshold criteria to facilitate the use for small and medium-sized enterprises and support to cope with redundancies resulting from globalisation and digitalisation.

Dedicated instruments like the globalisation adjustment fund help to support displaced workers and facilitate reintegration into the labour market. However, most policies that facilitate adjustment are under the exclusive responsibility of individual Member States and hence domestic policies to strengthen competitiveness and to reconcile open markets with social inclusion are central. To that extent, the EU's pillar of social rights defines a number of principles that can also be useful to complement an ambitious trade policy by fostering inclusion and facilitating adjustment for instance active support to employment and life-long learning.

<sup>12</sup> See Stokes (2018).

<sup>13</sup> See [European Commission](#) for information on the Globalisation adjustment fund and Claey's and Sapir (2018) for further on reform discussion.

Delivering on the pillar of social rights is a joint responsibility of member states, other stakeholders and the EU setting the framework. The EU plays a role in fostering sound economic policies at member state level through economic policy coordination in the European Semester. To that extent, the country specific recommendations can make an indirect contribution to facilitate adjustment through increasing market functioning, resilience to shocks and employment creation.

## **FTAs: A look ahead**

Back in 2016, the difficulties to conclude the CETA agreement had raised some questions as to whether the EU can still credibly and successfully negotiate with its partners. Overall, the past three years have shown that it can. FTAs with Vietnam, Japan and Singapore have been successfully concluded in the meantime,<sup>14</sup> there are new negotiations for instance with Chile to modernize existing agreements, or for new accords with Australia and New Zealand and potentially a new attempt to negotiate an agreement with the US.

On the scope of supranational competencies, an issue critical in the CETA negotiations, the European Court of Justice (ECJ) provided greater clarity on the exact delineation of competences between the EU and Member States based on the trade agreement with Singapore in 2017.<sup>15</sup> The ECJ opinion stipulates that non-direct foreign investment (portfolio investment) and dispute settlement fall in the area of shared competencies. Greater clarity on the scope of competencies in turn helps to define what issues should be negotiated together or form separate agreements that follow different procedures for ratification for mixed accords versus those under exclusive EU competencies.

As for trade policy communication, the publication of negotiation mandates and the regular reporting on the status of FTAs and their implementation are steps in the right direction. While negotiations on the next EU multiannual financial framework are not yet concluded, recent developments also point to reforms of the globalisation adjustment fund to facilitate its use for smaller firms and extent the scope particularly with a view to digitalisation.<sup>16</sup>

14 The agreement with Japan entered into force in February 2019. The EU Singapore trade and investment agreements were signed in October 2018 and following the European Parliament's consent now continue their respective ratification procedures. The EU FTA with Vietnam and the separate EU-Vietnam Investment Protection Agreement were both signed on 30 June 2019.

15 See Court of Justice of the European Union (2017).

16 See European Council press release 15/03/2019.

While these are all encouraging steps, looking ahead, the implications of digitalisation on trade and potentially domestic support for an ambitious trade policy require further consideration. Historically, technological change and trade are deeply intertwined. Technological advances have increased possibilities for global commerce, lowering transaction costs and extending the scope of what goods and services are tradable. This suggests that globalisation is far from over (or backtracking) but that digital technologies will increasingly shape goods and services trade over the coming years. At this point it is not yet clear what the effects of technologies such as 3-D printing or artificial intelligence (AI) on trade flows are going to be, for example whether spread of digital technologies is going to lead to re-localisation of parts of production chain, nearshoring or outsourcing of jobs that were previously considered as ‘safe from trade’.<sup>17</sup> However, two points seem certain. First, FTAs will remain important for the EU as they provide a flexible instrument to accommodate changing trade patterns against the backdrop of digitalisation. Here, there is also a chance for the EU to lead in this area and define rules for digital trade through its FTA negotiations. Second, the possibilities to benefit from digital trade – for the EU and its partners – are going to depend on skills, innovation and the availability of digital infrastructure. For the EU, this means that domestic policies to support digitalisation and strengthening inclusiveness are key, also with a view to maintaining support for an ambitious trade policy.

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