Senior European Experts

The EU's External Trade & Investment Policy

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Introduction

This briefing considers the EU's policy on external trade and investment in the light of the Commission's Communication of October 2015 *Trade for All: Towards a more responsible trade and investment policy.*[1] This is the first full statement setting out EU policy since the Commission published *Global Europe: Competing in the world* (October 2006).[2] Much has changed, both in the EU and globally, in the intervening decade. The changes include foreign direct investment becoming a matter of EU policy under the Treaty of Lisbon (2009) and growing political controversy over external trade and investment policy as a whole.

Background

Both for the UK and the EU as a whole, external trade is a very significant component of overall economic activity. As a single entity the European Union is the largest economy in the world. In 2014 one third of all global trade was with the EU. Two thirds of all global cross-border investment involves the EU. EU exports were worth £5 trillion and imports £4.7 trillion in 2014. Three fifths of this trade was within the EU. Even excluding this intra-EU trade, as a single entity, the EU was still the largest exporter and importer in the world. The EU is the UK's biggest trading partner: UK exports and imports are together worth 60 per cent of UK GDP, and that trade is roughly evenly divided between the rest of the EU and the rest of the world. Seven of the UK's ten largest import and export markets are other EU countries.[3] When measured against the scale of the EU's and the UK's international trade and investment interests, the EU's external trade and investment policy has a key role in securing economic advantage for the EU and the UK.

The EU manages external trade and investment relations with non-EU countries through its trade and investment policy. Because the EU is a customs union, its external trade policy has always been a common commercial policy (CCP) endorsed by all Member States, with the Commission acting as negotiator on behalf of the EU as a whole.[4] Trade policy is therefore an exclusive power ("competence") of the EU: only the EU, and not individual Member States, can legislate on trade matters and conclude international trade agreements. The scope of the EU's exclusive powers covers not only trade in goods but also:

- services;
- commercial aspects of intellectual property; and

[1] European Commission, *Trade for All: Towards a more responsible trade and investment policy*, COM (2015) 497 final, 14 October 2015
[2] European Commission, *Global Europe: Competing in the world*, 29 September 2006
[3] See Bank of England, *EU Membership and the Bank of England*, 21 October 2015
[4] *Consolidated Version of the Treaty on the Functioning of the European Union*, art. 207, 2012 OJ C 326/47 (hereinafter TFEU)

- foreign direct investment (FDI).

Although the Treaty of Lisbon brought FDI within the scope of the CCP, the precise extent of the EU's powers in relation to FDI is still a subject of debate. The wording of the relevant Articles of the Treaty on the Functioning of the EU[5] suggests that the exclusive powers are limited to foreign 'direct investment' (both into and out of the EU) but this and other related questions have yet to be definitively decided.[6]

A second major change in the Lisbon Treaty was the heightened role of the European Parliament in decisions on trade policy matters: this has been one factor in the wider phenomenon of greatly increased political debate on trade and investment policy, and in particular on how to combine international trade and investment protection commitments with satisfactory assurances on retaining the right to regulate at the domestic level. The context for the Commission's *Trade for All* initiative is the need to respond both to these developments and to the wider economic imperative of enhancing the EU's competitiveness.

Recent Trade and Investment Agreements and Negotiations

The EU's external trade and investment is important to the overall wellbeing of the EU and its Member States; and this has always been recognised by the European Commission. In a submission to the European Council in February 2013, the Commission said:

> Trade has never been more important for the European Union's economy. In today's difficult economic circumstances, it has become an important means of achieving much needed growth and creating jobs without drawing on public finances. It is the conveyor belt that links Europe to the new global growth centres and is a unique source of productivity gains. The EU, which is benefitting much more from globalisation than is sometimes portrayed, is well positioned to benefit from this intensified international trade.[7]

Various studies support the Commission's contention that the EU is well positioned, at least for merchandise trade, and has held its share of global merchandise exports. Others point to the need for the EU's CCP to be re-orientated towards securing greater gains for EU services exports. The EU as a whole is, for instance, the world's largest net exporter of financial services, with extra-EU exports of €78 billion, and a world leader in stock of FDI. There is therefore strong pressure for any commercial policy strategy to ensure that the EU's competitive advantage in services is fully reflected in EU trade and investment agreements. The EU has therefore embarked on a number of "new generation" bilateral agreements to strengthen and deepen trade relations with key markets. The first of these was the free

