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TRADE AND COMPETITIVENESS

ISSUES PAPER

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NON-TECHNICAL SUMMARY

Like the Single Market, the EU's ever greater openness to trade and investment has been a major "catalyst of growth" over the last two decades. Alone, it explains a quarter of the productivity gains witnessed across Europe, owing to greater competition, better specialisation based on comparative advantage, innovations generated by greater competition, the technological content of foreign imports and investments, and increased economies of scale. In many sectors (such as textiles or automotive), extra-EU liberalisation has been a major factor in reinforcing competitive disciplines in the EU economy, even compared to the effects of internal liberalisation.

Competitiveness has many dimensions. The external one is unavoidable for an open economy like the EU. The EU is the most open of the big economies in the world. The EU is also the largest exporter of goods and services and the first investor abroad.

While improving competitiveness is at the heart of EU trade policy, it is not limited to it: the external dimension of competitiveness can ill-afford to ignore traditional internal policy issues like services of general interest, R&D, and education.

Internal and external openness are inextricably linked. The further internal liberalisation within the framework of the Single Market, prioritised by the Growth and Jobs Strategy, will create a common set of rules for 400 million plus people and encourage overseas entry into these markets. The experience of the Single Market programme has shown that, in spite of fears of "Fortress Europe", third countries have generally benefited from greater access to the EU market due to further internal integration, sometimes more than European countries themselves.

The aim of this paper is to show how trade policy can, and indeed does, contribute to competitiveness and which policy levers should be used to maximise this contribution.

TRADE POLICY CAN HAVE A POSITIVE IMPACT ON COMPETITIVENESS BY ENSURING THAT:-

- (i) **The domestic market is sufficiently open to provide cheap inputs and allow healthy competition vis-à-vis the rest of the world, as well as to stimulate technical progress.** Border measures should not needlessly raise production costs for the EU industry through tariffs or non-tariff barriers (NTBs) on its inputs (raw materials, but also intermediary goods, parts and components and services) which would put European producers at a disadvantage. Border measures should also not shelter industries from the benefit of the introduction of more competitive disciplines, itself a key effect of trade openness. Regulatory measures should not deter foreign direct investment (FDI), which is a key provider of jobs, skills and technologies.
- (ii) **Domestic producers have adequate access to third markets,** which is the basis for better specialisation, economies of scale and the contribution of exports to growth. Market access restrictions encompass tariffs on goods, but also non-tariff barriers and non-traditional, behind-the-border restrictions on goods such as norms and standards, restrictions on competition or discrimination in public procurement. The same applies to services and investment, the latter is also an essential complement to the export of goods and services. All these restrictions carry a direct effect on competitiveness both directly through the possibilities afforded to our exporters to sell their products abroad, and indirectly through the economies of scale generated by the increase in volumes of sales.
- (iii) **Anti-competitive practices do not distort or undermine resulting trade.** Trade policy should also ensure that the positive changes induced by openness are not jeopardised by abuses of fair competition.

THE SITUATION WE START FROM:-

- (i) **The EU's open trade regime clearly helps EU competitiveness.** Reducing its own barriers has been a policy the EU has consistently followed since its inception. For example, the dramatic reduction of tariffs on industrial products during the successive GATT "rounds" and successful sectoral dismantling such as the Information Technology Agreement covering almost the entire IT sector, of which the EU was one of the major instigators. The borders of the EU are now largely open to trade, the only significant exceptions are in certain sectors of agriculture. There is no real restriction to inward investment. There are only limited pockets of distortions regarding inputs for basic industrial products. They are already partly addressed with tariff suspensions and quotas and likely to be removed in any case within the Doha Development Agenda (DDA). Regarding anti-dumping duties, they do not appear to lead to significant costs to downstream industries even when they are applied to products which are used as inputs. In any event, the "Community interest" clause is systematically applied to avoid anti-competitive impacts. The same applies to services: while measuring restrictions is more difficult here than for goods, the general conclusion is that there are no costly restrictions to the foreign supply of business related services.

There are some exceptions to this picture in the agriculture sector, where some significant inputs for the EU food industry, such as sugar or dairy, are still highly protected. This is not a special European feature, however, as indicated by a comparison with the US and Japan. Neither is it the only factor of competitiveness for the EU food industry: marketing, distribution, brand positioning and the degree of consolidation within the industry are also important in determining competitiveness. Besides price considerations, the quality of agricultural inputs is also a key element for the competitiveness of processing industries. The actual impact of the additional cost induced by the protection of inputs may thus be limited for highly differentiated products, but is not negligible for producers of less sophisticated manufactured goods. Tariff escalation and the protection given to processing industries partly compensate for this disadvantage on the domestic market, while export refunds (likely to be phased out) serve the same purpose on third markets. Globally speaking, despite some of the problems mentioned above, the EU processed food industry is considered to be highly competitive with strong domestic and international brand names and quality recognition.

- (ii) **Addressing barriers to EU exports in third countries accounts for the bulk of the potential to improve the competitive position of the EU industry.** The EU is one of the most open markets worldwide. Its leading trading partners are less open, sometimes significantly so. This implies that EU trade interests are first and foremost outward-looking in nature: the EU stands to win from the further opening of markets worldwide.

Both the analysis and our experience of running the Trade Barriers Strategy over the last decade show that there are still substantial access restrictions to third markets, due to both tariffs and non-tariff barriers, which include core NTBs but also non-traditional, behind-the-border practices limiting access for EU goods, services and FDI. The protection of intellectual property rights is essential in this respect. Geographical indications (GIs) are, for instance, of high importance to EU exporting interests in wines, spirits, beers and other agri-food products, given the high degree of usurpation of EU GIs on third markets. Public procurement is another example where national preferences are a major impediment to market access: it is probably the biggest trade sector sheltered from multilateral disciplines and it represents up to 15% of GDP, often reserved to domestic goods or suppliers.

(iii) **International rules for ensuring fair competition are insufficient.** The absence of international rules of competition is both a limit to market access in third countries where private barriers are often substituted for tariffs or traditional non-tariff barriers and an open door for predatory practices of foreign exporters on the EU domestic market. Trade defence instruments (TDIs), especially anti-dumping and anti-subsidy measures, are precisely designed to correct such distorting practices. While this is the purpose of EU TDI policy, European producers are often adversely affected in third country markets by WTO-incompatible anti-dumping investigations and measures. This is all the more important because anti-dumping use by third countries, especially developing countries, is on the rise, and the severity of US measures continues unabated despite numerous WTO rulings.

(iv) **EU trade shows a good export performance in upmarket, high-quality products, but this performance is at risk.** The EU industry's position on world markets is still good mainly due to its ability to sell upmarket products (products which sell at a higher price owing to quality, branding and related services). This is not just anecdotal. It is a striking fact that upmarket products now account for about half of European exports and a third of world demand. This is the case not only for consumer goods, but for the whole range of EU specialisation, including intermediary goods, machines and transport equipment. It actually reflects a new form of "vertical", qualitative, intra-sectoral international division of labour, according to the level of product range, that distinguishes itself from the classical "horizontal" inter-sectoral specialisation. The challenge now is not only to trade Airbus planes for T-shirts, but increasingly to trade similar products within the same sector, where European firms prosper as a result of their products' distinctiveness and quality. For example, parts of Europe's textile industry remain very competitive. Globally, the EU ranks in second place just behind Japan but ahead of the US: upmarket products account for 52% of Japanese exports and 48% of European exports, but for only 41% of US exports. On the other side, they still account for less than 15% of Chinese exports. This is a key point for the linkage between competitiveness and the EU social model: the EU produces expensive, upmarket products and can sell them abroad, due to a set of non-price factors such as innovative features, quality, reputation, continuity over time or related services. This is an unstable equilibrium, however, and the EU position is at risk, because the European industry is losing ground in high technology products. It is trailing behind in several high tech products whereas countries such as China are rapidly catching up, even if this in turn is in part an optical distortion: whenever an EU or US company has its most recent invention assembled in Asia, this appears as an Asian trade gain and our loss. Maintaining the EU's ability to sell expensive top-of-the-range products is not just a matter of technological advance, as stated above. The quality of products, their reputation, their continuity over time and their related services are all decisive factors in determining prices. However, innovation remains a key component of this picture.

In the mid to long term, the EU position is also at risk due to the geographic orientation of its exports, which are strong in countries where demand is static but less well positioned in rapidly growing areas. This is particularly true compared to the Japanese and US exports. It runs the risk of missing market opportunities in dynamic areas which already account for half of world import growth. This is, however, less of an issue to be addressed by public policy makers than by EU industry.

(v) **Market opening brings about transformations which are costly and disruptive for some in the EU,** particularly for the less qualified and most vulnerable workers. Even if the process as a whole is beneficial, openness to trade implies redistribution that needs to be managed on grounds of fairness. This is also a political imperative: the benefits of trade-opening are diffuse while the harmful impact is concentrated: such asymmetry directly feeds opposition to market opening. It is also an economic imperative: better anticipation helps to minimise costs of change, by facilitating and accelerating transitions (for example by limiting the duration of unemployment or the scope of wage losses).

It also helps to ensure that market opening can effectively take place and have full effect. The very scope of the internal adjustments necessitated by trade opening depends on the width of the specialisation of the EU industry. To some extent, this relates to the development of markets in developing countries themselves and to the nature of the trade the EU experiences with them. Enhanced institutional frameworks in the South along with a rapid catching-up in terms of living standards appear to be key for the development of trade of similar products differentiated either by quality or by variety (rather than simple inter-sectoral trade), which allows the preservation of a wide industrial basis in the EU and limits the scope of adjustments.

