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## **UNICE STRATEGY ON AN EU APPROACH TO FREE TRADE AGREEMENTS**

### **Summary**

An ambitious conclusion of the **Doha Development Agenda** remains the primary goal of European business in international trade policy. However, **international trends** to negotiate new bilateral agreements; the wider need for **new liberalisation** for the European economy to grow; and the fact that the EU is gearing up to launch a **new generation of free trade agreements** (FTAs), mean, that **UNICE must articulate its views** on his issue.

Past EU bilateral and regional agreements have been strongly influenced by political concerns. The new generation of FTAs must be based on **economic criteria**: Future FTAs must be pursued on the basis of where the EU's current and future markets lie. As regards content, the starting point must be **reciprocity** with new partners and agreements should also involve the **broadest product coverage** possible in both services and goods. Agreements should include the following elements:

- **Industry** talks should cover 100% of tariff lines and have elimination of duties as the goal;
- **Non-tariff barriers** should be effectively tackled, starting with a standstill for all new barriers;
- A robust approach to negotiating broad new opening on **services** should cover all modes of supply and be based on a negative list;
- Given that even a successful DDA will not deliver any improvement in global rules on **investment** it is highly important that the EU make meaningful progress in its bilateral deals in this vital area;
- **Intellectual property** elements are also crucial. Partners must as a minimum sign up to all major international conventions and agree to robust enforcement regimes;
- As the fundamental objective of future FTAs is that companies should be able to compete with each other in individual foreign markets on a level playing-field, taking full advantage of the expansion of international trade, **competition policy** elements should also be considered;
- As a minimum future EU FTAs should insist that partner countries sign up to the disciplines of the WTO **Government Procurement** Agreement. However, given the complex system of exemptions it contains, the agreements should also include further disciplines;
- Though the WTO is the trade **rule-making** body par excellence, bilateral or regional negotiations leading to free trade agreements can also be a tool to

ensure best practice in trade policies, this is particularly the case for **trade facilitation**.

- EU FTAs must seek to address **regulatory barriers**, setting a course towards regulatory convergence - around transparent, predictable, proportionate and science-based regulation.
- Future bilateral agreements will only be valuable to European growth and competitiveness if they include a binding and effective **dispute settlement mechanism**.
- The EU must address the “spaghetti bowl” issue and ensure that its regional and bilateral trade agreements create the **minimum degree of complications to the international trading system**.

## Introduction

From 1999 the EU maintained an effective moratorium on the opening of bilateral or region-to-region negotiations to conclude free trade agreements (FTAs). This so-called ‘Lamy doctrine’ was based on both the genuine favouring of the multilateral approach over FTAs and the political need to send a strong message on the EU’s prioritization of the Doha Development Agenda (DDA) negotiations. Other WTO members, however, have not shared this approach. The US has since 2003 concluded free trade agreements (FTAs) with eight countries – including Australia, Morocco and Singapore, and is in negotiations with a further five. In addition, the ASEAN countries have an FTA in goods with China and are negotiating with Japan, Australia and New Zealand. Japan, for its part, has deals with Singapore, Malaysia, Thailand and Mexico and in addition to the ASEAN talks is negotiating with Chile, India, Vietnam and the Gulf Cooperation Council (GCC).

To date, European business has strongly supported the EU’s strategy, agreeing that the multilateral process offered the best method of guaranteeing further market access. WTO agreements reinforce the system of multilateral rules, offer legal clarity and certainty through the MFN principle, avoid the creation of rules of origin-related barriers, and have the benefit of tackling all trading partners at the same time. Though FTAs some may prove easier to negotiate given the EU’s economic weight, the difficulties the US has faced in Korea and Thailand for example indicate that the process is not necessarily straightforward. The burdensome effects of an interconnected ‘spaghetti bowl’ approach to bilaterals may also create problems in the medium term for the international trading system as a whole. An ambitious conclusion of the DDA must therefore remain the primary goal for European business and any FTAs concluded by the EU must be at a minimum fully WTO compatible (see ‘Goods’ below).

