An Analysis of the Trade Policy Review of the European Union

Jackson, K.

This is the peer reviewed version of the following article: Jackson, K. 2021. An Analysis of the Trade Policy Review of the European Union. The World Economy, 44 (12), pp. 3482-3491, DOI: 10.1111/twec.13213, which has been published in final form at:

https://doi.org/10.1111/twec.13213

An Analysis of the Trade Policy Review of the European Union

A Preprint

Karen Jackson
Westminster Business School
University of Westminster
London, UK
k.jackson@westminster.ac.uk

August 8, 2021

Abstract

This paper provides an analysis of the latest World Trade Organisation Trade Policy Review of the European Union. The review period was one of heightened trade tensions, where the dynamic between China-US-EU dominated the policy agenda. A number of key findings emerge from the review, broader literature and events after the review period: (i) much remains to be negotiated as part of Brexit (ii) there has been a change of approach whereby trade and investment agreements tend to be separate; this has important implications for the speed of implementation (iii) strategic oversight regarding extra-EU investment inflows hinges on national screening mechanisms (iv) rival infrastructure development schemes are emerging, suggesting that the EU will struggle to create space for their own initiative (v) free trade agreements are increasingly covering a broader range of issues such as labour rights and environmental protection (vi) digitisation and a tax schedule for digital services is still work in progress. Overall, the review is an extremely useful reference document. However, a critical assessment of the factual information is necessary.

***K*eywords** WTO, EU, trade, investment

> *Tariffs are not the answer to a transforming global economy – they are rarely the answer to anything – they are the equivalent of shooting yourself in the foot to hurt the shoe salesman.*
>
> Cecilia Malmström, EU Trade Commissioner (Bruegel Annual Meetings 2019, 9 September 2019)

1 Introduction

The latest World Trade Organisation (WTO) Trade Policy Review of the European Union concerns the period from March 2017 until September 2019 (WTO, 2020)[1]. By the end of the review period, the China-US trade war was at its height. US trade-weighted tariffs on Chinese products had risen from 3.1% to 21% between the start of 2018 and September 2019 (Peterson Institute for International Economics). The Trump administration raised the profile of trade policy in the general media. While, at the same time, the WTO was struggling to remain effective as a multilateral negotiating body (Pomfret, 2021). In this context, EU policy makers increasingly positioned themselves against this rising tide of protectionism. The EU has an extensive portfolio of trade agreements, with the notable additions of arrangements with Canada and Japan during the review period[2]. An important shift has occurred where the Commission moved away from comprehensive trade and investment agreements and started to favour separate agreements in these two areas. Pragmatically, this may allow swifter implementation of trade arrangements. At the same time as these integration efforts, the European Commission has been engaged in negotiations regarding the UK's departure from the bloc. This has involved a significant number of adjustments and the prospect that this may not be the only exit from the EU.

While trade and investment agreements started to be dealt with separately, investment issues still remained an important element of the WTO review. A number of overlapping matters came to the fore. Firstly, replacing bilateral investment treaties (BITs) with EU-wide investment protection agreements; one of the high profile examples is the negotiations towards the China-EU Comprehensive Investment Agreement (CAI). Secondly, the Foreign Direct investment (FDI) screening mechanism targeting non-traditional investors. Thirdly, a proposal for a range of infrastructure development projects to rival the Chinese-led Belt and Road Initiative (BRI). These topics have often involved difficult discussions as trade and investment arrangements have increasingly become part of broader social and political concerns. Additionally, a significant volume of legislation in the area of digitisation has attempted to strengthen the EU digital economy. While at the same time, digital services taxation has also been high profile, where a complex picture of national, EU and global initiatives is still being worked through.

This paper provides an analysis of the WTO Trade Policy Review of the European Union published in 2020. The review is an invaluable source of information and, therefore, this analysis should be considered a companion document. A number of themes have been selected for discussion, while there are many others equally deserving of attention. The focus is upon areas that continue to be significant subjects of development after the review period and involve a shift in policy. Section 2 looks at Brexit. Section 3 examines the

[1] For the remainder of this paper, the WTO Trade Policy Review of the European Union will be referred to as the review.