WHAT CAN WE DO TO ADD TO EU EXTERNAL COMPETITIVENESS?

- (i) **Reduce our own protection in the few areas where it remains:** notably in some sectors of agriculture, but also the few remaining higher tariffs on industrial inputs as well as remaining restrictions on services where they exist bearing in mind the wider context e.g. the need to maintain the necessary “negotiating capital” in the WTO/DDA and in bilateral negotiations. Further opening within the Doha Development Agenda (DDA) will have to strike a balance between agricultural sensitivities and competitiveness requirements. As stated above, there is still room for a decrease in protection in some key agricultural inputs such as sugar and dairy. This would also make it easier to reduce protection of the EU food industry. There is also some room for tariff reduction in non-agricultural products, such as aluminium, trucks and tractors. Recent CAP reforms, which involve either price decreases and/or an improvement of quality are of crucial importance.
- (ii) **Urge trade partners to open their markets,** using our possibilities for movement on our own trade protection as negotiating leverage. This should be primarily pursued through an ambitious strategy in the Doha round: a successful completion of a far-reaching DDA is an essential deliverable of the Lisbon strategy in itself. Ambitious positions regarding tariffs, NTBs, services, geographical indications and rules (especially anti-dumping disciplines) must continue to be taken within the DDA. As an example, the reduction of the levels of protection at the lowest common denominator that the EU is requesting from its trade partners in the WTO for the sectors of textiles, clothing and footwear, should give such EU industries the opportunity to expand abroad in the context of the quota-free environment prevailing from 2005.

This should be complemented by bilateral or regional initiatives, such as Regional Trade Agreements (RTAs) with Mercosur and the Gulf Cooperation Council, which allow the pursuit of a wide agenda.

New initiatives could also be launched to urge improvement of market access in public procurement. Our idea is to apply reciprocity against third countries which fail to open up their public procurement markets.

Such a strategy would build on our existing systematic commitment to tackle and eliminate barriers to EU market access bilaterally, using the tool of the “market access database”. This puts the focus on registering and assessing the impact of all the complaints expressed by the EU industry, and where necessary and possible, tackling the barriers either through bilateral discussions / negotiations, or through the Trade Barriers Regulation.

- (iii) **Safeguard our internal operators from unfair competition practices through the use of trade defence instruments.** Continue to make firm use of trade defence instruments (TDIs) in order to counter anti-competitive practices. At the same time, continue to ensure that TDIs do not backfire on our (downstream) industries by applying the “Community interest” test in anti-dumping procedures, on a case-by-case basis. Work in the DDA for the adoption of tighter WTO rules in order to avoid unfair use of TDIs by our trade partners (based on the credible contribution the EU has to make given the prudent and rigorous approach it is pursuing in its own defensive cases). Bilaterally, take a firm line with third countries over unjustified use of anti-dumping on a case-by-case basis.

- (iv) **Contribute to developing our strengths by promoting intellectual property protection and the international projection of EU norms and standards.** Defend a better recognition of intellectual property rights (IPR) and an improved enforcement of IPR protection both multilaterally and bilaterally (especially in the neighbouring countries and China). This is of the utmost importance for the promotion of innovative products and to sustain the EU's position in upmarket products. Implement the IPR enforcement strategy adopted in November 2004 by the Commission.

Reinforce international norms and standards to tackle NTBs detrimental to EU industry, as well as pursue recently launched bilateral regulatory initiatives (with the US, Asean and Canada for example). These in turn reinforce the EU stance in favour of international norms and standards. Strengthen the EU position in international normative bodies, as well as the coherence of its positions in different organisations.

- (v) **Anticipate and manage the transition effects of trade opening in order to facilitate and accelerate change.** Push for more flexible labour markets and active safety nets within the EU, but also for anticipative measures. Support the Commission proposal in the framework of Financial Perspectives 2007-2013 to take the likely impact of openness into account within the programming of structural funds and foresee a reserve fund (1% of Objective 1 funds, 3% of Objective 2) being put aside for intervention in case of unexpected shocks. Indeed, the regional dimension is particularly important when managing the effects of market opening. Transition costs are disproportionate in those regions that have underdeveloped and non-diversified economies. Adjustment to changes induced by the Single Market was the key reason for the inception of cohesion policy at the end of the 80's. The adjustment to changes induced by international trade opening and the division of labour, which are of similar significance, should now become a key component of it.

- (vi) **Contribute to the long-term creation/development of export markets for EU exports,** both by encouraging the integration of larger regional markets, as well as promoting institutions and policies that favour "inclusive" development strategies in emerging countries. Such an inclusive development, based on enhanced institutional frameworks and a rapid catching-up in terms of living standards, is primarily beneficial for these countries themselves. However, it is crucial for the EU as well, as it favours the development of trade of similar products differentiated either by quality or by variety, which, unlike simple inter-sectoral trade, allows the preservation of a wide industrial base and limits the scope of the internal adjustments induced by trade opening. EU external instruments should converge in supporting this approach.

INTRODUCTION

Like the Single Market, the EU's ever greater openness to trade and investment has been a major "catalyst of growth" over the last two decades, accounting for roughly a quarter of the productivity gains witnessed across Europe, owing in particular to greater competition, better specialisation based on comparative advantage, defensive innovations generated by greater competition, the technological content of foreign imports and investments, and economies of scale. In many sectors (such as textiles or automotive), extra-EU liberalisation has been a major factor in reinforcing competitive disciplines in the EU economy, even as compared with the effects of internal liberalisation¹.

Competitiveness has many dimensions (see box below). The external one is unavoidable for an open economy like the EU. Compared to its size, the EU is one of the most open economies in the world. EU trade in goods and services accounts for 15% of its GDP, that is 3 points above the US or Japan. The EU is the first exporter of goods and services and the first investor abroad.

Internal and external openness are inextricably linked. The further internal liberalisation within the Single Market that the Growth and Jobs Strategy prioritises - will create a common set of rules for 400 million plus people and encourage overseas entry into these markets. The experience of the Single Market programme has shown that, in spite of fears of "Fortress Europe", trade with third countries has generally benefited from further internal integration, sometimes more than European countries themselves².

The external dimension of competitiveness can ill-afford to ignore traditional internal policy issues like services of general interest, R&D, and education. However, trade policy lies at the heart of it. To strengthen the competitiveness of European companies, trade policy necessarily includes both an internal and an external dimension:

- From the internal standpoint, trade policy should ensure that our border measures do not needlessly raise production costs for EU industry through tariffs or non-tariff barriers on its inputs (raw materials, but also intermediary goods, parts and components and services) which would put European producers at a disadvantage towards competitors. This is one of the underlying reasons for the policy of regularly reducing its own barriers, which the EU has followed since its inception (with, for example, the dramatic reduction of tariffs on industrial products during successive GATT "rounds" and successful sectoral dismantling like the Information Technology Agreement (ITA) covering almost the entire IT sector and of which the EU was one of the major instigators). Nevertheless, we should ensure that there are no unjustified pockets of distortion that would be detrimental to EU competitiveness.

- From the external standpoint, trade policy can improve the competitive position of EU industry on third markets by lowering tariffs and eliminating non-tariff barriers to trade. We should ensure that trade policy successfully improves the access of our exporters and investors to third countries, in particular to those rapidly growing markets like China, India and Brazil.

More fundamentally, fostering competitiveness implies the strengthening of the EU position by drawing upon its assets and defining EU trade policy accordingly. A recent report by CEPII, commissioned by DG Trade, shows that the EU industry's position on world markets is slightly better than that of the US and only marginally behind Japan, due to its ability to sell upmarket products. However, this is an unstable equilibrium because simultaneously the European industry, together with Japan and the US, is losing ground comparatively in high technology products, but this in turn is in part an optical distortion: whenever an EU or US company has its most recent invention assembled in

¹ See for example estimates in Cortes O. & Jean S. (1997), « Commerce international, emploi et productivité », *Travail et Emploi*, n°70. Hine R. C. et Wright P. (1998), "Trade with Low-Wage economies, Employment and Productivity in UK Manufacturing", *The Economic Journal*, vol. 108, n° 450

² Head K. et T. Mayer (2001), « Effets frontières, intégration économique et forteresse Europe », *Document de travail du CEPII*, 2001-06. (<http://www.cepii.fr/francgraph/doctravail/pdf/2001/dt01-06.pdf>)

Asia, this appears as an Asian trade gain and our loss. It is therefore important to assess the extent to which trade policy can help the EU maintain its positions.

While the process of market opening is generally beneficial to growth and employment, it undoubtedly brings about transformations which are costly and disruptive for some, particularly for the less qualified and most vulnerable workers. This should be addressed both with more flexible labour markets and with safety nets. But this also supposes anticipative measures to be taken to make sure that these structural changes are facilitated and managed swiftly within the EU. Lastly, it is essential to contribute to the long-term creation/development of export markets for EU exports both by encouraging the integration of larger regional markets, as well as promoting institutions and policies that favour “inclusive” development strategies in emerging countries. This is also the best way to ensure two-way trade and avoid having to give up large parts of EU industry.

The aim of this paper is to collect together analytical materials on these four issues, which should help to specify the contribution of trade policy and external aspects of competitiveness to the refocused Lisbon Agenda. It focuses on current situation, developments and prospects, without spending much time on past experiences. Policy implications are mainly within the framework of trade policy but also partly regard other common policies.