However, three developments mean that European business must now consider its position on complementary approaches to the WTO process. First, industry cannot afford to ignore the proliferation of bilateral and regional free trade agreements among its major trading partners. Without prompt action, the trend to is likely to have a considerable negative impact on EU market share in major high-growth markets around the world and a consequent effect on competitiveness, growth and jobs in

Europe. Second, the continuing delays in the DDA discussions and the lack of progress on the major issues of concern to European business in that context. Meanwhile, European business sorely needs the great benefits that will be gained by further trade and investment liberalisation with its major trading partners in order to secure future growth.

Finally, the Commission and Member States have also indicated their intention to open negotiations for FTAs with a number of partners in the short term. This week the Commission will seek mandates for discussions with India, the ASEAN countries and South Korea. UNICE will comment on these talks separately.

For now, it is clear that industry must articulate its views for this next generation of FTAs in terms of approach to targeting countries and content of agreements in order to ensure that the most is made of the this process.

### **Target countries**

It is important to note that the EU has quite a large number of bilateral deals – the agreements with the EFTA countries including the European Economic Area, the customs union with Turkey, the goods agreements with the Euromed countries and the preferential arrangements offered to the ACP countries. The EU's association agreements with Chile and Mexico also include free trade agreements. Furthermore, despite the moratorium on new negotiations, the EU has continued ongoing discussions with the Gulf Cooperation Council and Mercosur and in May 2006 launched negotiations with Caribbean and Andean countries in Latin America.

However, it remains the case that political motivations have to a large extent underlined the EU's bilateral policy to date. Historical relationships, in the case of the ACP agreements, or geographical proximity and the consequent need to foster political stability, in the case of the Euromed agreements have been drivers of FTA policy. In the case of Mercosur the prioritisation of fostering regional integration above obtaining real economic results has created serious logistical problems in the negotiations.

Given the competitiveness challenges now faced by European business, the next generation of EU FTAs must respond to economic criteria. These include:

- the actual level of tariffs and non-tariff barriers on industrial goods;
- existing barriers to effective trade in services;
- the economic potential of future partners;
- and the risk of EU companies being excluded from key markets by actual and/or potential FTAs between Europe's major trading partners.

Above all however, FTAs must be pursued on the basis of where the EU's current and future markets lie. Competing FTAs between EU trading partners may cause problems for individual European companies but an overall strategy should be based on the global impact of an FTA on the EU economy. It should be complemented, but not replaced, by considerations of creating a level playing field for European companies in specific national markets.

In this connection we would also like to stress that the total economic potential of intra-industry trade expansion between trading partners at a similar level of economic development is often greater than that of inter-industry-based trade expansion between trading partners at different economic development levels despite greater relative gains from the latter kind of FTAs. This is due to the far greater additional trade volumes to be expected from FTAs between large developed trading partners at a similar level of development. In fact, the economic rationale of the European Single Market is largely based on the advantages of intra-industry trade.

In 2005 the EU's top trading partners – outside of EFTA – were the USA, China, Russia and Japan. The ASEAN countries when taken together account for more trade with the EU than Japan. Trade with India is smaller but growing at roughly 20% per annum. Other key markets for EU producers include South Korea, Ukraine, Canada and Mercosur. Political difficulties would arise in the case of some of these agreements but the EU cannot stand by as key markets are integrated to the exclusion of European business. Tables 1 and 2 look at the EU's major trading partners in terms of GDP, average tariff level and ease of doing business. All of these factors must be looked at in advance, in close consultation with European business.

### **Model agreement**

As the EU establishes mandates for new negotiations, the Commission and Member States will need to work together to focus on the real barriers faced by EU companies as they seek market access around the world. As a starting point, this implies that future EU FTAs should be firmly based on the principle of reciprocity. Symmetry in tariff dismantling is crucial for European business, particularly in relations with emerging economies. Second, the agreements should involve full product coverage. Third, new FTAs must also deal with non-tariff barriers. Fourth robust new agreements on services and investment must give these key issues for the future of trade their full weight. Finally, UNICE also supports the inclusion of WTO-plus issues such as government procurement and regulatory cooperation. The EU should be careful, however, not to jeopardise substantive offers on market access in goods and services in order to secure WTO-plus commitments. UNICE recommends the following elements in relation to future EU FTAs:

#### *Process*

New negotiations should be clearly labelled as trade agreements and not be linked to parallel political cooperation accords. This will ensure that the EU approaches commercial negotiations with as strong a hand as possible. Pre-launch discussions with potential partners should establish that both sides' goals are consistent with an ambitious result. Commitments should also be secured from negotiating partners that negotiations will be concluded in a reasonable time period as experience has shown that the process can drag on interminably without a strict deadline. In all of this process, and moreover during the course of negotiations, there is a clear need for effective consultation with business on the issues under discussion. European trade negotiators must have available precise information on the interests of European business. This requires structures which enable experts from the business community

to give feedback to the trade negotiators. Accordingly, the European Commission should set up appropriate advisory structures.

#### *Goods*

Though the concept of ‘substantially all trade’ in the WTO context has not yet been successfully defined, any new free trade agreements must cover 100% of tariff lines to address Europe’s economic needs. Anything less than this would allow the exemption of highly protected sectors and dramatically reduce the potential benefits to the European economy. In the DDA context EU industry has taken a strong line against flexibilities allowing the exclusion of certain industrial tariff lines by advanced developing countries. Flexibilities should not be included in the bilateral/regional context. UNICE should also fully support the GATT article XXIV requirement that FTAs should eliminate tariffs, not simply reduce them.

Non-tariff barriers represent a hugely significant obstacle to European exports. It is crucial that EU FTA agreements tackle NTBs effectively and a standstill on non-tariff barriers should be the starting point for all negotiations. Export restrictions and taxes in particular must be eliminated in EU FTAs. Customs related barriers and discriminatory product regulations and standards must also be dealt with. An efficient process for monitoring regulatory and other activities to ensure new NTBs are not being created as well a mediation mechanism, analogous to that proposed by the EU in the DDA context, should be included in future agreements.

UNICE also insists that future FTAs cover agricultural goods. The EU food and drink industry has considerable offensive interests in terms of market access and mechanisms to reduce tariffs and expand tariff-rate quotas must reflect these priorities. It is highly unlikely that disciplines on domestic support and export competition will be the subject of the EU FTAs on the horizon. In the case that such a situation did arise however, the EU should not rule out commitments in these areas, particularly if this meant simply the binding of current practice. In any case future EU FTAs must deal with agriculture, if only to guarantee compatibility with WTO provisions requiring coverage of ‘substantially all trade’. However, EU sensitivities on agriculture should not be allowed to block the conclusion of ambitious agreements.

#### *Services*

Given the increasingly important role of services in EU exports all future FTAs must ensure comprehensive liberalization of key sectors including financial services, telecommunications, professional and business services and express delivery services. The coverage of agreements should be comprehensive as set out in GATS Article V. The EU has a comparative advantage across the board in services and needs to ensure that this advantage is pressed home in future FTAs.

Services chapter commitments should cover all modes of supply. This includes mode 3 even where there is also an investment chapter, as it must be clear that there is consistency between different modes of supply. Furthermore, the EU should seek a negative list approach to services scheduling. In a negative list approach, only those sectors which are not fully liberalized are included in the schedule. This implies full national treatment and full market access except where otherwise indicated and thus

clarifies commitments considerably. Future updating of agreements is also facilitated as the reduction of excluded areas is simply a matter of removing them from the schedule. Such an approach has proven possible in many FTAs concluded to date by other countries including the US and Canada and so should be possible for the EU, as a major trading power, to achieve. Negative list-based agreements have been shown to deliver more substantial results in recent FTAs covering services than positive list approaches.

#### *Investment:*

The oft-stated long term goal of UNICE is to achieve a worldwide comprehensive investment agreement guaranteeing full transparency, non-discrimination and national treatment, free access to markets and the full protection of investments. Given that even a successful DDA will not deliver any improvement in global rules, it is highly important that the EU make progress in its bilateral deals. Globalised supply chains are increasingly a requirement to make products competitive. In services, investment is equally crucial as much trade is dependent on the establishment of commercial presence in the third country for practical reasons. At the same time, the EU also needs to ensure that it provides an open and secure investment environment for third country business to invest in Europe as inward FDI is key to guaranteeing European competitiveness.