[2] "[t]he last half decade has been the most prolific ever for the EU in terms of concluding FTAs with the rest of the world" p33 (European Commission, 2019)

mechanisms used to provide oversight of extra-EU investment. Section 4 considers developments in the area of trade policy and agreements. Section 5 covers the important areas of digitisation, while section 6 concludes.

2 Brexit

During the review period, there was considerable uncertainty regarding the outcome of the Brexit negotiations. The review cites evidence (OECD) that the threat to the overall economic position of the EU was expected to be limited, although a number of countries could experience significant negative impacts if the UK left without a withdrawal agreement, notably Ireland. The review also mentions a number of activities that are ongoing in order to prepare for Brexit:

1. designing a UK tariff schedule;
2. dividing up the WTO tariff rate quotas;
3. issuing the UK a EU General Export Authorisation;
4. issuing a notice explaining that companies will not be exempt from EU competition law in the cases where there is an impact on the Single Market
5. application by the UK for independent accession to the Government Procurement Agreement; and
6. additional funding to farmers in Ireland to offset the uncertainty of Brexit (among other things)

While the review does not devote much attention to the issue of Brexit, for example it is not given a specific section, the process has required significant adjustment for the EU. During the negotiations, the European Commission also issued over 100 sector-specific notices and since the 1st Jan 2021 many have been revised. These provided guidance on how various stakeholders can prepare for the changes.

The review also omits mention of a number of Brexit related issues; for example, there is no discussion of the economic risks associated with further countries exiting the EU (Gastinger, 2019; Jackson and Shepotylo, 2021a). Bringing things up to date, a 'thin' Trade and Cooperation Agreement is now in place, while there is much left still to negotiate in various areas including the important one of services (Borchert and Morita-Jaeger, 2021). See Martill and Staiger (2021) for some interesting insights into the UK negotiating strategy, and Swinbank (2021) for a discussion of the lessons that can be learnt from the Brexit negotiations. When it comes to the UK tariff schedule, the UK has published two versions. The first version is the 2019 'no deal' tariffs, which was not implemented, followed by the 2020 UK Global Tariff schedule, which is now in operation. This schedule is largely mirrored on the EU schedule, with some simplifications, including the removal of so-called 'nuisance tariffs'[3]. At a practical level, trade statistics have also come under scrutiny as there have been significant differences emerging between the figures from the UK Office of National Statistics and Eurostat (Hughes, 2021).

At the conclusion of the Trade and Cooperation Agreement negotiations, President of the European Commission, Ursula von der Leyen said: *Finally, we can leave Brexit behind us and look to the future. Europe is now moving on.* (European Commission Press Release, 24 Dec 2020). However, during 2021, the process of moving on has proved difficult (for example the ongoing dispute over the Northern Ireland Protocol) - much remains to be discussed.

[3]The WTO defines a nuisance tariff as follows: "Tariff so low that it costs the government more to collect it than the revenue it generates." In 2019, the EU has 6.8% of its MFN applied rates defined as nuisance (WTO Secretariat calculations)

3 Oversight of extra-EU investment

During the review period and since, there has been considerable focus on the need to have greater strategic oversight of extra-EU investment coming into Member States. The European Commission has been reticent to single out China in its official statements, in stark contrast to the Trump and Biden administrations[4].

