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The Role of the European Union in the International Trade and Investment Order

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Abstract

The priority of the EU in the international trade and investment order is to provide leadership in supporting the open, rules-based order at a time when it faces its most severe test since the establishment of the General Agreement on Tariffs and Trade (GATT) more than 70 years ago. An effective EU policy on international trade and investment is important for the EU in terms of ensuring access to future growth markets and promoting sustainable development. But at the time of major threats from both the United States and China, it is important for the EU to support an open, rules-based trading system. The EU cannot however, achieve this aim alone, and will need to cooperate with like-minded countries that share this broad aim. The EU's capability to pursue a coherent policy in pursuit of these general aims requires the establishment of an effective trade policy regime that includes the Council of Ministers, European Commission, and European Parliament. It also requires the (re)establishment of a broad political consensus on the scope and aims of EU trade and investment policy, something that can only be achieved with the full engagement of member state governments and stakeholders in an informed debate.

Keywords

European Union, trade policy, global investment, GATT, rules-based trading system

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1. Introduction

The role of the EU in the international trade and investment order is important for the representation of the interests of the EU and its member states, but also for the maintenance of an open, rules-based international trade and investment order. For the EU and member states it is a means of gaining and retaining EU access to major growth markets, something that is essential for the maintenance of EU economic prosperity in the years and decades to come. Policymaking in this area is also central to the way the EU defines its 'collective preferences' and seeks to defend these in the context of global production and investment.

But the EU also has a vital interest in defending a rules-based trading system. The interests of China and the USA, the other two major poles, are not as closely associated with the maintenance of a rules-based order as are those of the EU. The scale of China's promotion of industry and technology is such that it challenges the prevailing rules-based order in a manner that the strategic trade policies of smaller emerging markets have not done in the past. The United States reversion to more unilateralist, power-based approach to trade under the Trump administration reflects a broader perception in the US that the existing rules no longer ensure a balance of benefits compatible with US interests.[1]

One of the key difficulties in current trade policy is that while most countries and policymakers say they support a rules-based system, there is no consensus on what a rules-based system should be. This paper therefore begins by identifying the normative roots of the EU trade and investment policy, henceforth referred to as the Common Commercial Policy (CCP). These normative roots along with concrete economic factors shape the EU's role in international trade and its interest in the maintenance of a balanced, stable, rules-based order. The paper then discusses the challenges to such a rules-based trading system emanating from the United States and China. The ability of the EU to respond to these challenges will depend upon its capabilities, so these are then assessed before the EU's response to these international challenges are discussed. The EU's ability to pursue a consistent and coherent role in international trade and investment is dependent on maintaining a broad internal consensus on the scope and aims of the CCP. There therefore follows coverage of the internal challenges facing the EU in terms of decision-making.

2. The EU's Normative Preference in Trade and Investment

2.1 A rules-based system

The CCP is shaped by a set of norms that the EU and its member states have evolved as part of a wider Organisation for Economic Co-operaton and Development (OECD) club model. The post-1945 trading system was shaped by the developed OECD economies. This was leadership by like-minded countries with an Atlantic focus. The rules were in particular developed at a plurilateral

1 A power-based trading system is one in which the willingness to use economic or market power predominates. Fairness in the system is then defined by the most powerful countries rather than a system of rules agreed upon through cooperation and codified in multilateral or other types of agreement.

level and took the form of soft law codes or best practice. The rules, such as those developed in the OECD, were then generally multilateralised in more binding GATT rules.[2] Importantly for an understanding of the EU role in trade and investment, these codes and best practice then adapted to the specifics of creating a European market and were adopted into hard law in the shape of the *acquis communautaire*. The *acquis* then largely shaped EU preferences in trade in the CCP. This was often with a lag, such as in the case of investment where there was a lack of formal exclusive EU competence (Woolcock, 2006). There was thus a synergistic relationship between developments in the EU and international norms and standards.[3] This use of international norms by the EU and thus the close synergy between international and the EU rules (the *acquis communautaire*) should come as no surprise because the main EU member states have been active participants in the OECD, the International Organization for Standardization (ISO), World Customs Organization, as well as all being members of the World Trade Organization (WTO) and contracting parties to the GATT before that. The EU 'normative power' in trade is therefore to a significant degree due to its implementation in hard law of the predominantly voluntary norms developed internationally. It is not in seeking to 'export' an exclusively EU model to the rest of the world, as is the often-heard criticism of the EU. Another way of looking at this is to argue that the EU is not a super state in trade but rather part of a multi-layer process of building a system of stable trade rules.

In the past, progress in developing trade rules largely depended on US and EU cooperation, although all OECD countries participated. The legitimacy of this shared leadership of the trading system depended on it delivering the international public good of an open trading system. The emerging markets of the 1960s and 1970s in the shape of Japan (reemerging), Korea (the Republic of) and other Newly Industrialising Countries (NICs) were content to be rule takers because the system helped ensure open markets for their exports on which their development depended. When the USA threatened to restrict access for Japanese exports based on 'fair trade' arguments in the 1980s, Japan moved to a policy of more explicit support for multilateral rules to contain US unilateralism. It was Canada that proposed and the EU and Japan that supported a stronger WTO in order to discipline US unilateral definitions of 'fair trade' (Van Grasstek, 2013).

In other words the EU's role in the international trading system has to date been very much as a part of the OECD club model in which the key counterparty was the USA. Over time the EU assumed a more important role in shared leadership of the club and, by the mid-1990s, had aspirations of leadership. It was the EU that pushed for a millennium round of multilateral trade negotiations (MTN) from 1996 onwards, at a time when the US was already showing clear signs of disenchantment with 'multilateralism'[4] and moving towards a policy of competitive liberalisation.[5]

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2 For example, the qualified most favoured nation (MFN) codes on technical barriers to trade (TBTs), subsidies, government procurement, and customs procedures adopted in the Tokyo round of the GATT were based on rules developed in the OECD.