Competitiveness, a controversial concept whose definition evolved

The notion of competitiveness is subject to a significant degree of subjectivity owing to the absence of a clear, explicit definition. Somewhat paradoxically, while the notion of competitiveness is at the heart of the political and media speech, it has never been strongly defined in the field of theoretical economic analysis.

The question of how to define this concept has fuelled a significant debate over the last decade. In Krugman’s 1994 “Pop internationalism”, the book which brought him public fame Krugman argued forcefully against the abusive use of the ‘competitiveness’ term. The controversy ran high in the US at the time, fed by concerns of economic decline and “loss of competitiveness” – a context similar to that of the current debate in Europe.

In his book and the statements he made at the time, Krugman criticised journalists and politicians who invoke the concept of competitiveness in the context of macroeconomic comparison between countries, as opposed to the microeconomic framework of competition among businesses. According to Krugman, it is the productivity of national companies which gives the best indication of a country’s economic performance.

1. At first, the concept applies to companies

Competitiveness is basically the capacity to weather competition. In the theoretical framework of perfect competition (assumption of homogenous goods), it boils down to the ability to produce at a marginal cost lower than the market price. This restrictive definition corresponds to what most economists call “cost competitiveness”.

Once the possibility of differentiated goods is considered – goods which nevertheless remain substitutable to each other – a company can benefit from a certain degree of monopoly power owing to the specificities (other than price) of its products, such as quality, brand name, distribution network, etc. Competitiveness in this context can be defined as the “capacity of a company to sell durably and with profit what it produces.”

Relying on price and non-price (or “other than price”) competition two distinct notions are combined to define the competitiveness of a company.

- The notion of “cost competitiveness” relates to a company’s costs, i.e. costs of factors of production and efficiency of production methods (in other words, to the productivity of factors of production). “cost competitiveness” rises when costs decrease, assuming constant quality levels and regardless of price or quantity sold. A relative definition of “cost competitiveness” relies on the comparison of a company’s costs of production relative to costs incurred by a group of similar companies.

- “Non-cost Competitiveness” in contrast relates to the demand for a product. Competitiveness rises when a company can increase demand for its products for the same price level. In other words, it implies a shift of the demand curve independently of costs of production. Hence “non-cost competitiveness” corresponds to the relative quality of products, rather than in an absolute sense, i.e.

to the differentiation of products. A good indicator of “non-cost competitiveness” would be the substitution elasticity of demand for this product relative to other similar products.

The two notions relate to different aspects, one associated to the cost structure and the other to the demand function. It is difficult to try to merge them into one synthetic indicator of “competitiveness”.

2. ... subsequently applied to geographical territories

Economists later sought to aggregate the competitiveness of companies within a territory, stirring the economic use of the concept towards a more commonplace use. In effect, it was inferred that at the macroeconomic level countries, rather than companies, are more or less competitive.

- Import Price competitiveness depends on the average price weighed by the national market share of each exporting country, and the price of the national good. Export Price competitiveness is more complex since it depends on the ratio of national prices to foreign prices on each foreign market. A multilateral export price-competitiveness indicator can thus be estimated in the form of an average price for foreign products against the average price for domestic goods. Price-competitiveness indicators can also be computed using a demand model where prices are considered as exogenous.

- But the capacity of countries to offer products at lower prices likely depends on their average productivity or lower average production costs. These can be linked in an index of unitary wage cost (wage costs revised for productivity) used against a reference group of countries.

- Along with this evolution in unitary costs, one can consider a number of qualitative and quantitative indicators to account for various institutional and structural factors which can affect costs and product specificities, or which generate externalities on the production process of companies. The selection of indicators and underlying weighted averages is arbitrary, therefore often subject to criticism. Country rankings for competitiveness levels as issued by the World Economic Forum (WEF) and the Institute for Management Development (IMD) are computed according to this methodology, on the basis of a synthetic indicator which supposedly summarises a large number of factors.

- According to this approach, the definition of a country’s competitiveness is its capacity to durably improve the living standard of the population and to provide for a high level of employment and social cohesion. It covers an immense field, effectively tying into all of political economy, which explains the difficulty of the synthesising exercise in considering education policies, research, the relationship between inequalities and growth, the determinants of productivity, the efficiency of public spending, policies designed to improve the territory’s attractiveness, exchange rate policies, labour market institutions, judicial systems, competition on the market of goods and services, trade openness, etc.

- What do these indexes really classify, what is the economic logic which underlies them, and what is their degree of reliability? It is difficult to answer these questions precisely. Indeed, despite an elegant rhetoric and the scientific endorsement of eminent specialists in economics and in companies’ strategy, these indexes suffer from several defects. First, their theoretical base is approximate. They entail many a priori assumptions regarding the determinants of growth and competitiveness, which can appear erroneous. Second, these determinants are measured quantitatively using uncertain indicators. Both weaknesses can lead to wrong indexes and fragile classifications. These classifications should therefore be used with extreme caution.

- The principal index GCI from the World Economic Forum is computed on the basis of, according to a weighting method defined a priori, the aggregation of numerous elementary indicators presumed to be determinants of growth and seen as the best summary of competitiveness. Using similar elementary variables however, alternate weightings give several indexes closely related to the GDP per capita variations of selected countries, yet with a massive impact on countries’ classification. By way of illustration, according to the index under consideration Estonia’s ranking can end up as the 26th or the 1st, China the 3rd or the 35th, and Finland the 21st or the 1st... In summary, the WEF index suffers from a major limit, in particular that of a low capacity to give plausible explanation of growth differences between countries. Because of this inaccuracy, any classification based on this type of index is not very informative: one can obtain markedly different classifications from indicators having a very nearby explanatory power for a given sample of countries under consideration.

1. DOES THE EU TRADE REGIME HELP OR HINDER EU COMPETITIVENESS?

Trade policy should ensure that our border measures do not needlessly raise production costs for EU industry through tariffs or non-tariff barriers on its inputs (raw materials, but also intermediary goods, parts and components and services) which would put European producers at a disadvantage towards competitors. This is of course not the sole concern regarding competitiveness: trade policy should ensure a sufficient degree of competition in final goods markets, which is also essential to give firms clear incentives to increase their efficiency. Nevertheless, this section considers EU protection in the first perspective, only.

At first glance, the EU is the largest and, by and large, the most open economy in the world. There is no border protection for the vast majority of inputs used by European industries (none on raw materials and little or nothing on intermediate products). Besides, there is no significant restriction to inward investment. Real EU protection is even lower due to its wide network of preferential trade agreements, which has confined the application of its MFN tariff to imports from nine WTO Members accounting for only a third of its total merchandise imports. Preferential margins are very important, including for sensitive products: according to World Bank estimates, the GSP halves the level of duty applied to tariff peak products and the ACP or EBA regimes are even more effective.

However, this low level of global protection in itself does not necessarily prevent the existence of pockets of distortion that could be detrimental to EU competitiveness if they bear on inputs.

The answer to the question of whether the EU trade regime helps or hinders EU competitiveness is a priori not the same in all sectors of the economy:

- Distortions are, globally speaking, negligible for industrial products where MFN applied tariffs are very low (the average is below 4%), with little variation around this average: distortions detrimental to EU competitiveness should therefore be necessarily restricted to a very limited number of products;
- This is not so clear regarding some agricultural raw materials, which enjoy a significantly higher level of protection. The extent to which such protection is really detrimental to EU competitiveness thus needs to be assessed;
- Lastly, the cost of protection in the services sector, if any, is also a relevant issue (see below), but comparative analysis is difficult.

1.1. Potential pockets of distortion on industrial products

Tariffs for non-agricultural products are characterised both by a low average and a low dispersion around this average. The objective in this section is to identify the areas where pockets of distortion do remain and whether they are detrimental to the competitiveness of downstream industries.

Non-agricultural non-fish products can be divided according to their use into raw materials, intermediary goods (including semi-finished products, parts and components) and finished products. Inputs for industry are either raw materials or intermediary goods. Some finished products, such as equipment goods, should also be considered in the analysis as they enter into the costs of production. According to this breakdown, there are about 250 raw products (accounting for one fifth of EU imports of non agricultural and non fish products), 1500 intermediary goods (15% of EU imports) and 2500 finished products (2/3 of EU imports) at the 6 digit level of the Harmonized System.

Average duty by type of products, according to processing stage

	Simple average	Weighted average
Raw materials	0,5 %	0,1%
Intermediary goods	4,3 %	3,0%
Finished products	3,8 %	3,5%

Source: European Commission, DG Trade

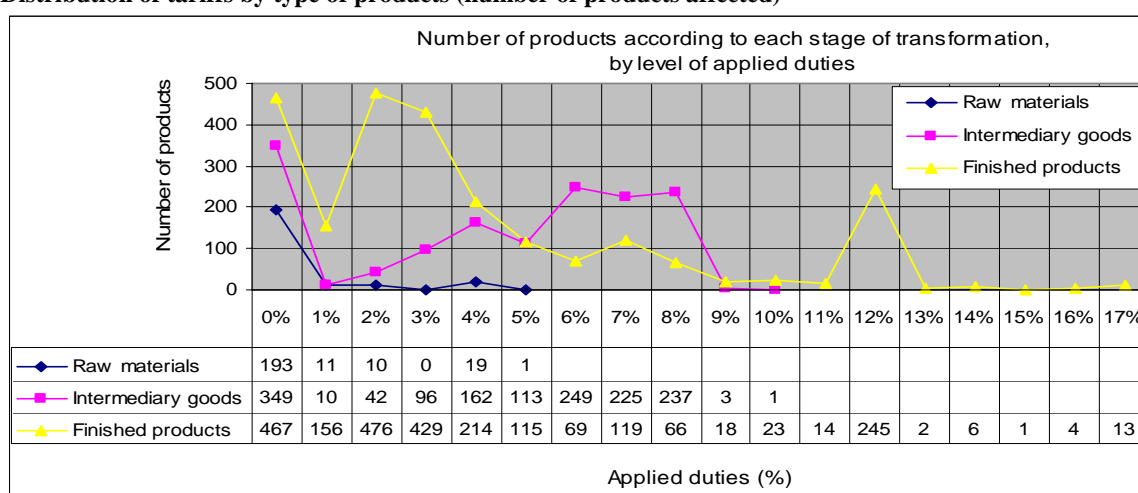
At first glance (see table above), imports of raw materials appear to be virtually totally open, with a

duty-rate weighted average close to zero³. Imports of intermediary and finished goods are also very open with duties averaging respectively 3% and 3.5%, below the level applied to finished products.