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[5] TFEU, arts. 206 and 207, *supra* n. 4

[6] One question concerns the CCP's coverage of portfolio investment (into and out of the EU). For a general discussion, see Michael Waibel, *Competence Review: Trade and Investment*, 13 January 2014: *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/270992/bis-14-511-trade-and-investment-competence-review-independent-review-legal-research-by-michael-waibel.pdf*

[7] European Commission, *Trade: a key source of growth and jobs for the EU – Commission contribution to the European Council of 7-8 February 2013*, 5 February 2013, p. 2: http://ec.europa.eu/archives/commission_2010-2014/president/news/archives/2013/02/pdf/20130205_2_en.pdf

trade agreement (FTA) with South Korea, which entered into force in July 2011.[8] It goes further than any previous agreements in lifting trade barriers, and is the EU's first agreement with an Asian country. Negotiations with Canada and Singapore were completed in the second half of 2014, and with Vietnam in December 2015; but the resultant agreements have yet to be ratified and to enter into force. Currently under negotiation are the EU-US Transatlantic Trade & Investment Partnership (TTIP), which, if completed, will be the most ambitious trade deal of its kind; FTAs with various ASEAN countries (at different stages of negotiation); an EU-Japan FTA; and an FTA between the EU and Mercosur (which has long been stalled but which would, if completed, establish a new relationship with partners including Argentina and Brazil as Mercosur's principal members). The EU is also participating (with some 45 WTO members) in negotiations for a Trade in Services Agreement (TiSA) aimed at extending liberalisation of services between the parties. FTA negotiations are also in hand with India, as well as talks on an EU-China bilateral investment agreement; and *Trade for All* announced the prospect of further FTA negotiations with Australia, New Zealand, and additional ASEAN countries.

All of these agreements aim at liberalising trade in both goods and services and in facilitating regulatory cooperation between the parties. The EU-South Korea FTA illustrates the potential benefits: by July 2015 (the fourth anniversary of the FTA's entry into force), EU exports of goods to South Korea of goods increased by 55 per cent compared with the year before the FTA's entry into force (from €30.6 billion to €47.3 billion) and EU exports of fully liberalised goods increased by 57 per cent.[9] The EU's previous trade deficit with South Korea has turned into a trade surplus of €7.4 billion. The FTA also confers advantages for EU services exporters: UK law firms have already taken advantage of the FTA's provisions allowing EU law firms to open offices or form partnerships in South Korea.[10]

At the same time, the EU remains an active participant in the multilateral trade agenda taken forward in the World Trade Organization (WTO). The Ministerial Declaration at the Tenth WTO Ministerial Conference (Nairobi December 2015) is the most recent example: in her Press Release, Commissioner Malmström noted that: "The EU has successfully concluded what we set out to achieve." The WTO Information Technology Agreement (part of the WTO Nairobi package) will reduce barriers to IT products trade worth an annual $1.3 billion among the WTO's members and is estimated to add $190 billion per year to global GDP[11].

Trade for All

In *Trade for All*, Commissioner Malmström, as Commissioner for Trade, sets out a refreshed trade and investment strategy. Central to this is the recognition that more than 30 million EU jobs already depend on exports outside the EU, and that 90 per cent of future global growth will happen outside Europe's borders. Inevitably, much of *Trade for All* is a restatement of existing policy. It is acknowledged that external trade and investment policy have become much more politically controversial, particularly in the context of the investment provisions under negotiation in TTIP: there is a promise of greater policy

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[8] *Council Decision 2011/265/EU on the signing, on behalf of the European Union, and provisional application of the Free Trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part*, 2011 OJ L 127/1

[9] European Commission, 'Trade: Countries and regions – South Korea', 6 November 2015

[10] European Commission, *The EU-Korea Free Trade Agreement in practice*, 24 October 2011, p. 16

[11] See HM Government, 'New IT free trade deal could boost UK exports by £113 million', 16 December 2015

transparency (already implemented through much-expanded publication of negotiations and their subject-matter) giving effect, in the trade policy field, to the Juncker Commission's pledge to listen and respond to EU citizens' concerns.