3 This can be seen can be seen in the close similarity between the EU and international trade rues and standards as well as in the application in the European Social Charter, which is based on International Labour Organization standards. The EU applies the standards and principles of the World Customs Organization in its internal customs procedures as well as in preferential trade agreements.

4 As indicated in the text the GATT was part multilateral (the application of MFN to tariffs) and partly plurilateral (rule-making)

5 The idea of competitive liberalization, or using alternative preferential means of promoting liberal trade, was aired in 1996 (Bergsten, 1996)

The EU's vested interest in maintaining an open, rules-based trading system is therefore, in part, because the EU norms and approach to market integration draw on those developed internationally. The nature of EU decision-making also means the EU is heavily inclined towards a rules-based order, because of the lack of sufficient member state support for power-based trade policy. Decision-making is formally by a qualified majority voting (QMV) in the Council (and a simple majority in the European Parliament). But in practice the EU works by consensus and there is always a sufficient number of member states ready to block the threat or use of market closure as part of a more power-based strategy. The EU single market is also based on a broad liberal consensus that has precluded active interventionist policies at the EU level. The EU cannot therefore match the more power-based approach of the US in which the current administration uses the threat of market closure to get concessions from its trading partners, or China's large-scale investment in strategic trade policies (discussed below) and must rely on a rules-based trading system to defend its interests.

2.2 Regional integration

The normative roots of the CCP are also in European economic integration. The CCP stems from the establishment of the customs union, and thus the requirement to adopt a common external tariff (CET). The customs union is the foundation stone of European economic and political integration. As the international trade agenda moved beyond tariffs to include first non-tariff measures and then to services and regulatory policies and standards, the EU member states opted to negotiate with one voice. This began as early as the Kennedy round of the GATT (1964–67), and continued through the Tokyo (1974–79) and Uruguay (1986–94) rounds. The European Economic Community (EEC), European Community and finally the EU negotiated as one, even on topics that were not exclusive EU competences, in order to ensure that member states did not adopt different positions and thus limit or undermine the common—later the single—market.[6] This was, for example, the case for technical barriers to trade (TBTs), state subsidies, government procurement, and customs procedures in the Tokyo round. It was true for services, some aspects of investment and intellectual property rights in the Uruguay round. In other words, the CCP is inextricably linked to EU integration.

The normative preference for regional integration is also reflected in the CCP through efforts to conclude region-to-region trade agreements. The EU has been called the "patron saint of regional integration" (Aggarwal and Fogarty, 2004). Thus the EU has sought to negotiate region-to-region agreements with the African, Caribbean, and Pacific (ACP) states, with ASEAN, and with Central America, but with mixed success.[7] Delays and competition in the shape of other major economies

6 This has a relevance for the debate on the scope of EU competence, or power, because a common voice and thus a common position in external trade established de facto competence for the EU and thus favoured the establishment of formal exclusive EU competence for the policy area concerned. For more details see Eeckout, 2011 and Devuyst, 2013.

7 In practice, region-to-region trade agreements have been possible with regions in which integration was already fairly well advanced, such as the East African Community/Union and the Caribbean. The EU approach to other Economic Partnership Agreements (EPAs) was controversial in that some saw them as impeding regional integration.

negotiating bilateral agreements with members of regional groupings and thus gaining first-mover advantages has resulted in the EU following suit, but with the ultimate aim of concluding wider region-to-region agreements.

To sum up, the EU's role in the international trading system has been as a progressively more important member of the OECD club. It took emerging international norms and standards and applied them in binding European legislation. European integration is therefore embedded in the rules-based system. The EU does not have the option of an easy shift back to more power-based trade and investment policy. In short it is in the EU's vital interests that an open, rules based trading order is maintained.

3. Challenges to a Rules-Based Trading System

There are a number of challenges to the rules-based, open trading system. In terms of the structure of world trade it has been the growth of China in particular, and the emerging markets in general, that has undermined the legitimacy of the OECD club model. This model based its credibility and legitimacy on the fact that the economies concerned were large enough to generate positive externalities for smaller trading partners through the establishment of an open trading system. This output legitimacy compensated for the fact that it was an exclusive club model. With the growth of China and other emerging markets and the relative decline in the OECD's share of world trade, this is no longer the case. [8]

The EU has a vital interest in defending a rules-based trading system.

3.1 US return to power-based trade policy

At the international level, the immediate challenge is the shift towards more power-based policies in the United States. This is based on a view that the existing rules are 'unfair' on the USA. Rather than seek joint gains from negotiating changes in the trading regime, the Trump administration has pursued a pure value-claiming trade strategy. This has taken the form of threats to close the US market, backed by a willingness to carry out such threats. As a result, the Trump administration has withdrawn from the Trans-Pacific Partnership (TPP), recast NAFTA (as UMSCA, the United States Mexico Canada Agreement) and is threatening the viability of the WTO.