The review notes the opinion of the EU Court of Justice that aspects of investment policy (specifically, investment protection as it relates to FDI) are an exclusive competence of the EU. Thus investment protection agreements typically have components where the EU has exclusive competence with other parts to be decided at member state level. This has implications for member state BITs being replaced with EU-wide treaties. The China-EU CAI has been a particularly high profile example of an EU treaty, where much is made of the desire to achieve a 'level-playing field' for EU investors in China as well as Chinese investors in the EU. Furthermore, there has been a change of approach, whereby trade agreements are separated out from investment protection agreements(for example the separate EU-Singapore Free Trade Agreement (FTA) and EU-Singapore Investment Protection Agreement). The logic of this is that the EU negotiators have exclusive competency over the matters included in the trade agreement and, therefore, this arrangement provides a strong negotiating position for the EU. While this separation is not mandatory - for example the EU-Canada Comprehensive Economic and Trade Agreement (CETA) combines trade and investment aspects - this approach towards separation is noted in the review as a significant policy shift since the previous review. It is most likely that investment protection agreements will take much longer to conclude as they will need to be approved by each Member State separately (assuming that all of the provision contained in the agreement is not within the exclusive competence of the EU).

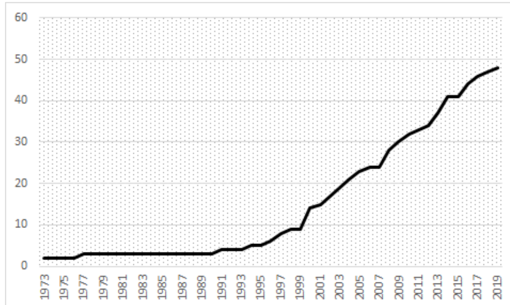
Further complexity exists when it comes to the FDI Screening Mechanism, including investments that could involve security or public order issues. The potential for ripple effects to cross national boundaries is the core premise of this legislation; in other words, issues arising from investments may not be confined to one Member State. The system was initially proposed during the 2017 State of Union address and at the time of the review, the screening mechanism was a major piece of work for the European Commission. The system was based on the national screening measures of 15 Member States. Subsequently these countries have needed to notify the Commission of their individual screening mechanisms with the composite list maintained and published at an EU-level[5]. Member States are not obliged to introduce screening, nor are States required to converge towards similar mechanisms. From October 2020, the system was implemented and there is a new level of EU coordination, which offers the opportunity for strategic oversight across the Union. In practice this works by a Member State undertaking the screening of a particular investment, informing the Commission and other States so comments can be submitted and the Commission may offer an opinion. There is also a similar process if screening of an investment is not taking place and another Member State, or the Commission, believe there is a reason for concern.

Investments from extra-EU state-owned enterprises (SOEs) have been singled out when the new rules have been discussed, particularly after the onset of the Covid-19 pandemic. The European Commission Report into FDI in the EU published in 2019 indicates the vast majority of assets under extra-EU ownership remain in the hands of 'traditional investors' (e.g. the US and Switzerland), with the new screening mechanism aimed at dealing with the emerging trend where countries such as China invest in strategic sectors. Other countries including India, in connection with pharmaceuticals, and Russia are also targeted. When it comes to SOEs, the report into FDI indicates that only a small number of investments are made by these entities; nevertheless, these types of businesses are singled out for particular attention. While there is little doubt

[4]For a recent example under the Biden administration see the Statement and Release from The White House on the 12th June 2021: FACT SHEET: President Biden and G7 Leaders Launch Build Back Better World (B3W) Partnership.

[5]List available here: https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc$_1$57946.*pdf*

Figure 1: EU participation in Regional Trade Agreements (notified and non-notified in force)



Source: Based on data collected from the WTO Secretariat

that concerns around Chinese investments are a major driver for this legislation, there are questions around whether this new mechanism will prove effective since there is little action that can be taken at the EU-level if the screening process proves to be lacking or comments/opinions are ignored (Kao, 2020).

Another key pillar which received little attention at the time of the review, but much more so afterwards and therefore deserves a mention, are the various attempts by the EU to bridge the investment gap across a number of areas of the world. This is an area of work where the trade and investment link is well established: infrastructure projects can help develop trade routes and lower transport costs (De Soyres et al., 2019; Jackson and Shepotylo, 2021b). There is little doubt that these attempts are in competition with the Chinese-led BRI. The EU connectivity strategy looks set to try to pull together a range of initiatives including the EU-Japan Partnership on Sustainable Connectivity and Quality Infrastructure, EU-India connectivity partnership and EU-ASEAN connectivity partnership. While the foundations of this strategy have been building for some time, the EU will now be under further pressure to move quickly given the announcement of the Build Back Better World (B3W) initiative at the 2021 G7 summit. We can expect to see much more attention in this area in future reviews since including strategic connectivity projects into the EU budget is already being discussed.