Trade for All goes further than previous EU trade policy statements in recognising the importance of trade in services. The services sector is now the primary contributor to economic growth, employment and competitiveness in the EU. *Trade for All* underlines the case for an EU trade and investment policy that focuses on the liberalisation of trade in services, given that European private-sector services businesses already contribute more than 55 per cent of EU GDP and account for more than 50 per cent of all EU employment (rising to 77 per cent for GDP and employment across all public and private sector services). The EU is also the largest exporter and importer of services, with more than 26 per cent of total world trade in services (extra-EU). Moreover, 65 per cent of all outward FDI by European businesses (extra-EU) and more than 80 per cent of all FDI coming into the EU is invested into services sectors. With services trade comprising only 28 per cent of EU external trade, there is huge scope for expansion, with the promise of enhanced EU competitiveness and prosperity.

Trade Policy & Services: some challenges

Giving greater primacy to services in trade and investment policy requires policymaker attention to certain key questions affecting services. Services did not form part of trade policy in the early days of the CCP and there are still difficulties (which do not apply to goods) in formulating evidence-based policies for services. *Trade for All* recognises the following specific issues:

(1) <u>*Integration of goods and services*</u>

The growing role of services in international trade, and in the EU's export performance, is not simply a matter of degree. There has also been a substantive change as the intermixing of services and goods in international business has become a feature of global trade in general, and of the trade of advanced economies in particular. There is growing use by manufacturing and agricultural businesses of services in areas such as externally-sourced services inputs, in-house services production, or services sold as part of a good or along with it.[12] Policies previously framed largely by reference to trade in goods now need to take account of services interests and the services component of all trade.

(2) <u>*Services trade restrictiveness*</u>

The increasing attention given to services trade flows has led to improved measurement by the OECD and the World Bank of restrictions on services trade.[13] OECD measurements illustrate not only the variations in services trade restrictiveness in different markets but also the sharp contrasts, even among EU Member States, in the levels of market access

[12] This is technically known as "servicification" and has been analysed by the Swedish National Board of Trade in relation to Swedish manufactured goods businesses, in which services play a part at all stages of the production, sales and delivery chain. See Swedish National Board of Trade, *Servicification of Swedish manufacturing*, 9 March 2010

[13] See OECD, 'Services Trade Restrictiveness Index (STRI)', 5 September 2015; I-TIP Services is a joint initiative of the World Trade Organization and the World Bank. It is a set of linked databases that provides information on Members' commitments under the WTO's General Agreement on Trade in Services (GATS), services commitments in regional trade agreements (RTA), applied measures in services, and services statistics. See: *http://i-tip.wto.org/services/default.aspx* (accessed 13 November 2015)

and national treatment for professional services offered by the EU. These sharp variations curb the EU's scope for seeking market-opening from its trading partners.

(3) *Complex supply chains: global value chains (GVCs) and trade in value added (TIVA) as tools for policy*

Globalisation has altered the way in which trade is carried on, how production is organised, and the basis of competition in the international economy. The rise of GVCs is an integral part of that process, which means that it will not be enough to focus on the incremental removal of barriers to trade already evident decades ago: the challenges of a more networked global economy have also to be tackled.

(4) *"21st century" policy issues*

A further challenge is how to react to policy and legislative choices by authorities in different trading partners. These do not arise simply from the evolution of the global market place and have as much – or more – to do with conscious policy choices by governments. Collectively they tend to be known as "21st century" issues.

(a) *Data and data localisation*

The rise of e-commerce and/or digital trade is the biggest recent change in patterns of global trade. All trade has become digital in various ways, and necessarily involves international transfers, storing and processing of data, which in turn raises sensitive questions about both individual privacy and about national security.

Government restrictions on data-transfer or data-processing have already arisen in the negotiation of FTAs, notably the negotiation of the EU-Korea FTA, and in anti-terrorist measures taken or proposed by governments for curbing cyber-terrorism threats. Likewise, various governments have introduced restrictions on where data can be stored and analysed. Some of these are neutral in intention, even if trade-restricting or trade-distorting in their effects. Others amount to outright protectionism. OECD studies have shown how they affect businesses' ability to adopt the most efficient technologies, influence investment and employment decisions, increase the cost of innovation and lead to missed business opportunities. As shown in the recent debate on the striking-down of the EU-US Safe Harbour agreement, the EU faces the challenge of finding the right balance between legitimate concerns about privacy and proprietary information on the one hand and the practicalities of commerce on the other. These complexities delayed finalisation of a new EU data protection regime, on which political agreement was confirmed in the Committee of Permanent Representatives on 18 December 2015.[14]