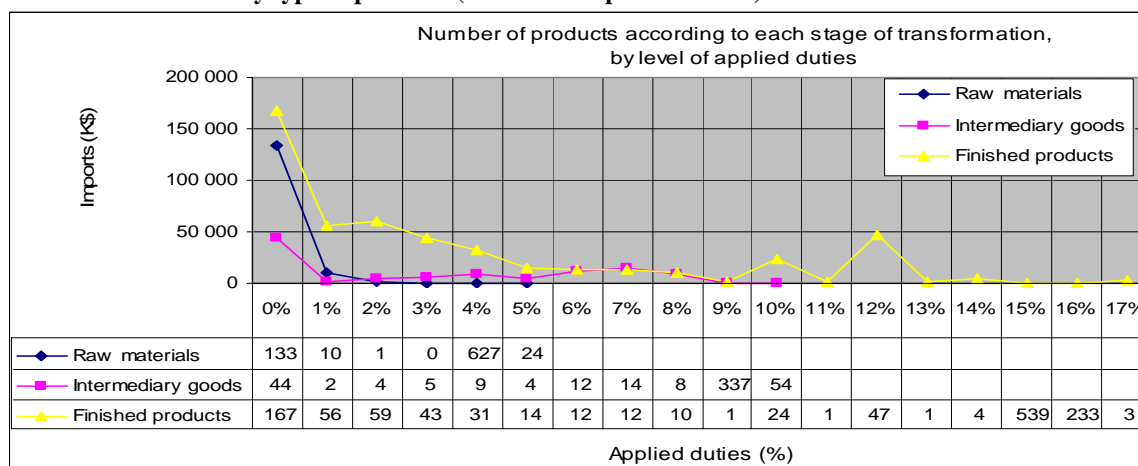
These results are confirmed by a more thorough examination of the distribution of tariffs by type of products (see graphs below):

- More than 80% of raw materials enter the European market duty-free. These account for 90% of imports of these products. Besides, 90% enter the European market with duty below 2%, accounting for 99,5% of imports. There is no duty above 5% for this range of products. There is no problem of competitiveness associated to these products, which account for one fifth of EU total imports and three fifth of its imports of industrial inputs.
- Only one quarter of intermediary goods enters the European market duty-free, but it accounts for 42% of imports of intermediary goods. Two thirds of intermediary goods (i.e. 1000 products) enter the European market at tariffs between 4% and 8%. Duties applied are above 8% for only 4 products of this range of inputs.
- All products for which applied duties are above 10% are finished (most of which consumer) products.

Distribution of tariffs by type of products (number of products affected)



Distribution of tariffs by type of products (volume of imports affected)



Source: European Commission, DG Trade

The table below provides the list of the most important intermediary products for which duties applied are above 5%, ranked by volume of imports. There are 780 intermediary goods for which duties applied are between 5% and 10%, accounting for €37bn of imports. The 40 products below account for half of these imports (€18,5bn). Aluminium ranks first, with €5bn imports affected and a 6% duty.

³ When imports are so open, averages weighted by imports are more accurate than simple average, which are more useful in case of high tariffs and risks of “endogeneity bias” (high tariffs imply few imports).

Intermediary products for which duties applied are above 5%, ranked by volume of imports

HS6	Description	Average duty	Max. duty (tariff line level)	Imports, 2001 (million euros)
760120	Aluminium Alloys, Unwrought	6,00	6	2712
760110	Aluminium, Not Alloyed, Unwrought	6,00	6	2365
760612	Lates, Sheets And Strip, Of Non-Alloy Aluminium, Of A Thickness Of >0.2 Mm, Rectangular Including Square (Excl. Expanded Plates, Sheets And Strip)	7,50	7,5	842
290511	Methanol Methyl Alcohol	5,50	5,5	726
390110	Polyethylene With A Specific Gravity Of <0.94, In Primary Forms	6,50	6,5	693
760429	Bars, Rods And Solid Profiles, Of Aluminium Alloys, N.E.S.	7,50	7,5	611
292250	Amino-Alcohol-Phenols, Amino-Acid-Phenols And Other Amino-Compounds With Oxygen Function, N.E.S.	6,50	6,5	523
540761	Woven Fabrics Of Yarn Containing >=85% Non-Textured Polyester Filaments By Weight, Incl. Monofilament Of >=67 Decitex And A Maximum Diameter Of <=1 Mm	8,00	8	497
320417	Synthetic Organic Pigments; Preparations Based On Synthetic Organic Pigments Of A Kind Used To Dye Fabrics Or Produce Colorant Preparations (Excl. Preparations Of Headings 3207 , 3208 , 3209 , 3210	6,50	6,5	434
392190	Plates, Sheets, Foil, Film And Strip Of Plastics, Reinforced, Laminated, Backed Or Similarly Combined With Other Materials, Unworked Or Merely Surface-Worked Or Merely Cut Into Squares Or Rectangles,	6,50	6,5	422
760611	Plates, Sheets And Strip, Of Non-Alloy Aluminium, Of A Thickness Of >0.2 Mm, Rectangular Including Square	7,50	7,5	412
441214	Plywood Consisting Solely Of Sheets Of Wood <=6 Mm Thick, With At Least One Outer Ply Of Non-Coniferous Wood	7,00	7	401
310210	Urea, Whether Or Not In Aqueous Solution (Excl. That In Pellet Or Similar Forms, Or In Packages With A Gross Weight Of <=10 Kg)	6,50	6,5	384
520812	Plain Woven Fabrics Of Cotton, Containing >=85 % Cotton By Weight And Weighing >100 G To 200 G Per M2, Unbleached	8,00	8	369
320611	Pigments And Preparations Based On Titanium Dioxide Of A Kind Used To Dye Fabrics Or Produce Colorant Preparations, Containing >=80% By Weight Of Titanium Dioxide Calculated On The Dry Weight (Excl. P	6,00	6	361
441219	Plywood Consisting Solely Of Sheets Of Wood <=6 Mm Thick (Excl. Plywood Of Subheadings 4412 .11 And 4412 .12; Sheets Of Compressed Wood, Hollow-Core Composite Panels, Parquet Panels Or Sheets, Inla	7,00	7	359
390760	Polyethylene Terephthalate, In Primary Forms	6,50	6,5	353
520942	Denim, Containing >=85 % Cotton By Weight And Weighing >200 G Per M2, Made Of Yarn Of Different Colours	8,00	8	341
390730	Epoxide Resins, In Primary Forms	6,50	6,5	334
720221	Ferro-Silicon, Containing By Weight >55% Of Silicon	5,70	5,7	333
391990	Self-Adhesive Plates, Sheets, Foil, Film, Tape, Strip And Other Flat Items Of Plastics, Whether Or Not In Rolls >20 Cm Wide	6,50	6,5	332
310530	Diammonium Hydrogenorthophosphate Diammonium Phosphate	6,50	6,5	329
390410	Polyvinyl Chloride, In Primary Forms, Not Mixed With Any Other Substances	6,50	6,5	326
540752	Woven Fabrics Of Filament Yarn Containing >=85 % Textured Polyester By Weight, Incl. Monofilament Of >=67 Decitex And A Maximum Diameter Of <=1 Mm, Dyed	8,00	8	319
441213	Plywood Consisting Solely Of Sheets Of Wood <=6 Mm Thick, With At Least One Outer Ply Of Tropical Wood Specified In Subheading Note 1 To This Chapter (Excl. Sheets Of Compressed Wood, Hollow-Core Comp	8,50	10	316
390810	Polyamides -6, -11, -12, -6.6, -6.9, -6.10 Or -6.12, In Primary Forms	6,50	6,5	279
760511	Wire Of Non-Alloy Aluminium, With A Maximum Cross-Sectional Dimension Of >7 Mm (Excl. Stranded Wire, Cables, Plaited Bands And The Like And Other Articles Of Heading 7614 , And Electrically Insulated	7,50	7,5	279
310520	Mineral Or Chemical Fertilizers Containing The Three Fertilizing Elements Nitrogen, Phosphorus And Potassium (Excl. Those In Pellet Or Similar Forms, Or In Packages With A Gross Weight Of <=10 Kg)	6,50	6,5	264
390210	Polypropylene, In Primary Forms	6,50	6,5	259
290919	Acyclic Ethers And Their Halogenated, Sulphonated, Nitrated Or Nitrosated Derivatives (Excl. Diethyl Ether)	5,50	5,5	258
281410	Anhydrous Ammonia	5,50	5,5	235
280469	Silicon Containing <99.99 % By Weight Of Silicon	5,50	5,5	228
391910	Self-Adhesive Plates, Sheets, Film, Foil, Tape, Strip And Other Flat Items, Of Plastics, In Rolls <=20 Cm Wide	6,41	6,5	222
280920	Phosphoric Acid And Polyphosphoric Acids	5,50	5,5	204
290531	Ethylene Glycol Ethanediol	5,50	5,5	201
810890	Articles Of Titanium N.E.S.	5,60	7	200
390720	Polyethers, In Primary Forms (Excl. Polyacetals)	5,20	6,5	199
551311	Plain Woven Fabrics Containing >50 % To <85 % Polyester Staple Fibres By Weight, Mixed Principally Or Solely With Cotton And Weighing <=170 G Per M2, Unbleached Or Bleached	8,00	8	191
320419	Synthetic Organic Colouring Matter Other Than Dyes; Preparations Based Thereon Of A Kind Used T	6,50	6,5	188
390330	Acrylonitrile-Butadiene-Styrene Copolymers Abs , In Primary Forms	6,50	6,5	187