4 Trade policies and agreements

The EU considers four types of FTAs

1. 1st generation, which focus on tariffs (concluded before 2006)
2. New generation, which tend to go beyond trade in goods and include sustainable development aspects
3. Deep and comprehensive, which include political and economic integration between the EU and its neighboring countries
4. Economic Partnership Agreements (EPAs), which are used in the African, Caribbean and Pacific (ACP) region

By the end of the review period, the EU had 48 Regional Trade Agreements (RTAs) in force, some notified and others not notified to the WTO, with new generation agreements with Canada and Japan entering into force during the review period[6]. Figure 1 shows the number of trade agreements in force since the early 1970s until the end of the review period. A significant uplift in activity occurs from the 1990s onwards, mirroring the global pattern of agreements reported to the WTO. A considerable focus for EU negotiators has been FTAs with EU neighbouring countries in the Mediterranean and Middle East, deep and comprehensive agreements with countries east of the EU as well as stabilisation and association agreements with countries

[6]For further details on the WTO notification requirements see WTO (2021)

in the Western Balkans. The Americas and ACP EPAs have tended to be completed in the 2000s, while Asia has only recently become of more interest.

In 2016, attempts were made to consider approval of CETA at only the EU-level[7]. However, it was concluded that only certain parts come under the exclusive competence of the EU; with other parts the competence of Member States[8]. Therefore, the agreement with Canada is only provisionally applied since this arrangement has not yet been ratified by all Member States. This offers a useful reminder of the long ratification process with complex (so-called 'mixed') agreements[9]. It is also noteworthy that the CETA negotiations were the first time that the EU used a 'negative list' approach, where the starting point is complete trade and investment liberalisation unless a specific concern is raised (European Commission, 2016)[10]. There was also a time where UK policy makers were keen on a bespoke CETA style agreement. However, such a proposal would likely have required ratification at Member State level. For a detailed discussion regarding mixed agreements see Puccio and Conconi (2021).

Furthermore, as the new generation FTAs encompass a broader range of issues, including areas such as labour rights and environmental protection, trade agreements are difficult to conclude if the EU and third country do not share the same 'values' (Mckenzie and Meissner, 2017). This concern also extends to other preferential arrangements such as the Everything But Arms (EBA) initiative, which permits least developed countries to have tariff-free and quota-free access to the EU market. In Aug 2020, Cambodia had its preferential access suspended:

We have provided Cambodia with trade opportunities that let the country develop an export-oriented industry and gave jobs to thousands of Cambodians. We stand by their side also now in the difficult circumstances caused by the pandemic. Nonetheless, our continued support does not diminish the urgent need for Cambodia to respect human rights and labour rights. I stand ready to continue our engagement and to restore fully free access to the EU market for products from Cambodia provided we see substantial improvement in that respect.
Phil Hogan (EU Commissioner for Trade, European Commission News Archive, 12 August 2020)

In Feb 2018, the EU set-out a 15-step action plan to support the sustainable development aspects of the EU's FTAs. This included developing stronger links with international organisations (e.g. International Labour Organisation, ILO) and civil society as well as identifying actions by partner. Although economic sanctions were considered, the final plan focuses on achieving the aims collaboratively rather than with the use of penalties. Under this plan the European Commission has attempted to target non-compliance with provisions in trade agreements. For example, in the case of the labour provision in the agreement with South Korea, formal talks were held in 2019 and a dispute panel was established. In Jan 2021, the panel of experts found South Korea should apply the four fundamental ILO conventions as it promised in the trade deal. For a more detailed discussion of the labour provisions in FTAs see Agustí-Panareda et al. (2014).