(b) *State-owned and state-sponsored enterprises (SOEs) competing in commercial markets*

In its relations with trade partners, the EU needs to tackle the growing problem of state-owned and state-sponsored enterprises (SOEs) that compete on non-transparent terms in commercial markets. The EU has strong mechanisms for

[14] The package of measures comprises the General Data Protection Regulation and the Data Protection Directive. Commenting on the Trilogue agreement reached on 15 December 2015, Commission Vice-President and Digital Single Market Commissioner Andrus Ansip said: "Our next step is now to remove unjustified barriers which limit cross-border data flow: local practice and sometimes national law, limiting storage and processing of certain data outside national territory."

enforcing fair terms of competition between EU-based enterprises, whether wholly private or with state participation. But other trading partners are often less rigorous.

(c) *Regulatory coherence*

Regulatory convergence and divergence between trade partners is a huge and expanding subject. It is no accident that it has come to the fore in the EU-US TTIP negotiations: given that trade and investment between the EU and the US is – in conventional terms of tariffs and traditional non-tariff barriers – substantially liberalised, regulation, particularly duplicative regulation, has become the main hindrance to still freer EU-US trade and investment and to the evolution of the transatlantic marketplace.[15] But the issue is not confined to TTIP.

FDI and investment protection

On current trends, FDI is likely to be of growing importance to the EU and the global economy. The EU's deepening involvement in investment policy therefore has important implications for all EU Member States, particularly those with significant services interests, given that investment – both inward and outward – plays a significant role in service-delivery. The EU is the largest global source and destination of FDI measured by stocks and flows. According to Eurostat, EU27 FDI outflows to the rest of the world reached €370 billion in 2011, while FDI inflows into the EU27 from the rest of the world were €225 billion. As to stocks, in 2011 European businesses held €4,983 billion outside the EU, while non EU businesses held €3,806 billion within the EU.[16]

Less well known is the services sectors' share in total EU FDI. Services accounted for by far the largest contribution to both outward (59 per cent) and inward (57 per cent) stocks. EU services firms hold nearly €3 trillion of investments outside the EU. Almost two-thirds are held in financial and insurance activities, with, recently, high growth in information and communication. By contrast, manufacturing represents some 20 per cent of outward and 31 per cent of inward investment.

The EU's investment policy is still evolving. There is little experience, so far, of the EU's policy in practice; indeed Member States are still free, in certain instances, to negotiate their own bilateral investment treaties (BITs) with third countries. Virtually all such BITs have included an investor-state dispute settlement (ISDS) process, which allows for legal proceedings before an impartial and neutral arbitral tribunal, in addition to other recourses. Use of ISDS by EU firms has increased in recent years, largely because more countries have taken protectionist measures particularly after the global economic crisis and because FDI flows to developing countries now account for more than half of global FDI flows.

For decades, the ISDS component in BITs was entirely uncontroversial. But this has now changed amid assertions that foreign investors should not benefit from a special legal recourse and suggestions that the ISDS process itself – particularly in the context of TTIP – could lead to assaults on the right to regulate in the public interest as practised by the EU

[15] The hazards of regulatory divergence in financial services are examined in Chris Brummer, *The Danger of Divergence: Transatlantic Financial Reform & the G20 Agenda*, Atlantic Council, 22 January 2014

[16] Eurostat, 'Foreign direct investment statistics', 30 November 2015

and its Member States. The Commission accordingly embarked in 2014 on a major consultation on ISDS within TTIP, as a result of which it published a proposal in the TTIP negotiations for the replacement of the existing ISDS system with a new International Investment Court.[17] This proposal, which would ultimately require global agreement, would take some years to develop; in the meantime, it is not clear how far it will gain traction in the TTIP negotiations.[18]

The UK's Position

The UK Government has always been a leader in advocating a liberal EU trade policy and supporting the EU's generally trade-liberalising policy stance: indeed that advocacy has been a notable influence on the evolution of the CCP. Unlike many other areas of EU policy, EU trade policy has not, generally, been regarded as controversial over the forty years of the UK's EU membership (although current debates over trade, investment protection and the right to regulate are revealing some changes of attitude).