Investment provisions must, however, be assessed on a case by case basis for each negotiation. The Commission must possess a clear mandate from the Council before proceeding and negotiations on investment must not be used to transfer competencies from Member State to Commission level. The EU must also ensure that future chapters on investment do not undermine the legal rights of companies under existing bilateral investment treaties.

Where FTAs do include investment elements they should take a broad definition of investment to capture the full array of companies' assets, including for example physical assets, IPR and securities. Transparency – through publication of all elements of a target countries investment regime – and national treatment – non-discrimination against foreign investors in any regulatory measures – are key principles to be respected. Market access elements must go further than the post-establishment provisions common to bilateral investment treaties and address pre-establishment issues such as foreign equity caps and restrictions on legal form. A negative list approach would again be preferable here. EU FTA provisions on investment should be complementary to Member State bilateral investment treaties (BITs), neither undermining nor creating conflict with them. They must also offer strong protection from expropriation and provide a mechanism for investor-to-state dispute settlement.

#### *Intellectual Property Rights*

The protection of intellectual property is key to encouraging innovation and thus safeguarding the competitiveness of the EU. For EU business to be able to take full advantage of the opportunities presented by future FTAs, companies must know that their intellectual property is secure in the countries they trade with and, more importantly, invest in.

UNICE strongly supports the WTO TRIPS agreement. Full implementation and enforcement of TRIPs commitments must be the starting point for any new bilateral deals. However the EU must also grasp the opportunity offered by new FTA negotiations to go further than was possible during the negotiation of the Uruguay Round. At a minimum future EU FTAs must contain commitments from partner countries to sign up to all provisions of all relevant international conventions on intellectual property. The agreements must also contain strong procedures on enforcement, and provide detailed prescriptions on the legal and procedural reforms necessary to ensure that regimes effectively protect intellectual property. The implementation of these commitments must be fully subject to agreements' dispute settlement provisions and UNICE considers that a company-to-state dispute settlement mechanism should also be examined in this context.

#### *Competition*

For UNICE the fundamental objective of future FTAs is that companies should be able to compete with each other in individual foreign markets on a level playing-field, taking full advantage of the expansion of international trade. Though the specifics of each country should be assessed so that the approach on competition is tailor-made for each negotiation, EU FTA partners should where appropriate be required to install meaningful systems to enforce competition policy. Disciplines should include basic principles of transparency and non-discrimination as well as commitments to tackle cartels. If possible, strict rules on government subsidies similar to those covering trade in industrial goods in the EEA, should be sought in new FTAs in order to avoid as much as possible the need for anti-subsidies measures between the EU and its FTA partners. Procedures to enforce common strict rules on government subsidies should be envisaged where possible and appropriate.

Cooperation between enforcement bodies in the EU and its FTA partners should also be envisaged, as long as this protects confidential business information. In addition, the implementation of such provisions should be subject to dispute settlement. It should remain clear, however, that individual cases are the preserve of domestic authorities.

#### *Government Procurement*

Public procurement markets represent a substantial proportion of GDP in both goods and services in many countries. In OECD countries this is estimated at roughly 19% and in non-OECD countries at 14.5%. As a minimum future EU FTAs should insist that partner countries sign up to the disciplines of the WTO Government Procurement Agreement. However, given the complex system of exemptions that operates in that context, the agreements should also include further disciplines to ensure that national treatment and non-discrimination are guaranteed and that national and/or local preferences are to the greatest extent possible eliminated. Provisions on transparency, qualification procedures/decisions and access to an expedited DSU for individual cases - perhaps through the NTB mechanism above are also crucial.

#### *Rules including trade facilitation*

Though the WTO is the trade rule-making body *par excellence*, bilateral or regional negotiations leading to free trade agreements can also be a tool to ensure best practice

in trade policies. Clearly, bilateral trade agreements should make reference to the full respect of WTO agreements on trade defence instruments.