The case of aluminium

With duties of up to 6% on its raw form and 7.5% for semi-finished products, aluminium stands out as an exception amongst base metals. These duties only affect a quarter of all European imports, with three quarters of imported primary aluminium facing no duties at all due to preferential tariffs in place in bilateral agreements and the GSP regime. Still, European industries which produce primary aluminium benefit on European markets from prices 3-6% higher than the world price. This level of protection has long been justified by strategic considerations, being used as a bargaining token in trade negotiations.

Even at this modest level, aluminium duties result in higher purchasing costs for consumer industries which use aluminium as an input relative to those faced by their competitors in third countries. They generate an economic rent for aluminium producers in countries which benefit from tariff preferences, and which compete directly against European producers on downstream markets.

The table below provides the list of the finished products whose applied duties exceed 10% and which are of use to processing industries. For example, apparel products, which are consumer products and which account for the bulk of products whose duties exceed 10%, are excluded of this list. There are actually only three types of products which constitute significant issues: trucks, on which duties applied range between 14% and 16% (with peaks at 22% at the tariff line level) corresponding to €2,5bn imports; television picture tubes (14% duty; €400mio imports); and tractors (16% duty; €80mio imports).

Finished products with duties above 10%, of use to industry

HS6	Description	Average duty	Max. duty (tariff line level)	Imports, 2001 (million euros)
870421	Motor Vehicles For The Transport Of Goods, With Compression-Ignition Internal Combustion Piston Engines Of A Gross Vehicle Weight =<5 Tonnes, N.E.S.	13,50	22	2049
854011	Cathode-Ray Television Picture Tubes, Including Video Monitor Cathode-Ray Tubes, Colour	14,00	14	422
870210	Motor Vehicles For The Transport Of >=10 Persons, Incl. Driver, With Compression-Ignition Internal Combustion Piston Engine Diesel Or Semi-Diesel	13,00	16	332
870431	Motor Vehicles For The Transport Of Goods, With Spark-Ignition Internal Combustion Piston Engines, Of A Gross Vehicle Weight =<5 Tonnes (Excl. Dumpers For Off-Highway Use Of Subheading No 8704 .10 An	13,50	22	125
870120	Road Tractors For Semi-Trailers	16,00	16	78
870423	Motor Vehicles For The Transport Of Goods, With Compression-Ignition Internal Combustion Piston Engines, Of A Gross Vehicle Weight >20 Tonnes, N.E.S.	15,83	22	77
870422	Motor Vehicles For The Transport Of Goods, With Compression-Ignition Internal Combustion Piston Engines, Of A Gross Vehicle Weight >5 Tonnes But =<20 Tonnes, N.E.S.	15,83	22	75
870600	Chassis Fitted With Engines, For Tractors, Motor Vehicles For The Transport Of Ten Or More Persons, Motor Cars And Other Motor Vehicles Principally Designed For The Transport Of Persons, Motor Vehicle	9,88	19	34
870490	Motor Vehicles For The Transport Of Goods, With Engines Other Than Internal Combustion Piston Engines (Excl. Dumpers For Off-Highway Use Of Subheading No 8704 .10 And Special Purpose Motor V	10,00	10	12
870290	Motor Vehicles For The Transport Of >=10 Persons, Incl. Driver, Not With Compression-Ignition Internal Combustion Piston Engine Diesel Or Semi-Diesel , Of A Cylinder Capacity Of >2500 Cm3, New	12,40	16	4
870432	Motor Vehicles For The Transport Of Goods, With Spark-Ignition Internal Combustion Piston Engine, Of A Gross Vehicle Weight >5 Tonnes (Excl. Dumpers For Off-Highway Use Of Subheading No 8704 .10 And	15,83	22	2

A systematic comparison with other countries has not been done at this stage, but at least regarding industrialised countries, the situation is likely to be very close to the European one, with the bulk of remaining protection on non-agricultural goods being on finished, consumer goods rather than on

intermediary goods. For example, in the US case, the USITC import restraint report⁴, which analyses the economic effects of removing significant U.S. import restraints on the U.S. economy, considers that the gains from liberalisation are by far concentrated on apparel, luggage and handbags and home furnishings. Nearly all duties on finished products above 10% (which in the US case can be quite high: up to 37,5%) are on consumer goods, mostly apparel, the only exceptions being, as in the EU, trucks and television picture tubes (but with higher duties). Intermediary goods are more protected than in the EU (duties above 10% for 175 products) but the bulk of this protection is located in textiles, the main exception being certain base metals (with duties up to 10%) and chemicals (with duties around 7%). Contrary to the EU, there are duties up to 8% on raw materials, mostly in textiles (filament tow, staple fibres of polyesters), but also on precious stones and semi-precious stones (5% in average).

A number of mechanisms have already been developed in order to limit the impact of potential pockets of distortion in our trade regime on EU competitiveness:

- **Tariff suspensions and quotas:** Tariff suspensions and quotas adopted on the basis of Article 26 of the EC Treaty constitute an exception to the normal state of affairs (application of normal customs duty rate) since, during the period of validity of the measure and for an unlimited quantity, they permit the total (total suspension) or partial waiver (partial suspension) of the normal duties applicable to imported goods (anti-dumping duties are not affected by these suspensions).

The main purpose of tariff suspensions and quotas is to enable Community enterprises to use raw materials, semi-finished goods or components without being required to pay the normal duties laid down in the common customs tariff. Suspensions and quotas are proposed after a thorough examination of the economic reasons on which the requests are based and only insofar as they seem likely to benefit the Community economy.

They are normally granted to raw materials, semi-finished goods or components which are not available in the EU (suspensions) or which are available but in insufficient quantities (tariff quotas). When identical, equivalent or substitute products are manufactured in sufficient quantities within the EU or by producers in a third country under preferential tariff arrangements (GSP), the grant of suspension is normally excluded.

It is thus perfectly possible to cancel the effects of our protection on a per need basis, assuming there is no risk for a European competing industry. Roughly 500 products regularly benefit from tariff suspensions and quotas.

- **Inward and outward processing:** The customs code of the EC provides for customs duty relief on goods re-exported after inward processing under the drawback procedure (inward processing) as well as special rules on goods re-imported into the EU after working or processing in certain third countries (outward processing). For several decades, outward processing has clearly been a way to reinforce European producers competitiveness by outsourcing in cheap labour countries some of the most labour-intensive operations (in textile or leather industries for example).

The case of trade defence instruments

Trade defence instruments, especially anti-dumping and anti-subsidy measures, are first and foremost designed to correct distorting practices (resulting from distortions of competition) that affect the competitiveness of European operators and, in the absence of international rules on competition, to restore normal conditions of competition. This 'normal' competition situation which is guaranteed by the AD/AS instruments enables the European industry to compete on fair terms on the European market and also to launch itself from a solid home base into third country markets. In this sense, correctly applied trade defence instruments are also a part of the rule of law, contributing to stability and predictability in the market and a healthy investment climate, equally enhancing competitiveness.

⁴ US International Trade Commission (2002), *The Economic Effects of Significant U.S. Import Restraints*, June.

In this context, it is worth underlining that both the anti-subsidy and the anti-dumping instrument combat unfair subsidisation. Indeed, dumping means that the domestic sales prices in the exporting country are higher than export prices due to market segregation (e.g. through high import tariffs or inaccessible distribution systems). Thus, the consumers in the exporting country “subsidise” the low export prices. It follows that both instruments address very similar trade distortions. The only difference is that in the case of subsidies the exporters’ “deep pockets” are directly financed by the State, while in the case of dumping consumers in the exporting country are forced to support their exporters by paying high domestic prices. From the competitiveness point of view, if trade defence instruments did not exist, the Community industry would have to compete on its own against these “deep pockets”, an unequal and uphill struggle⁵.