This generally positive viewpoint was reflected in the UK Government's recent reaction to *Trade for All* when the Prime Minister said:

> One of the biggest benefits of our EU membership is the free trade deals between the EU and the rest of the world which tear down barriers to business and open up markets. That's why sixty per cent of the UK's exports go to the single market and the countries with which the EU has trade deals […] And we achieve much more in these trade agreements with third countries by negotiating as part of a market of 500 million consumers than we would if the UK went it alone.
>
> We already benefit from more than fifty trade agreements between the EU and third countries and today's strategy from the European Commission shows the huge prize still on offer – if the EU completed all the agreements on the table, it could add £20 billion each year to the UK economy. That's one of the benefits I've been pushing for as part of the UK renegotiation and so I'm delighted that the European Commission has committed today to push ahead with ambitious agreements with China, Australia, New Zealand and countries in South East Asia and to do more to ensure that SMEs and consumers across Europe can benefit from these trade agreements.[19]

If the UK left the EU, the benefits accruing to it from the CCP would be removed. At present the UK is, through its EU membership, a party to preferential trade agreements between the EU and some 60 non-EU countries or organisations (together covering some 35 per cent of world trade). Leaving the EU would mean that the UK ceased to be a party to these. Nor would the UK any longer enjoy the prospect of benefiting from agreements that have been concluded but are not yet in force (*e.g.* those with Canada and Singapore) or other

[17] See European Commission, *Transatlantic Trade and Investment Partnership: Trade in Services, Investment and E-Commerce – Chapter II - Investment*, 12 November 2015

[18] The established ISDS system, and the potential effects of the Commission's proposal, are discussed in Peter H Chase, 'TTIP, investor-state dispute settlement and the rule of law', *European View*, 14(2), pp. 217-229

[19] HM Government, 'European Commission trade strategy: Prime Minister's statement', 14 October 2015

agreements currently under negotiation (*e.g.* TTIP, the Trade in Services Agreement (TiSA) or free trade agreements with Australia, New Zealand, India or the ASEAN countries)[20], together accounting for a further significant percentage of world trade. Instead, the UK would need to establish its own tariff, in readiness for trading with other countries on a WTO most-favoured-nation basis, unless and until it could complete negotiations to reinstate preferential trade arrangements with trading partners.

Outside the EU, it would fall to the UK to negotiate individually with all its trade partners in the hope of regaining similar or better levels of preferential access. Those favouring leaving the EU argue that the UK would enjoy far greater freedom of manoeuvre in negotiating with third countries. But the UK could also suffer disadvantages in bargaining power: already very open itself, it would be seeking market access for its highly competitive services exports while only offering a market of some 60 million consumers of merchandise exports rather than the 500 million that the EU can offer. The UK would also need to re-establish trade policy resources and capacity, as it is 40 years since the UK last negotiated a trade agreement or managed the other matters that go with being outside the EU (*e.g.* administering an independent UK tariff). It is of course possible to re-tool to undertake tasks not done for 40 years – but it would be challenging to do so quickly[21]; and the task of renegotiating preferential trade agreements would take a matter of years, with uncertainties and risks for the UK's international businesses over that period.

Future Developments

The proof of the strategy set out in *Trade for All* will of course be in how far its prescriptions can be put into practice in a programme of trade negotiations with trade partners. At another level, the strategy needs to be robust against the kind of controversy that is now endemic in trade policy, particularly as regards the balance to be struck between further trade liberalisation (an increasing part of which will depend on reducing regulatory barriers of all kinds) and maintaining the right to regulate (where there is a popular if inaccurate perception that trade liberalisation restricts the freedom of governments to regulate in the public interest in domestic legislation). *Trade for All*, plus other steps such as the Commission's proposal for an International Investment Court, seeks to meet these challenges by a more diversified strategy combining transparency with some genuinely new initiatives to allay controversy.

December 2015

[20] For putative trade policy scenarios if the UK left the EU, see, *e.g.*, TheCityUK & Clifford Chance, *A legal assessment of the UK's relationship with the EU: A Financial Services Perspective*, 27 April 2014; and John Springford, Simon Tilford & Philip Whyte, *The economic consequences of leaving the EU*, Centre for European Reform, 3 June 2014

[21] As a comparison, the Office of the US Trade Representative has over 200 staff plus external advisers and advisory committees; in addition, the US Department of Commerce, the US International Trade Commission and US Customs have many trade-related responsibilities, including the administration of the US tariff

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