The question that arises is whether this is a phenomenon of the Trump administration or a more enduring feature of US policy. While President Trump has taken the use of unilateral actions based on claims of 'unfairness' to an extreme, it is not the first time the US has pursued such policies. The so-called 'Nixon shock' in August 1971 included a 10 percent tariff across the board in order to

8 In concrete terms, the WTO has failed to conclude the Doha Development Round due in large part to the inability to differentiate between countries according to their level of development. The leading OECD economies and in particular the US are no longer ready to tolerate free-riding, but the emerging economies continue to claim developing country status.

force Japan and West Germany, which had trade surpluses with the US, to revalue their currencies. During the 1980s the US applied unilateral measures under Section 301 of the 1974 Trade Act (then a catch-all measure to address "unfair trade") as leverage in the negotiation of "voluntary export restraints" as a form of managed trade to reduce the US trade deficits (at that time with Japan). In the 1980s, as today, such a power-based strategy has been used in the pursuit of a narrowly defined aim of reciprocity. A narrow definition here means bilateral reciprocity in cases of US trading partners having a trade surplus.

It remains to be seen if the current policy will endure.[9] What differs this time around is that it is the executive branch that is pushing unilateral measures based on vague justifications of national security.[10] In the past the executive provided a check on unilateralist pressures in the US Congress.[11] In the first two years of the Trump administration, Congress has failed to act as a check on the executive. There is clearly not much left of the belief that the US has a role in providing leadership for the international trading system. President Trump is also openly attacking the European model of integration, which is based on shared sovereignty and binding obligations and has been supported by every US administration since Kennedy's.

3.2 The Chinese challenge

The challenge from China is less short-term but no less real. China is using its financial and economic strength to pursue a strategic trade policy on a scale that cannot easily be reconciled with the existing trade rules.[12] When it opened its economy during the 1980s and 90s and joined the WTO in 2000, China could be said to have been supporting the established trading system. On accession to the WTO China accepted binding commitments and a lower average, most favoured nation (MFN) tariff of below 10 percent, compared to other emerging markets such as India, Brazil, and many developing countries, which can have much higher bound tariffs.[13] It was in China's interest to join the WTO because the country benefitted from the open trading system. The reform-minded leaders of the Communist Party also saw in WTO membership an opportunity to justify and promote domestic reform. In more recent times, President Xi has also claimed that with the US administration turning its back on multilateralism, China can assume a leading role.

But what does China understand by the rules-based trading system? It has signed up to commitments on tariffs, but the WTO provisions on non-tariff measures are less binding and more open to interpretation. If one considers the content of China's preferential agreements concluded

9 See 'What Trump's America First Policy means for the International Trading System' https://blogs.lse.ac.uk/usappblog/2018/10/17/what-trumps-american-first-policy-means-for-the-international-trading-system/.

10 In fact it is a relatively small group of political appointees and the President that have brought about the shift in US policy. Whether the policy endures depends on whether sector interests and the US Congress can reassert themselves and provide more checks and balances.

11 In the literature this had been explained by the ideational commitment to free (or shall we say open) trade on the part of the president/executive branch (Keohane and Goldstein, 1993)

12 For a description of strategic trade policies see Krugman, 1986. These use domestic support in the shape of subsidies, preferential treatment for national suppliers, and the promotion of state-owned champions to enhance the competitive position of national industries and thus achieve economies of scale.

13 India's average applied tariff is only 13.4 percent while its average bound MFN tariff is 48.5 percent (WTO tariff data as of 2018).

since 2000, these do not contain any binding obligation that limits China's ability to pursue a strategic trade policy. In other words China's idea of what the rules should be differs considerably from that of the EU.

China also represents a challenge in the sense that it appears to be moving from a policy based on domestic development towards one based on economic statecraft. China now appears much more willing to use its economic weight to gain political influence and project power. As in the case of the US, it can be argued that this is only a readjustment or a temporary trend. There also remain doubts about the sustainability of the Chinese model of state-led capitalism. But opinion in Europe (following that in the USA) seems to be shifting from a benign view of Chinese economic strength to one that sees China as more of a threat. China is becoming a major source of outward investment, which can be used to gain influence—such as through the well-publicised Chinese investment in some EU member states.[14] It can use Foreign Direct Investment (FDI) to acquire advanced technology as part of its strategic trade policy. It also has a large domestic market that is less open than that of the EU (or the US). With centralised decision-making it can also make full use of the carrot of market access and the stick of closure to maximize leverage in trade and investment relations.

The growth of China in particular and the emerging markets in general has undermined the legitimacy of the OECD club model.

4. The EU's Capabilities

Leaving aside for the moment the question of what the EU response should be to these challenges, how capable is the EU of acting? Here is not the place to rehearse the debate about EU actorness (Scheler, 2014), but the ability of the EU to shape agendas and outcomes in international trade is clearly important.

There are various metrics for this. The size of the EU market is clearly one factor, at 16.9 percent (or 14.54 when the UK leaves) of world GDP, the EU weighs in as one of the heavyweights (China 17.1 percent, USA 15.8 percent), but its share is declining. In terms of the share of world trade in goods the EU accounts for 15 percent (excluding intra-EU trade) of world trade (15.7 percent of exports and 2016 and 14.8 percent of imports), but here the EU share has declined more rapidly over the past decade, as has that of the USA. This is an indicator of the shift in the focus of world trade from the Atlantic to Asia Pacific.

The old adage that what counts in trade is what you bring to the table still holds. In other words, power or the ability to get concessions from others depends on a party's ability to make offers or concessions. So governments of relatively closed economies have more bargaining power than those of open economies. In this respect the emerging market economies are generally in a stronger

14 See Deutsche Welle Exit the Dragon? 5 February 2018 https://www.dw.com/en/exit-the-dragon-chinese-investment-in-germany/a-42457712

position than developing economies had been in the past. The EU has an average, trade-weighted bound MFN tariff of 3 percent. There are only a few sectors in which the EU still has leverage on tariffs, such as agriculture, cars, and textiles. It is liberal in terms of investment and services. In terms of regulatory impediments to trade, the EU has fairly rigorous requirements, so has some leverage in this area, but the *acquis* means that exporters generally need only to comply with one set of standards or regulations to access the whole single market. This is trade facilitating, as is the EU tendency to use international standards. In other words the EU, like most OECD economies, has relatively limited market access concessions to offer. Compared to the US, the EU member states are also more—and in some cases much more—trade dependent.