Anti-dumping and anti-subsidy measures should naturally not be implemented in order to delay necessary industrial adjustments or to impose an unjustified burden on downstream industries or consumers. The EU has both the legal means and a solid expertise at its disposal to ensure that this does not happen. Indeed, experience shows that we have been successful in avoiding this pitfall. Anti-dumping and anti-subsidy measures are set at a level ensuring that proper competition is restored (and measures have ensured the survival of otherwise competitive Community industries exposed to unfair trading practices in some three-quarters of all cases), but which does not allow the Community industry to refrain from undertaking restructuring which is necessary in order to remain competitive. It is not a cushion but a safety net. The interests of industrial users and of consumers are systematically assessed in the context of trade defence investigations, which may lead to the non-imposition of measures should a significant and unjustified burden on them be identified. Trade defence measures are effective and punctual, since they only cover the narrowly defined products which are dumped/subsidised. At the overall level, however, they only affect a very limited share of our imports (e.g. 0,4% of imports of goods are subject to anti-dumping or anti-subsidy measures), with a significant level being reached only in the sectors of fertilisers and fish (20,5% and 3,9% respectively), both sectors rife with (non) market distortions in the exporting third countries concerned.

Trade defence duties are only imposed on dumped or subsidised imports, not on imports whose low price is based on a genuine competitive advantage. Thus, they often lead both to a fall in imports from countries with companies subjected to the measures and an increase of non-dumped imports from countries with companies not subjected to the measures. The Community industry continues, as it should, to be exposed to third country competition which takes place under fair terms.

Nor do trade defence measures unduly penalise downstream industries. The EU investigates as a rule the impact of anti-dumping and anti-subsidy duties on downstream industries through Community interest analysis. The results of these tests show that the impact of anti-dumping measures on the costs of downstream industries is most often limited. For example, in the investigation on Carbon blacks, a product used in particular in the production of tyres, it was calculated that a 17% anti-dumping duty would have an impact of € 0,02 – 1,28 (i.e. 0,05 – 0,63% depending on the tyre model) on the price of tyres. In the Polyethylene Terephthalate (PET) case, the impact of duties ranging from 28 to 223 €/tonne on user industries (bottle producers, producers of PET films and sheets as well as bottled water and soft drinks producers) was estimated to range between 0,4% and 4%. It was also determined that, in the past, extremely volatile PET prices (well above any increase introduced by the application of TDI duties) had not influenced the prices of bottled water and soft drinks.

This very careful use of trade defence instruments is not systematic in other parts of the world. European producers are often affected in third country markets by WTO-incompatible –and/or at times ill-founded– trade measures. This of course has implications for EU exports (see part 2.2 below), but also has consequences for third country producers themselves, the most obvious example being US safeguards on steel products, which have severely penalized downstream industries (e.g. automotive): according to some estimates, 200 000 jobs have disappeared in downstream industries following these measures, which is more than the total number of jobs in the US steel industry.

All EU trade defence measures are under permanent monitoring and open to review. Should exporting countries open their markets and thus reduce domestic prices due to increased competition, the level of

⁵ Certain specific situations may not be totally covered by TDI and therefore need specific instruments. This is the case of shipbuilding, subject to the current OECD negotiations.

dumping will fall, measures will be reviewed and adapted or terminated if warranted. Also, measures are not kept in place, even if dumping or subsidisation persist, if the Community industry has regained strength and suffers no more injury from dumping or subsidised imports, or is otherwise in a healthy position.

In any case, it would be useful to develop positive instruments to facilitate trade-induced changes (see part 4.1. below), which would diminish the possible pressure on trade defence instruments to delay adjustments.

Conclusion on non-agricultural products:

- The analysis confirms that there are zero or very low tariffs on the bulk of EU industrial inputs.
- There are still a few relatively higher tariffs that may increase the price of industrial inputs (e.g. aluminium), yet this phenomenon remains very limited in intensity and in scope. Moreover, certain mechanisms, including tariff suspensions, mitigate potential effects.
- In any case, tariffs will be substantially eroded by the DDA, removing any residual effect on competitiveness. In the meantime, we should, whenever possible, continue using tariff suspensions to make sure that there is no negative impact on our industry.
- EU trade policy also involves a very active policy in terms of access to raw materials, which should be pursued. Indeed, export taxes and quotas on raw materials have the same effect as import duties in terms of relative competitiveness. Examples of active policy include: coke, metal scrap, hides and skins with Russia and Ukraine, coke with China.

1.2. EU agricultural protection and the competitiveness of the European food and drink industry

The EU food and drink industry is an important component of overall EU industry: with 13.4% of the total production value of all manufacturing sectors, the food and drink industry ranks first in Europe ahead of motor vehicles and chemicals.

It relies heavily on EU agricultural inputs: it uses and processes about 70% of EU agricultural raw materials. It purchases for instance the entire European production of sugar beet (used for the production of white sugar, 75% of which is later used to produce further transformed products) and rice, and almost all of oil seeds production, as well as over 95% of EU milk supplies (which is delivered to dairy industries for the manufacture of a large range of milk products), while 90% of all cereals processed by the food and drink industry originate in the EU.

The relatively high level of EU agricultural protection, as compared with industrial, and its impact on agricultural prices is therefore a potential issue for the competitiveness of EU food and drink industry. But, at the same time, 27% of agricultural tariff lines carry the zero rate. The actual effect of the EU agricultural tariff schedule thus crucially depends on the type of products it is focused on and on its relative level compared to other food producers: it is a concern for competitiveness only if it is focused on agricultural inputs, not if it is focused on products sold largely without further processing or on processed products.

The table and graphs below provide an overview of EU agricultural protection for 46 commodity groupings, and a comparison with the US and Japan. For each commodity grouping, they indicate the average duty rate, its median⁶ and the number of tariff lines exceeding 100%.

Part of EU agricultural protection pertains to products that are not mainly used for further processing, such as products of the meat sector (average duty of 40-70%) and bananas. This is also the case for processed products such as grain products, grape juice, prepared or preserved mushrooms.

There are zero or very low tariffs on many inputs, such as skins and hides, certain fibers (cotton, wool, flax, and hemp) or essential oils.

However, part of EU agricultural protection also pertains to inputs for processing industry:

⁶ Comparisons between median and average give useful insight into the magnitude of tariff peaks: the greater the average relative to the median, the greater the peaks.

- sugar is the most protected sector, with an average duty of 350% and 10 tariffs exceeding 100%;
- it is followed by milk products, with an average duty of 87% and tariffs exceeding 100% applying on almost all items (with the exception of cheese) – but not all of them are inputs for further use;
- grains (average duty of 53%) and animal feed (average duty of 47%) are also more protected than the average.

The comparison with Japan and the US shows that the situation is not so different between the three countries: dairy and sugar products are highly protected in all three countries, while hides and skins and most of fibers (with the exception of cotton in the US) are almost free of protection. There are 5 tariffs exceeding 100% on sweeteners in the US and 13 in Japan. According to the USITC import restraint report, the US protection on sugar and dairy is one of the most costly features of the US trade regime for the US economy. Moreover, the US is highly protected on inputs such as tobacco, cocoa or cotton where EU protection is low. However, Japan and the US are not the EU's only competitors: other manufacturers e.g. Brazil have access to agricultural raw materials at much lower prices.

Mean tariff, median and megatariffs by product: United States, EU, Japan

	United States			EU			Japan		
	Mean	Median	Megatariffs	Mean	Median	Megatariffs	Mean	Median	Megatariffs
All commodities	12	3	24	30	13	141	58	10	142
Grains	2	1	--	53	63	2	191	3	7
Grain products	8	2	--	48	45	2	162	24	26
Feed	15	0	2	47	11	9	9	0	--
Starches	1	1	--	24	20	--	126	53	3
Oilseeds	17	0	2	0	0	--	72	0	2
Oilcake	2	2	--	3	0	--	1	0	--
Vegetable oils	4	2	--	13	6	1	10	9	--
Fats & oils	3	2	--	10	3	1	4	4	--
Live animals	1	0	--	30	22	--	107	0	5
Meat: fresh, or frozen other meat	1	0	--	70	74	29	39	0	2
Meat: fresh beef, pork, or poultry	12	1	--	41	27	6	45	7	3
Meat: frozen beef, pork, or poultry	9	5	--	66	38	24	38	9	3
Meat: prepared	2	2	--	43	26	7	79	20	7
Skins & hides	0	0	--	0	0	--	1	0	--
Dairy	43	38	7	87	70	41	322	227	48
Eggs	9	8	--	22	24	--	18	21	--
Fruit: Fresh	4	1	--	21	12	1	10	6	--
Fruit: Frozen	8	9	--	20	21	--	9	10	--
Fruit: dried & fresh (coconuts, dates & figs)	8	4	--	4	6	--	3	3	--
Fruit: dried (raisins)	2	2	--	2	2	--	1	1	--
Fruit: preparations	6	4	--	21	21	--	18	17	--
Fruit juice	0	0	--	37	22	3	22	23	--
Vegetables: fresh	7	4	--	16	10	2	3	3	--
Vegetables: frozen	9	8	--	14	15	--	10	10	--
Vegetables: frozen or prepared (other)	6	5	--	18	12	1	110	9	1
Vegetables: dried & fresh roots & tubers	6	5	--	38	16	--	7	7	--
Vegetables: dried	3	2	--	2	0	--	197	6	6
Vegetables: preparations	6	5	--	21	14	2	13	13	--
Vegetable juice: tomato	--	--	--	16	16	--	26	26	--
Nuts	17	3	3	5	4	--	8	8	--
Nuts & fruit: dried, fresh, & prepared	6	4	--	16	17	--	13	12	--
Horticulture: live	10	1	--	5	7	--	0	0	--
Horticulture: cut flowers & foliage	4	4	--	5	3	--	2	3	--
Sugar beet	0	0	--	349	349	2	0	0	--
Sugar cane	1	1	--	56	56	--	--	--	--
Sweeteners	46	51	5	59	57	8	82	55	13
Tobacco: unmanufactured	83	5	3	14	11	--	0	0	--
Tobacco: products	102	9	1	38	34	--	9	3	--
Fiber	3	0	--	0	0	--	21	0	2
Food preparations	17	10	--	15	13	--	52	21	10
Coffee	0	0	--	6	8	--	6	6	--
Coffee: other	5	1	--	10	12	--	37	17	2
Tea & tea extracts	7	3	--	2	0	--	57	17	2
Cocoa beans & products	18	18	--	17	15	--	16	14	--
Spices	1	0	--	2	0	--	2	0	--
Essential oils	1	0	--	3	3	--	2	2	--