With the ongoing reduction in customs duties, formalities at borders have a growing impact on the costs of trade and limit the ability of companies - especially small companies - to develop internationally. In addition, these procedures and rules can easily be misused by countries to restrict imports for protectionist purposes. Accordingly any new FTAs must also assertively address the question of trade facilitation. The provisions of the agreements should be focused on:

- the minimisation and/or elimination of fees and charges;
- procedures for legal recourse and appeal, complaint or mediation services in the case of disputes with customs;
- the establishment of a single window;
- publication of trade regulations
- and accelerated and simplified procedures for release and customs clearance of goods.

Such an approach will help significantly to facilitate trade for both the EU and its future FTA partners.

#### *Domestic regulation*

As the levels of tariff and border protection around the world become gradually lower the significance of the barriers created by domestic regulation increases. Non-tariff barriers can take the form of the customs barriers and export restrictions listed above but also can be the result of divergent regulation and standards. EU FTAs must seek to address this, setting a course towards regulatory convergence - around transparent, predictable, proportionate and science-based regulation.

That such agreements are possible is evidenced by the success of the European Economic Area. Such an integrated approach could also be appropriate in the context of deals with EU neighbourhood countries such as Russia and Ukraine for example. Strong disciplines on domestic regulation should be an element of all FTAs, however, and this should include the competition and non-tariff barrier elements referred to above and build on the provisions of the WTO TBT, SPS and GATS agreements to ensure a transparent, predictable regulatory process, based on the best available scientific information. UNICE would also support disciplines that would also cover issues such as impact and risk assessment.

#### *Dispute settlement*

European business remains convinced that dialogue and negotiated solutions are the best way of resolving trade disputes. However, future bilateral agreements will only be valuable to European growth and competitiveness if they include a binding and effective dispute settlement mechanism. The WTO's Dispute Settlement Understanding should serve as the model for such provisions. However, the EU's bilateral deals should take the opportunity to improve on the DSU. A key point to address is direct access by companies to the mechanism. Such an approach would introduce much greater efficiency into the procedure and would eliminate the burden on both the EU

and third country governments to follow cases. Further improvements should include introducing more legalistic elements such as greater transparency and a standing panel of experts to carry out arbitration.

#### *Addressing the 'Spaghetti Bowl'*

The EU must endeavour to ensure that its regional and bilateral trade agreements create the minimum degree of complications to the international trading system. This can be achieved in a number of ways. As mentioned above securing 100% product coverage in goods and as broad a sectoral coverage as possible in services is a necessary starting point. The EU's FTAs should also include straightforward rules of origin that are clear, transparent, easily implemented and as harmonised with WTO rules as possible. In appropriate cases, the possibility to apply the common European rules of origin should be considered. The EU should also explore ways to include new FTA partner countries in the European cumulation area.

Finally the EU must remain conscious of the potential downsides of a drift to competitive regionalism, particularly in relation to the United States. Transatlantic cooperation to achieve coherence of approaches in FTA negotiations is vital as it can help avoid both the worst excesses of the 'spaghetti bowl'. Common parameters for such issues as coverage and rules of origin would greatly reduce the administrative burden of administering different standards in FTAs.

#### **Conclusion**

An EU strategy for bilateral and regional free trade agreements is essential to maintain Europe's position in major world markets. The strategy should seek to conclude robust, ambitious FTAs creating deep economic integration with countries that are - and will be - economically important for European exports. EU business must be ready to contribute to these efforts through ongoing dialogue with European negotiators.