EU bargaining power has also been shaped by the cohesion and dynamism of integration. This was the case in the 1960s with the creation of a common market and common external tariff (CET). During the Kennedy round of the GATT between 1963 and 1969, the EEC, as it then was, was able to negotiate tariff concessions from the United States[15] that had not been possible before. During the Uruguay round between 1986 and 1994, the dynamism of the single market programme again enabled the EU to have a considerable impact on shaping trade policy agendas and outcomes. These periods contrast with the 1970s and the period after 2000 when there was little or no integration dynamic, and as a result the EU had less impact on outcomes. After the 2008 financial crisis, the integration dynamic slowed further. The implications of the euro crisis and a lack of common approaches to inward migration have created centrifugal forces, a populist backlash against what is seen to be an EU policy elite, and Brexit. How to restore an integration dynamic is beyond the scope of this paper. The point here is that the EU would enhance its bargaining power and thus its ability to shape outcomes if it could regain an integration dynamic.

The EU cannot easily match the Chinese strategic trade policy.

The degree of flexibility in terms of the negotiating strategies it can pursue in trade is another factor. In this respect the EU is more constrained than most WTO members because of the need for decisions to be based on at least QMV of the EU member states, and in most cases now a majority of the European Parliament.[16] In practice the EU operates by consensus, at least on major decisions. This means the EU cannot wield the stick of threatening market closure, except in cases of compensation when other WTO members infringe the rules. There has always been a group of liberal member states that has opposed such a power-based strategy. The UK leaving will diminish the group of mostly northern liberal member states, but this is likely to still be strong enough to preclude purely power-based strategies.[17] The EU negotiators are therefore left with little option

15 During the 1950s the US held back from further tariff liberalization following the establishment of the GATT (Dür, 2010).

16 One important exception here is that of anti-dumping actions, where over time the more defensive member state governments have moved decision making to a simple majority to block the adoption of definitive dumping duties from a position in which a qualified majority was needed.

17 Two examples illustrate this point: 1) The Trade Barriers Regulation (TBR), which was seen as the EU response to the US Section 301, the unilateralist fair trade legislation of the USA recently used against China. But the use of this was made conditional upon first pursuing WTO remedies and on a qualified majority vote. The TBR has never been used. And 2) in public procurement, where there have been efforts dating back to 1994 to enable the EU to threaten closure of the EU market as a means of achieving a level playing field in procurement. The Directive on International Trade in Procurement, proposed in 2010, has however continued to languish.

but to pursue value-creating (win-win) negotiating strategies. Another way of looking at this is to see the EU's decision-making as providing less scope for discretionary measures than most of its trading partners. Chinese trade diplomacy has been described as 'fragmented authoritarianism', but China is still a unitary state. In addition, as recent US trade policy has shown, the US executive retains some scope for discretionary action. In other words, the other major trading powers of the USA and China have either market power or a willingness and ability to use discretionary power in the pursuit of their national interests. The EU has less market power than China, and is unwilling or unable to use discretionary power due to the need to find consensus among the member states.

The scope of EU exclusive competence is also a factor in bargaining power. The Lisbon treaty extended exclusive competence to cover foreign direct investment, which enhanced the potential leverage of the EU. However, as will be discussed below, the lack of an internal consensus on what EU investment policy should be has meant that this leverage was not exploited. Another limiting factor is that the member states still compete in both attracting inward FDI and seeking contracts in third markets, as do the states in the US and other federal states and private companies everywhere in seeking contracts. In terms of investment policy vis-à-vis China, the EU's recent efforts to coordinate the screening of inward investment may mean some greater coherence with regard to inward investment, but they are limited to national security considerations and do not compare with the ability of the Chinese government to direct inward FDI to favour national development aims (Copenhagen Economics, 2018). Even the USA has stronger measures in the shape of the Committee on Foreign Investment in the United States.

It has been argued that the EU has normative power (Manners, 2006). This can be seen as derived from the EU model of creating a single open market and creating the regulatory framework to facilitate trade while pursuing other policy objectives. As discussed above, in the context of trade and investment EU normative power is related to how it takes norms developed at the international level and incorporates and implements them in EU rules.[18] In other words, the strength of the EU as a normative power depends in part on these norms and thus the continuation of a rules-based trading system.

Although not directly related to bargaining power, it is worth observing that just as the EU cannot easily pursue a power-based strategy, nor can it match the Chinese strategic trade policy. For this, the EU would need interventionist instruments to promote EU champions. There are limited instruments available at the EU level for such purposes, and past debates on the need for EU industrial strategies or technology policies have made little or no progress.[19] Even if there were a consensus to do so, the member state governments would simply not have the resources to match what the Chinese government has been willing and able to spend supporting its national champions in recent times.[20]

18 Normative power has been seen as "not just a European project—it is part of a global effort to coordinate and reconcile human differences under conditions of globalisation" (Manners op. cit p. 168, citing Kristeva).