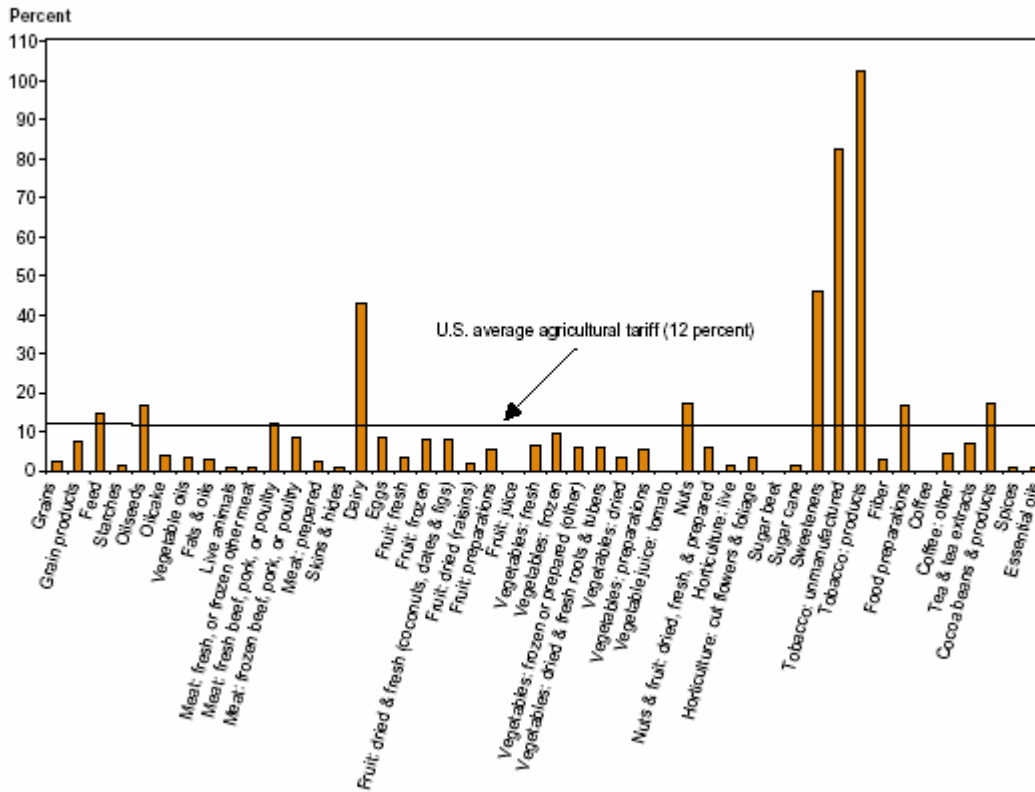
-- = not applicable.

¹ Tariffs are bound MFN rates based on final URAA implementations.

Source: Economic Research Service, USDA.

Source: Gibson P. (2001), *Profiles of Tariffs in Global Agricultural Markets*, AER-796, Economic Research Service/USDA.

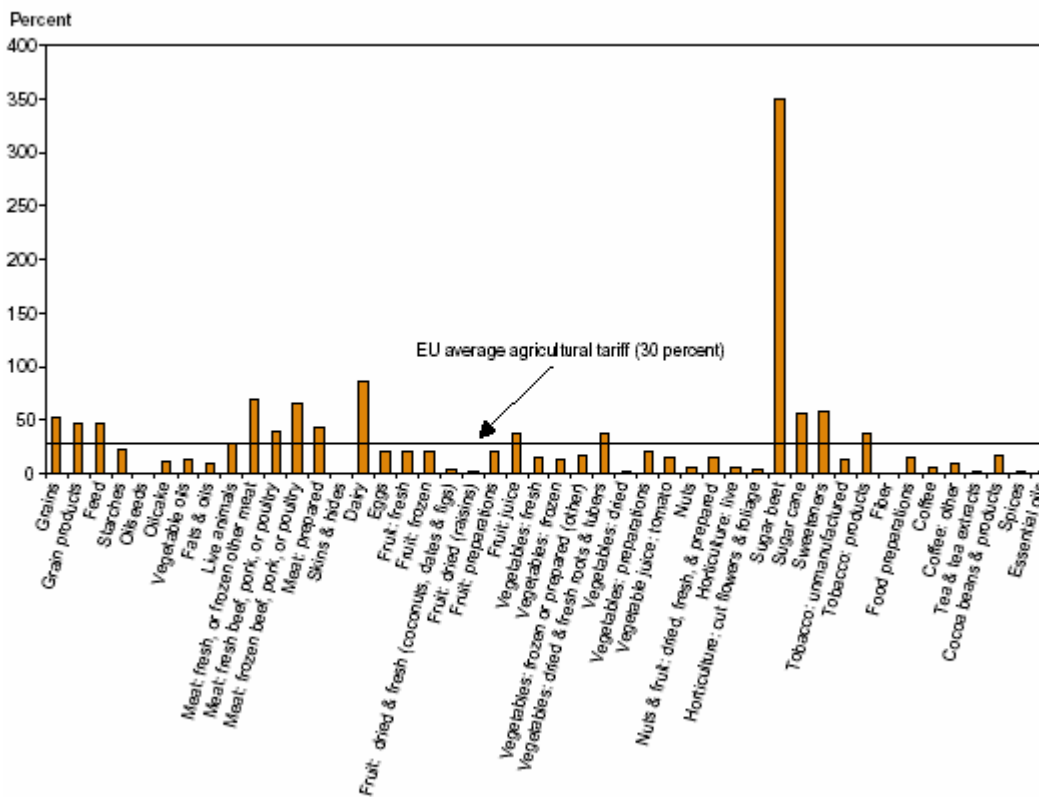
United States averages by commodity group¹



¹Tariffs are bound MFN rates based on final URAA implementation.

Source: Economic Research Service, USDA

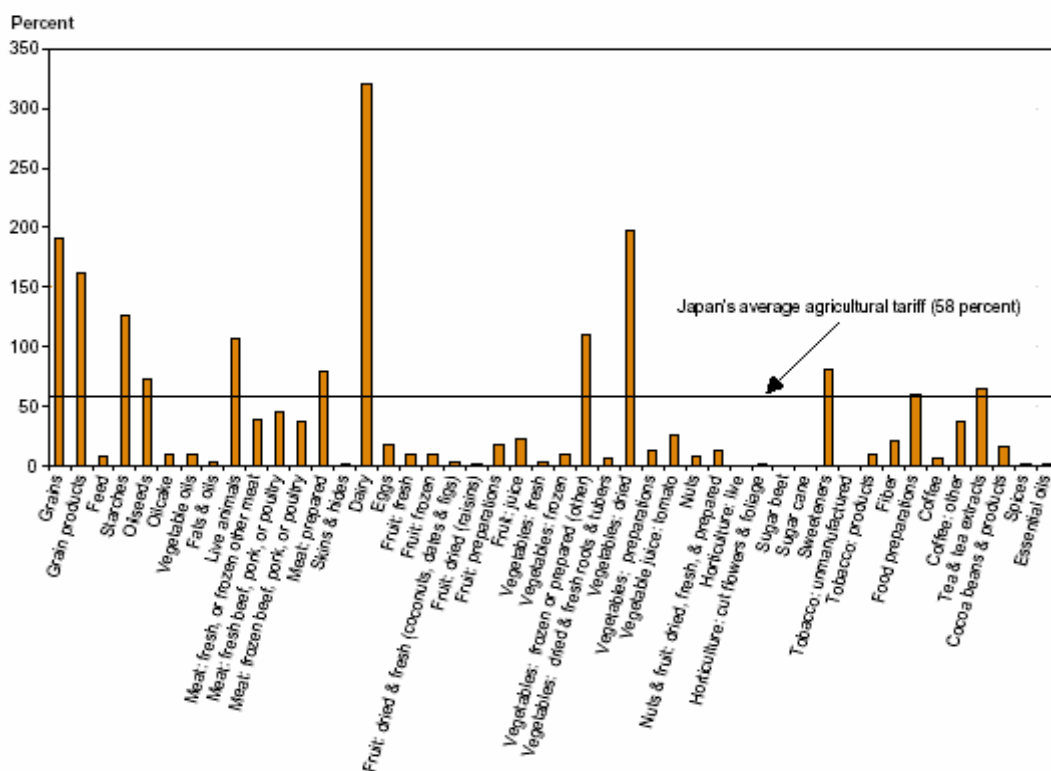
EU averages, by commodity group¹



¹Tariffs are bound MFN rates based on final URAA implementation.