## Bilaterals targeted by the European Union\*

EC bilaterals: targetted, ignored and done

|           | Market size [a] |            | Average industrial tariff [b] |         | Regulatory ranking [c] |                        |                       |                      |                      |
|-----------|-----------------|------------|-------------------------------|---------|------------------------|------------------------|-----------------------|----------------------|----------------------|
|           | at current USD  | at PPP USD | bound                         | applied | ease of doing business | trading across borders | dealing with licences | registering property | protecting investors |
| ASEAN     | 1,9             | 4,5        | --                            | --      | --                     | --                     | --                    | --                   | --                   |
| Indonesia | 0,6             | 1,6        | 35,0                          | 8,3     | 135                    | 60                     | 131                   | 120                  | 60                   |
| Malaysia  | 0,3             | 0,5        | 11,2                          | 8,6     | 25                     | 46                     | 137                   | 66                   | 4                    |
| Singapore | 0,3             | 0,2        | 4,1                           | 0,0     | 1                      | 4                      | 8                     | 12                   | 2                    |
| Thailand  | 0,4             | 0,9        | 20,2                          | 13,4    | 18                     | 103                    | 3                     | 18                   | 33                   |
| Korea     | 1,6             | 1,6        | 10,2                          | 6,7     | 23                     | 28                     | 28                    | 67                   | 60                   |
| Mercosur  | 1,9             | 3,6        | --                            | --      | --                     | --                     | --                    | --                   | --                   |
| Brazil    | 1,5             | 2,6        | 29,4                          | 15,1    | 121                    | 53                     | 139                   | 124                  | 60                   |
| Argentina | 0,4             | 0,8        |                               |         | 101                    | 71                     | 125                   | 74                   | 99                   |
| India     | 1,6             | 5,8        | 37,0                          | ~12.0   | 134                    | 139                    | 155                   | 110                  | 33                   |
| Russia    | 1,4             | 2,6        | --                            |         | 96                     | 143                    | 163                   | 44                   | 60                   |
| Gulf CC   | 1,2             | 1,0        | --                            | --      | --                     | --                     | --                    | --                   | --                   |
| UAE       | 0,3             | 0,2        |                               | ~5.1    | 77                     | 10                     | 79                    | 8                    | 60                   |
| S. Arabia | 0,6             | 0,6        |                               |         | 38                     | 33                     | 44                    | 4                    | 99                   |
| China     | 4,7             | 14,6       | 9,2                           | 9,1     | 93                     | 38                     | 153                   | 21                   | 83                   |

\* Source: Patrick Messerlin, ECIPE

### Completed bilaterals & regions not targeted\*

|               | Market size [a] |            | Average industrial tariff [b] |         | Regulatory ranking [c] |                        |                       |                      |                      |
|---------------|-----------------|------------|-------------------------------|---------|------------------------|------------------------|-----------------------|----------------------|----------------------|
|               | at current USD  | at PPP USD | bound                         | applied | ease of doing business | trading across borders | dealing with licences | registering property | protecting investors |
| Australia     | 1,5             | 1,1        | 11,0                          | 3,5     | 8                      | 23                     | 29                    | 27                   | 46                   |
| Canada        | 2,4             | 1,8        | 5,3                           | 3,3     | 4                      | 8                      | 32                    | 22                   | 5                    |
| Hong Kong     | 0,7             | 0,4        |                               | 0,0     | 5                      | 1                      | 64                    | 60                   | 3                    |
| Japan         | 11,1            | 6,6        | 2,3                           | 1,6     | 11                     | 19                     | 2                     | 39                   | 12                   |
| Taiwan        | 0,8             | 1,0        | 4,7                           | 4,5     | 47                     | 42                     | 148                   | 24                   | 60                   |
| USA           | 28,4            | 20,3       | 3,4                           | 2,6     | 3                      | 11                     | 22                    | 10                   | 5                    |
| All countries | 45,0            | 31,1       | --                            | --      | --                     | --                     | --                    | --                   | --                   |
| Chile         | 0,2             | 0,3        | ~25.0                         | ~6.0    | 28                     | 44                     | 40                    | 30                   | 19                   |
| Mexico        | 1,7             | 1,8        | 34,8                          | 17,2    | 43                     | 86                     | 30                    | 79                   | 33                   |
| South Africa  | 0,5             | 0,9        | 11,0                          | 8,3     | 29                     | 67                     | 45                    | 69                   | 9                    |
| Turkey        | 0,7             | 0,6        |                               | 4.2     | 91                     | 79                     | 148                   | 54                   | 60                   |
| All countries | 3,1             | 3,6        | --                            | --      | --                     | --                     | --                    | --                   | --                   |

[a] GDP (in USD, 2004) as a share of world GDP. [b] Australian Productivity Commission. [c] Doing Business 2007.