19 The recent proposal for a new Industrial Policy Strategy is a series of measures aimed at improving the framework conditions rather than a strategic trade strategy, https://ec.europa.eu/commission/news/new-industrial-policy-strategy-2017-sep-18_en

20 There is a debate as to the sustainability of this policy given the level of public debt in China.

To sum up, the EU's bargaining power is in relative decline. It has already liberalised more than many WTO members and therefore has less to offer in terms of concessions than the emerging powers, such as China. The nature of EU trade policy decision-making means that it does not have the option of following the US and reverting to a more power-based trade strategy. Contrary to China, the EU does not have the capability to pursue a strategic trade policy. The EU's interests therefore lie in sustaining a rules-based order. The interaction between international norms and the EU *acquis* is also an important component in the EU's normative power.[21] Even when it comes to retaliation against unilateral measures taken by others, such as in the case of the US tariffs on steel and aluminium, the EU response has been to do the utmost to keep within WTO rules.[22]

5. The Domestic Challenges

At the domestic level, the EU has the challenge of defining the scope and objectives of trade and investment policy in the context of majoritarian—as opposed to the interest based—trade politics (discussed below) that has hitherto been predominant. Other WTO members, such as the United States, face similar domestic challenges. To have a credible EU trade strategy in response to the current challenges, it is necessary to have a broad consensus on the scope and aims of policy and trust in domestic decision-making. This has been questioned recently.[23]

The EU's ability to respond to the challenges it faces internationally are determined by domestic factors. Here we shall focus on two key factors: the dynamism of European integration or the centrifugal forces it is currently facing, and what should be the EU's collective preferences on trade and investment policy. Closely linked to this second factor is how or who should define EU preferences.

5.1 What should be the scope of the CCP?

Trade and investment policy has reached progressively deeper into domestic (and EU) policy autonomy. This necessitates a balance between the commercial or economic interests on the one hand and retaining the 'right to regulate' in the pursuit of other legitimate, domestic policy objectives, on the other. "(T)he aim … is to ensure that economic growth goes hand in hand with social justice, respect for human rights, high labour and environmental standards and health and safety' (Cremona, 2017). The challenge is to deliver on this aim. Such a balance has always been implicit in trade rules, but the need to define or redefine the balance has become more urgent. The current EU trade agenda is also influenced by how to use trade and investment measures as a means of pursuing other policy objectives internationally, such as sustainable development, human rights, and EU foreign policy aims.[24] This is a continuous process, and the issues concerning the

21 The argument here is that the EU can be effective in shaping international norms and thus the rules-based order if its norms or regulatory standards are in the mainstream of international norm- or standards-making. If the EU approach diverges too far from international norms, it is likely to have less normative power.

22 The EU response to the US tariffs was justified under Article 8 of the Safeguards Agreement of the WTO.

23 A concrete illustration of this is how the EU negotiated comprehensive trade and investment agreements with Canada and Singapore, only to face difficulties having these ratified.

24 The human rights objective is set out in the Treaty of Lisbon (TFEU) Art 3(5) and elsewhere. Art 207 states that EU trade policy must be guided by the principles established in Art 3(5). The EU also has a policy of including a human rights clause in all preferential trade agreements it concludes.

balance need to be discussed in relation to specific topics. But stakeholder trust in the decision-making is crucial. The following section assesses the factors that determine EU decision-making on trade.

5.2 Who decides on the rules in the EU?

In all the time trade rules under the GATT were focused on MFN and national treatment, the politics of trade policy was shaped by the aim of a broadly defined reciprocity. Reciprocal market opening was determined by GATT contracting parties (CPs) making mutual concessions on tariff reductions, which were then extended on an MFN basis to other GATT CPs. The politics of trade was predominantly *interest based*. National preferences were defined by balancing offensive against defensive interests and these were then aggregated at the EC/EU level. Sectors with a comparative or competitive advantage sought access to export markets, and those without sought protection. When a major competitor country gained preferential access to a third country market the EU preference was to achieve a level playing.

The political economy of trade took on the classical form of concentrated costs, for instance of imports in the agricultural, steel, or clothing industries, but diffuse benefits for the users of such inputs or final consumers through lower prices. There were also benefits for competitive sectors such as transport equipment and machinery, science-based sectors such as pharmaceuticals, or services in which the EU had a strong competitive position. In this model, consumers and voters suffer from a collective action problem. The sector-specific nature of trade meant that capital and labour often shared a common interest in pressing for protection, but consumers and the wider voting public had little incentive or ability to engage in decision-making. Trade officials sought the best balance in the national interest, with input from politicians. At the EC/EU level in the Council working group on trade (now the Trade Policy Committee (TPC)) then decided on the EU preference on the basis of a proposal from the commission trade officials. Decision-making was therefore 'technocratic' (Woolcock, 2014) and two steps removed from consumers or voters,[25] first at the EU level of aggregation and then the international level of negotiation between the EU and its trading partners. As a result, the collective action problem was especially pronounced, which made for trade politics shaped by the interaction between interests and officials the core of the EU policymaking process.[26]

An EU decision-making regime emerged in which the key stakeholders (trade policy officials and the fairly specialised trade policy community in the EU) understood how decisions were taken and trusted that these would—on balance and over time—reflect their interests. Decisions were almost always based on consensus so the process would go through various iterations until a final consensus could be reached. Ideational factors played a role, but more indirectly and in the sense that some member states, such Sweden, the UK, the Netherlands, Demark, and especially Germany

25 Not as a means of ensuring autonomy for the EU process, but as a result of the nature of taking decisions for the 6, 9, 12, or 28 member states.

26 Some academic analysis of EU trade policy has put forward the view that the EU institutions were purposely given autonomy to decide on policy in order to prevent protectionist capture. But this is an over simplification. The distancing of policymaking was in many respects a practical result of taking decisions at an EC/EU level.

mostly favoured more liberal policies and others such as Italy, France, and Spain generally favoured more mercantilist approaches. The differences were in how broadly to define reciprocity, with the liberals taking a relaxed or broader view and the less liberal a narrower or more mercantilist position.