This panel ruling shows the effectiveness of our cooperation-based approach to trade and sustainable development. We have closely engaged with our Korean partners for some years, and the panel of experts process led to concrete actions by Korea. We will be working closely with Korea to ensure it effectively implements commitments on workers' rights.
Valdis Dombrovskis (Executive Vice-President and Commissioner for Trade, European Commission Press Release, 12 Jan 2021)

The EU is firmly wedded to a rules based approach and supports the WTO, although the EU welcomes the prospect of WTO reform. However, it should be noted that the global trading system is moving away

[7] Reported by Reuters on 28 June 2016: EU Commission to opt for simple approval for Canada deal: EU official
[8] In July 2016 the European Commission presented CETA to the European Council as a mixed-agreement.
[9] 13 Members had ratified the agreement by the end of the review period.
[10] The EU-Japan agreement also used a 'negative list' approach. The EU also uses a 'positive list' approach and 'hybrid approach'.

from clearly defined FTAs, which are reported to the WTO. Examples of new types of arrangements include the China-US Phase One Agreement and the array of arrangements under the BRI umbrella. These new agreements may increasingly challenge the traditional approach to EU trade policy making. The tried and tested FTA format can prove slow to implement. Therefore, this adds further pressure to find ways to 'fast-track' deals at the EU-level.

5 Digitisation

Digital technologies have become an integral part of the Single market to a point that the distinction between the traditional "brick and mortar" Single Market and the 'digital' Single Market is no longer relevant. Digitisation of businesses – including traditional industries – and administrations is essential, and rules for the Single Market need to be designed and kept up to date to ensure that innovation and the diffusion of new technologies boost productivity growth.
European Commission (2018)

The Digital Single Market Strategy (DSMS), introduced in 2015, aimed to support the growth of the EU digital economy. Within the review period, this led to almost 30 pieces of legislation. Progress was monitored by using the newly established Digital Economy and Society Index (DESI). A number of interesting points emerge from the review together with additional data available from Europa (E-commerce statistics for individuals; DESI 2020):

1. Over the period 2010-2020, the proportion of people aged 55-74 buying online over the last 12 months (for private use) grew more slowly than for those in the younger categories (16-24 and 25-54 age groups). The largest growth occurred for 25-54 years, and from 2015 there was little difference in the proportion buying online compared to the 16-24 age group.
2. Ireland made the most progress in the DESI over the period 2015-2020.
3. Bulgaria, Greece and Romania are both low on the DESI and have made little progress over 2015-2020.
4. In 2017, 18% of EU companies sold online across borders.
5. In 2020, Finland, Sweden, the Netherlands and Denmark are leaders in the DESI.
6. In 2020, 31% of people in the EU purchased online from another Member State.

While actions have been taken since the launch of the DSMS, this snapshot provides a basic understanding of the work ahead for the European Commission. This progress has also highlighted the need to consider digital services taxation. Once again, this is work in progress. In essence, the argument is that the taxation system has not kept pace with the development of digital services, thus the European Commission argues that this creates a wedge between the amount different types of companies (traditional vs. digital) are liable to pay. For an alternative position, see Bauer (2018) which includes a discussion of EU estimates versus real effective corporate tax rates. Despite these criticisms, efforts were initially focused on an EU agreement. However, work towards a EU digital service tax was formally suspended in March 2019, while a number of member states moved forward with national legislation as well as efforts within the OECD towards a global framework. At the present time there is still much uncertainty with opposition within the EU to the global/OECD agreement. Although it is yet to be tested, the expectation is that elements of the OECD agreement will be deemed outside the area of the EU's exclusive competence. Therefore, if this is the case, it will be necessary for all EU Member States to agree individually. The OECD global framework has two main elements. Firstly, a minimum 15% tax rate for multinationals, and secondly, redistribution of profits of the top 100 companies to the states where the sales were made. In addition, the EU has suggested that further proposals on the EU digital services tax may be forthcoming, essentially reopening the process that was suspended in 2019 but with a strategic rethink so as not to overlap with the global framework. If the proposals come to fruition, this could mean two tax systems running in parallel. This might be workable if the EU digital tax focuses on a broader range of digital companies.