5.3 Towards a new trade politics

This interest-based politics shaped EU preferences even as non-tariff measures became more prevalent in trade policy. Regulatory policies such as technical regulations, standards, or food and sanitary standards were generally seen as technical *barriers* to trade. The inherent tension between the aim of regulatory policies to promote public policy objectives, such as social cohesion, consumer safety, or environmental protection on the one hand, and market opening on the other was already the subject of policy debate. But it was still at a 'technical' level between trade officials and the respective EU and member state regulatory bodies or agencies. Balance was sought in the form of concepts such as proportionality, least trade-restrictive measures, or non-discrimination in the form of national treatment. As noted above, in promoting these concepts, the EU followed international norms and standards on topics such as TBTs, sanitary and phytosanitary (SPS) measures, and public procurement in the acquis communautaire. But the EU developed these norms and standards further, such as by developing the concept of mutual recognition as a means of dealing with divergent national regulations. The acquis then became the EU preference in trade negotiations.

Among developed OECD economies there appears to be growing support for plurilateral initiatives as a means of making progress.

A change in trade politics began when awareness of the trade-off between market opening and regulation began to emerge during the 1990s. Civil society actors began to resolve the collective action problem by engaging a wider set of stakeholders through information and advocacy campaigns and seeking to shape the debate about trade policy preferences. Environmental non-governmental organisations (NGOs) were the first to emerge, arguing that trade policy did not account for environmental externalities. Development NGOs argued that policies based on reciprocity were undermining the development aims of developing countries. For organised labour, the growth of global production and value chains brought an end to the shared interests with capital in specific sectors as global supply chains led to the off-shoring of jobs in manufacturing from which trade unions drew most of their support. The effect of these civil society NGOs' efforts to shape national and EU preferences helped shift the politics of trade (and investment) from a predominantly interest-based to a more majoritarian politics.[27]

It is this shift to more-majoritarian trade politics that poses a major 'domestic' challenge for the EU (and the member state governments). In order to respond to the systemic challenges discussed above, the EU needs to have credibility. But the broader, more majoritarian trade politics in the EU

27 This is sometimes seen as a politicisation of trade, but trade policy has always been politicised. "What has changed has been the actors engaged in the process.

makes defining 'trade for all' more difficult, and requires the integration of the European Parliament, which has become a conduit for civil society engagement in the EU decision making regime. The tensions between the broader strategic aims of the EU in international trade and the domestic debate on the balance between trade/economic interests and the 'right to regulate' came to light in the debate on the Transatlantic Trade and Investment Partnership (TTIP), the Comprehensive Economic and Trade Agreement between the EU and Canada (CETA) and the EU–Singapore Free Trade Agreement (FTA).[28] Negotiating trade agreements with these strategic partners was part of the EU Global Europe policy, enunciated in 2006, to negotiate trade agreements with strategic partners. They were also a response to the weakening of the WTO system and arguably an effort to re-establish shared leadership of the trading system with the US. But both initiatives became the focus of debate on how EU trade and investment policy should reconcile trade and economic interest and regulatory objectives.

6. So what role for the EU?

The EU's role in trade and investment is as a supporter of a rules-based, open trade and investment order because this is in line with EU interests. Based on the points made above, the EU definition of a rules-based system importantly rest on taking the soft law international norms, such as those developed in the OECD, GATT, the International Labour Organization, World Customs Organisation, the World Intellectual Property Organisation or multilateral environment agreements (MEAs) and implementing them in hard law. While some other countries have used the international norms, the EU approach is to go further and be more comprehensive.

It is in the EU's interests to ensure compatibility between its model and the wider international trading system and to ensure that other countries support a similar set of norms and standards. A case can also be made that EU normative power depends on it being in the mainstream of international rule-making. Another way of looking at this is that the EU member states have accepted the need to pool some regulatory autonomy or sovereignty in order to keep pace with the internationalisation of markets. Having done so at a regional level makes this easier at the international level, provided the international rules are consistent with those of the EU.

The EU also has an interest in a rules-based order because its relative market power is declining as the centre of gravity of the world economy moves further from the Atlantic to the Asia-Pacific region. The EU was never a hegemonic trade power, but has shared leadership in trade. The shift to Asia has been eroding the viability of the shared US–EU leadership function in trade, something that the recent shift in US trade policy appears to have confirmed. The nature of EU decision-making makes it difficult if not impossible to emulate the US in pursuing a power-based trade strategy. Equally, there is no consensus in favour of the kind of intervention needed for the EU to pursue a strategic trade policy.

28 The tensions over the EU–Singapore FTA reflected those between the EU institutions in the shape of the question of exclusive competence. It is interesting to note that the EU–Japan agreement attracted very little public debate and criticism.

7. But What Rules?

At the international level, the EU interest is in the effective application of the established international norms and standards. But do these match the current EU collective preference? Is the balance between commercial and other legitimate policy objectives the right one, or is there a need for adjustment? What should be the balance in new areas of policy such as digital trade and e-commerce? These questions have both domestic (or EU internal) and international dimensions.

7.1 The domestic EU level

Within the EU, there is a need to establish and maintain a broad consensus on the aims and scope of trade and investment policy. This necessitates a balance between the pursuit of economic/commercial aims, in particular maintaining access for EU exports and investment to future growth markets. This will be needed to sustain EU economic prosperity on the one hand, and legitimate social and environmental aims on the other. Maintaining such a balance is an ongoing process and involves an acceptance of the need for adjustment. The EU could be said to be going through a sometimes-painful correction away from the (neo)liberal paradigm that shaped policy in the 1980s through the mid-2000s, towards a balance that gives more weight to sustainable development and the right to regulate. This is illustrated by, for example, the shift in investment policy that took place in response to the debate over TTIP away from a policy based on the market and protection of investors towards a greater role for public policy and the right to regulate.