6 Conclusions

The EU made significant policy changes over the review period, which have impacted upon areas such as extra-EU investment, trade agreements and the digital economy. All three aspects also depend on extra-EU policies such as the BRI, B3W, China-US Phase One Agreement and global digital tax framework. The EU is in a strong position in terms of its network of trade agreements but it is likely that the speed of ratification will come under the spot-light in years to come. Moreover, geopolitical issues and EU values look set to add more complexity to trade deals. In terms of extra-EU investment, new flows from non-traditional investors are acting as a key driver for EU investment policy. The EU is more selective in its use of language regarding China than US policy makers, but considerable efforts are targeted towards developing a clearer strategy in this regard. The US-EU-China dynamic will be one to watch, as will the race to roll-out infrastructure development schemes to rival the BRI. Finally, Brexit had the potential to create a domino effect of other exits, but the UK's experience doesn't appear to be one that many EU countries look likely to follow in the near future.

References

Agustí-Panareda, J., Ebert, F. C., and LeClercq, D. (2014). Labour provisions in free trade agreements: Fostering their consistency with the ILO standards system. *International Labour Office Background Paper*.

Bauer, M. (2018). Digital companies and their fair share of taxes: Myths and misconceptions. *ECIPE Occasional Paper*.

Borchert, I. and Morita-Jaeger, M. (2021). Taking Stock of the UK-EU Trade and Cooperation Agreement: Trade in Services and Digital Trade. *UKTPO Briefing Paper*.

De Soyres, F., Mulabdic, A., Murray, S., Rocha, N., and Ruta, M. (2019). How much will the Belt and Road Initiative reduce trade costs? *International Economics*, 159:151–164.

European Commission (2016). Services and investment in EU trade deals: Using 'positive' and 'negative' lists. Technical report, European Commission Briefing.

European Commission (2018). The Single Market in a changing world: A unique asset in need of renewed political commitment. Technical report, European Commission Communication.

European Commission (2019). Trade for You Too: Why is trade more important than you think? Technical report.

Gastinger, M. (2019). Brexit! Grexit? Frexit? Considerations on how to explain and measure the propensities of member states to leave the European Union. *Robert Schuman Centre for Advanced Studies Research Paper No. RSCAS 2019/85*.

Hughes, M. (2021). Trade off: different ways of measuring imports and exports. *National Statistical: News and insight from the Office for National Statistics*.

Jackson, K. and Shepotylo, O. (2021a). An examination of EU trade disintegration scenarios. *The World Economy*, 44(1):2–20.

Jackson, K. and Shepotylo, O. (2021b). Belt and road: The China dream? *China Economic Review*, 67:101604.

Kao, C.-C. (2020). The EU's FDI Screening Proposal–Can It Really Work? *European Review*, 28(2):173–184.

Martill, B. and Staiger, U. (2021). Negotiating brexit: The cultural sources of british hard bargaining. *JCMS: Journal of Common Market Studies*, 59(2):261–277.

Mckenzie, L. and Meissner, K. L. (2017). Human rights conditionality in European Union trade negotiations: The case of the EU–Singapore FTA. *JCMS: Journal of Common Market Studies*, 55(4):832–849.

Pomfret, R. (2021). "Regionalism" and the Global Trade System. *The World Economy*.

Puccio, L. and Conconi, P. (2021). EU Trade Agreements: To Mix or Not to Mix, That Is the Question. *Journal of World Trade*, 55(2).

Swinbank, A. (2021). Some lessons that might be learnt from Brexit Britain's trade negotiations with the European Union. *Journal of World Trade*, 55(4).

WTO (2020). Trade Policy Review of the European Union. Technical report, WTO.

WTO (2021). Handbook on notification requirements. Technical report, WTO.