Defining the EU collective preference in terms of the rules is a continuous process, so there is a need to (re)establish trust in the decision-making process on the part of all stakeholders. This is also necessary because of the changes resulting from the implementation of the Treaty on the Functioning of the European Union (TFEU), in particular the need to integrate the European Parliament into the EU decision-making regime, a process that is still not complete. The Commission and, with some hesitation, the Council has also introduced more transparency that should facilitate the open and informed public debate that is needed to respond to the shift towards majoritarian politics in EU trade and investment. But the EU institutions cannot carry this debate alone; the member state governments must engage more. All too often, member state governments or populist politicians deflect opposition to 'globalisation' to the EU when in fact it is the member states that fully share responsibility for the policy. The debate on the role of trade and investment policy must also find a balance between the multiple objectives set out in the TFEU, namely the promotion of economic growth and an open trading system, as well as human rights and sustainable development.

At the EU level it is also necessary to take the question of adjustment to changes in comparative and competitive advantage more seriously. The shift to more-liberal policies led to a reduction in the willingness to manage adjustment. At both the member state and EU levels, structural policies that could ease the costs of adjustment have been insufficient and sometimes largely token. The austerity measures following the 2008 financial crisis have further weakened the general social safety

net. In other words, the ability to bring about adjustment to shifts in the pattern of trade and international competition has been reduced. Neither the member states nor the EU has adequate structural or adjustment policies compared to those of the 1970s or early 1980s. A consequence has been that those affected by shifts in trade or the growth of global value chains have been susceptible to populist arguments opposing EU policy.

7.2 The international level

On the international dimension there is equally a need to establish a broad consensus on the scope and balance of trade and investment rules. At the multilateral level, which here means the WTO, the role of the EU must include support for the WTO and the continuation of a strong multilateral order. This is needed to prevent a drift back to a more power-based trade or malign mercantilism.[29] The reference here is to current US power-based and Chinese strategic trade policies. In the short term the EU has acted by supporting the 'friends of multilateralism' group of developed and developing country members of the WTO and has tabled a number of proposals on how to strengthen the WTO (European Commission, 2018). In the short term this can be seen as part of an effort to engage the US and thus head off more unilateral action by the current administration, which has made vague threats about leaving the WTO.[30] Another short-term need is to find a way of unblocking the freeze on appointments to the appellate body to the WTO, which the US has brought about. If this cannot be done, the dispute settlement function of the WTO is in real danger of being sidelined.

EU policy can promote compliance and transparency rather than a divergent set of regulatory norms.

The EU has supported medium-term proposals to make the WTO more effective by moving ahead on reforms of the dispute settlement procedures and proposing a strengthening and rationalisation of WTO committees. In an effort to make progress on the negotiating front, the EU has lent its support for initiatives, such as on e-commerce.[31] Among developed OECD economies there appears to be growing support for *plurilateral initiatives* as a means of making progress. Plurilateral initiatives are those taken by a limited group of WTO members. In those sections of US opinion that see the need for the trade rules to keep pace with developments in the world economy, there is a solid consensus in favour of plurilateralism.[32] This is based on the view that there will only be progress if a group of like-minded countries moves ahead without the ability of others to block. This implies a non-MFN plurilateral, in other words one that excludes China and other emerging powers.[33]

29 A distinction has been made between benign and malign mercantilism. The former consists of short-term measures to ease the costs of adjustment to shifts in patterns of trade, such as safeguard measures, that do not threaten the open trading system. Malign mercantilism is the sustained use of power and economic influence to enhance the relative position of a country in a manner that undermines the established order.

30 This seems unlikely even for the Trump administration and there is very broad based support for the WTO across US business and in Congress.

31 See Commission Concept note op. cit and WTO communiqué from the Buenos Aires Ministerial, 2017 https://www.wto.org/english/thewto_e/minist_e/mc11_e/documents_e.htm.

32 See for example, the CSIS debate with six former US Trade Representatives from both Republican and Democrat administrations. https://www.csis.org/events/conversation-six-former-ustrs-0.

33 This was US policy, for example, with regard to the Trade in Services Agreement (TiSA).

The position of the Trump administration on plurilateral agreements seems to be negative, given the decision to take the US out of the TPP and President Trump's preference for bilateral negotiations. The EU approach, however, is more in favour of the retention of MFN. In other words, like-minded parties can work on rules, but the negotiations should be open to all those wishing to take part, and the benefits should be extended on an MFN basis to all WTO members.[34] This is important because trade rules are only effective if there is buy-in from all the key players. Some of the topics proposed for plurilateral initiatives at the Buenos Aires WTO ministerial in November 2017, might gain support from a wide range of WTO members, such as e-commerce, subsidies on fish,[35] or enhanced transparency measures, But plurilateral negotiations on subsidies or state-owned enterprises without the emerging members of the WTO would be divisive.

In the longer term the goal of the EU should be to promote a broad consensus on trade and investment rules. It will probably have to do so through number of forums. The OECD is no longer the legitimate forum for developing norms because it is not inclusive of the emerging economies. The WTO cannot be relied upon, as it is more a forum for negotiating reciprocal commitments, so developing countries have been suspicious of any new issues introduced by the developed economies, which they see as part of a bargaining process.[36] To date, the G20 has not proven to be very effective in dealing with some of the main tensions in trade relations.

7.3 Preferential trade agreements

Another vehicle for the EU to influence trade and investment is preferential trade agreements (PTAs). These have come to dominate trade policy in the absence of sufficient progress on multilateral rules that keep pace with markets. The content of EU preferential trade policy is clearly an expression of EU aims and objectives. After unsuccessfully seeking a comprehensive multilateral trade and investment agenda in the Doha Development Agenda, the EU reluctantly—and after other major WTO members—shifted to a policy of promoting a comprehensive agenda in PTAs (Woolcock, 2007). In its PTA approach, the EU has pursued a de facto differentiation policy, something that is needed at the multilateral level if there is to be progress in the WTO. [37] In agreements with developed market economies, such as Canada, Japan, and Singapore, it has pushed for coverage of a full range of non-tariff measures, government procurement, competition, and investment. In PTAs with middle-income countries it has accepted a less-extensive coverage of rules and less than full reciprocity, and in the Economic Partnership Agreements (EPAs) with

34 This remains a contentious question in the WTO. For plurilateral agreementsto come under the WTO, a consensus of all members is required (Annex 4 of the WTO agreement) see Woolcock, 2016. But emerging market members such as India, China, and Brazil have refused to approve any plurilateral approaches, which they see (with some justification) as an effort to re-establish the leadership function of the OECD club.

35 China has, however, held up negotiations on reducing subsidies for fishing fleets.

36 China, India, and some other emerging countries have explicitly opposed any change in the WTO rules that would deny them the power to veto the inclusion of plurilateral agreements under Annex 4 of the agreement establishing the WTO.

37 Differentiation here means differing commitments according to the level of development of the country concerned. In the WTO to date, differentiation has been largely between developed and developing, with so-called self-declaration of developing country status. But the current trading system is no longer predominantly north-south, it is multi-polar with economies at very different levels of development. China still claims developing-country status, but is a leading trading nation of clear systemic importance.

developing countries it has included some transparency provisions but otherwise only rendezvous clauses (i.e. agreement to negotiate sometime in the future) and less-binding obligations on the so-called Singapore agenda topics.[38]

The question for EU PTA policy is whether it can ensure that the PTAs it negotiates are reasonably compatible with multilateralism, even though the tariff and other market access provisions of PTAs are discriminatory. There is an argument that PTAs negotiated between two parties will result in a proliferation of PTAs as third countries seek to negotiate equivalent access to re-establish a level playing field. The desire to ensure a level playing field does indeed appear to be a major factor shaping PTA initiatives. The danger here is that divergence in the rules elements of PTAs will result in added complexity. To date, the EU PTA agreements have tended to be WTO-plus[39] in terms of implementation, rather than adopting radically divergent rules. EU policy can therefore promote compliance and transparency rather than a divergent set of regulatory norms.

7.4 Autonomous trade policy

In addition to the multilateral, plurilateral, and preferential, the EU also adopts autonomous trade policy, such as in the form of the tariff-free preferences for least developed countries under the Everything But Arms (EBA) policy and applies Generalised System of Preferences (GSP) vis-à-vis developing countries. By offering more-favourable terms to least-developed economies, the EU therefore seeks to introduce a form of differentiation between countries according to their level of development.

An effective EU policy on international trade and investment is important for the maintenance of an open, rules-based world trade and investment order.

Finally, the EU applies trade instruments such as anti-dumping, countervailing duties, and safeguard measures to address 'unfair trade' measures and provide protection for sectors that are adversely affected by unforeseen surges in imports. In this way the EU implements the existing GATT/WTO rules that govern the use of such instruments. The application of the GATT anti-dumping rules by the EU has varied over time. Once one of the most frequent users of anti-dumping actions, the EU's use of anti-dumping decreased during the 2000s, probably due to the growth of global supply chains (Messerlin and Woolcock, 2012) and remains far lower than that of the USA or India. International companies that import intermediate products do not want to have to pay anti-dumping duties. The shift from interest- or industry-based trade policymaking is also probably a factor.

The EU makes less use than, for example, the United States or India of countervailing measures to counteract the distortive effects of subsidies provided by other countries. The EU also makes limited use of safeguard measures. Taken together, these trade instruments provide a means of

38 The 'Singapore agenda items' were those topics (investment, competition, public procurement, and trade facilitation) that the EU and other OECD economies sought to get on the WTO agenda at the Singapore WTO ministerial meeting in 1996.

39 WTO-plus means provisions in PTAs that go beyond the scope of existing WTO rules.

managing the process of adjustment and defending EU sectors when other countries pursue 'unfair trade' as defined in the respective GATT articles and WTO agreements. What the EU does not have, as noted above, is a general trade instrument based on a purely EU definition of what is unfair trade.

7.5 Summing up

An effective EU policy on international trade and investment is important for the EU in terms of ensuring access to future growth markets and promoting sustainable development. But it is equally important for the maintenance of an open, rules-based world trade and investment order. At a time of major structural changes in the world trading system, the EU's role is as a key pillar of such an open, rules-based system. The EU cannot, however, achieve this aim alone, and will need to cooperate with like-minded countries that share this broad aim. To date, the EU has shared leadership with the US, but this is no longer a viable option, at least for the present given the Trump administration's preference for bilateral negotiations and apparent reluctance to share leadership. In trade as in foreign and security policy, the EU is faced with a major rupture in transatlantic cooperation. Given its relative strength in trade policy, however, the EU can and should be able to shift away from the default of shared transatlantic leadership of the trading system and work with other countries to maintain a stable trade and investment order. The EU's capability to play a coherent and effective role in pursuit of these general aims requires the establishment of an effective trade-policy regime that integrates all three EU-level institutions. It also requires the (re)establishment of a broad political consensus on the scope and aims of EU trade and investment policy, something that can only be achieved with the full engagement of member state governments and stakeholders in an informed debate.

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