Source: Economic Research Service, USDA

Japan averages, by commodity group¹



¹Tariffs are bound MFN rates based on final URAA implementation.
Source: Economic Research Service, USDA

The scope of any potential competitive disadvantages faced by EU industries is somewhat reduced through a variety of factors:

- Tariff escalation, production and export refunds: EU agricultural protection may raise the cost of some inputs for the food industry, but it also provides substantial protection to food products themselves. There are duties on sugar but also on sugar-based processed products according to their sugar content for instance. Protection of processed agricultural products is often higher than the one of their inputs: according to FAO calculations, the gap averages 16 points to the benefit of the former. At least on the EU domestic market, this largely compensates the effect of more expensive inputs. However, it does not protect nor compensate in third markets. Compensations are also granted on the basis of budgetary transfers to downstream industries on the basis of the additional cost they bear on their inputs due to CAP price policy. This goes beyond food and drink industry to cover chemical industry (see table below).

Budgetary transfers to sectors negatively affected by CAP price policy (2003)

Beneficiary sector	Compensated for	Appropriation 2003 (M€)
Food processor	Potato starch	234
	Starch	25
	Olive oil	24
	Butterfat	425
	Cereals	20
	Sugar	156
	Milk	142
	Butter	90
	Eggs and others	6
Chemical industry	Sugar	166
Spirit drinks industry	Cereals	1
French DOM	Sugar transport and refinery	18
Total		1 348

Source: Wichern R. (2004), Economics of the Common Agricultural Policy, European economy, Economic papers. No. 211. August 2004. European Commission.

Regarding export markets, export refunds allow the European industry to claim back the extra costs of raw materials compared with the world market when it exports a product.

Tariff escalation nevertheless raises competitiveness issues: because the protection it offers is limited to the domestic market, and because this very protection, which can be high, protects processing industries from the introduction of more competitive disciplines, which is a key positive effect of trade openness. In addition, tariff escalation precludes the development of downstream industries in agricultural producing developing countries. The same applies to the mitigating effect offered by export refunds, which should be phased out over time.

- The cost of inputs in the prices of processed goods is not necessarily significant. Marketing costs, distribution costs, brand positioning and the degree of consolidation within the industry are key factors in determining final product prices, particularly for differentiated products. Currency changes also have wide effects on prices. In this context, the cost of inputs may account for less than 3% of final prices (an extreme case being, for example, the impact of the price of barley on the price of whisky; another example is the price of cereal feed for the price of Parma ham).

However, this is obviously not always the case and while certain specific inputs may account for a small part of the costs (see detailed examples in part 1.2 below on anti-dumping), the cumulative effect of the cost of protection on selected inputs (sugar, milk, cereals) may be much greater (see for instance the price of sugar in candies or milk, butter, sugar and cereals in Danish cookies).

- Beyond strict price considerations, the emphasis adopted by the CAP on production conditions and the quality of agricultural products is, however, a key element for the competitiveness of the EU food and drink industry: good (Italian) pasta requires good quality durum wheat. CAP reform clearly has gone far in the right direction. This is the case in particular for the principle of making payment of decoupled aid dependent on the respect of the regulatory requirements defined at Community level and good farming practices. This is also the case of the strengthening of rural development measures and the introduction within this pillar of a chapter on food quality, which should further reinforce consumer confidence.

Nevertheless, these mitigating factors are not always sufficient to fully compensate the competitive disadvantage. For instance, the European biochemical industry receives compensations for the cost of its agricultural inputs (e.g. sugar), which make up to 50-70 % of total production costs. However, these do not seem to be sufficient to compete with companies outside the EU, which can buy their feedstock on the world market.

Conclusion on processed agricultural products:

- The analysis shows that part of EU agricultural protection bears on products which are not primarily inputs for further processing, and that many inputs, such as skins and hides, fibers and essential oils are duty free. However, it also shows that the cost of some inputs for the EU food and drink industry such as sugar, cereals or milk is increased by the level of protection of EU agricultural products.
- The EU is not alone in this situation. The US and Japan also highly protect major inputs such as sugar or dairy products, and also on other agricultural inputs. However, Japan and the US are not the EU's only competitors: other manufacturers e.g. Brazil have access to agricultural raw materials at much lower prices.
- The actual impact of this protection for the EU food and drink industry depends on the type of product under consideration. Producers of highly differentiated products sustain their level of competitiveness on factors such as quality, brand-name, which somewhat cushion the disadvantage of high input costs. Lightly processed and/or first necessity products, on the other hand, face potentially more significant negative effects in terms of competitiveness. An accurate estimate of these effects would require a far more detailed and systematic analysis, which is beyond the scope of this paper.

- The CAP reform adopted last year and subsequent proposals especially on sugar, which imply a substantial decrease of sugar prices inside the EU, certainly go far in the right direction both in terms of price reductions and quality improvements.
- Globally speaking, despite some of the problems mentioned above, the EU processed food industry is considered to be highly competitive with strong domestic and international brand names and quality recognition. The EU should press for further overseas market opening in this sector and be ready to reciprocate.

1.3. Services

As leaders in their sectors, EU service producers are strongly competitive on world markets and therefore stand to gain from international market opening. The EU presently claims, for, the 3 largest firms in construction services worldwide, 6 out of the top 10 companies in telecommunication services, and similarly in distribution, finance, insurance, transport and environmental services including water supply.

Cross-border services trade more than tripled in size during the last fifteen years, reaching \$1.2 trillion at the beginning of the 2000's, and currently accounting for a quarter of all cross-border trade. More efficient services — in finance, telecommunication, distribution, transportation, and professional business services — improve the performance of the whole economy because they have broad linkage effects. Purchases of services by industry often account for two thirds of industry value-added (this is, for example, the case of France). Dynamic gains are likely to stem from it: see, for instance, the effect of a service like telecommunications in terms of knowledge diffusion. Collectively, they are essential to increasing domestic productivity. The World Bank argues that liberalising entry of foreign service providers would have strong impacts in promoting growth and improving productivity – with effects up to four times larger than simple tariff elimination and other reforms affecting goods. Even if overstated, the basic principle is persuasive.

Measuring restrictions on trade in services is more complex than in goods because these restrictions usually take the form of government regulation. They can affect the entry and operations not only of foreign service suppliers, but also of new domestic service suppliers, thereby directly raising the price or cost of both foreign and domestically-supplied services. This section necessarily does not infer the same level of accuracy as the analysis of restrictions on trade in goods. It does not prejudge the results of detailed studies undertaken in the framework of the Single Market's completion.

The Australian Productivity Commission developed a methodology to estimate the direct price and/or cost effect of restrictions on trade in services. This methodology involves two steps. First, qualitative information about regulations is converted into a quantitative 'restrictiveness index'. Second, the effect of this measure of restrictions on prices and/or costs is estimated. As all comparisons trying to quantify issues which by their nature are qualitative, this should be taken with a big grain of salt.

- Restrictiveness measure: Restrictiveness indices range from 0 to 1 (the more stringent the restriction, the higher the score). An index score is then calculated separately for domestic and foreign service suppliers. A foreign index is calculated to measure all the restrictions that hinder foreign firms from entering and operating in an economy. It covers both discriminatory and non-discriminatory restrictions. A domestic index represents restrictions that are applied to domestic firms and it generally only covers non-discriminatory restrictions.

The results should not be over-emphasised or lead to over-interpretations due to the importance of subjective judgement in this type of analysis. However, the general overview is that EU seems widely open to intra and extra competition in services, and to some extent slightly more than the US for several sectors (see first table below). This is notably the case for maritime transport and legal services. US restrictions of maritime cabotage services under the Jones Act are considered by the USITC import restraint report as one of the most costly feature of the US trade regime for the US economy. Japan also appears to be significantly less open than the EU in the legal services, maritime services and accountancy services. In telecommunication services, the present

study is not valid for Europe since it relies on data prior to the general movement of liberalisation which occurred in the EU in the late 90's.

The general overview concerning domestic competition is also quite positive. There are no clear effects either on domestic or foreign competition due to regulatory measures in the main business-related services sectors, with perhaps the exception of accountancy services and, in a smaller proportion, legal services.

Trade restrictiveness indices (Scores range from 0-least restrictive to 1-most restrictive)

	Accountancy Services		Architectural Services		Banking Services		Engineering Services		Legal Services		Maritime Services		Telecom. Services	
	Domestic index	Foreign index	Domestic index	Foreign index	Domestic index	Foreign index	Domestic index	Foreign index	Domestic index	Foreign index	Domestic index	Foreign index	Domestic index	Foreign index
Australia	0,16	0,41	0,03	0,15	0,00	0,12	0,04	0,08	0,27	0,42	0,13	0,42	0,04	0,04
Canada	0,22	0,42	0,25	0,33	0,00	0,07	0,11	0,16	0,31	0,52	0,09	0,32	0,14	0,44
Hong Kong	0,20	0,32	0,09	0,22	0,04	0,09	0,08	0,13	0,08	0,27	0,09	0,40	0,21	0,21
India	0,31	0,44	0,02	0,08	0,05	0,60	0,00	0,10	0,09	0,40	0,25	0,61		0,69
Indonesia	0,00	0,56	0,04	0,30	0,07	0,55	0,05	0,24	0,17	0,57	0,21	0,56	0,34	0,67
Japan	0,28	0,43	0,08	0,19	0,13	0,19	0,14	0,18	0,33	0,52	0,15	0,41	0,04	0,04
South Korea	0,24	0,48	0,00	0,19	0,19	0,43	0,00	0,12	0,11	0,44	0,28	0,58	0,35	0,68
Malaysia	0,09	0,51	0,04	0,33	0,27	0,65	0,08	0,26	0,13	0,54	0,25	0,52	0,24	0,58
Mexico	0,14	0,36	0,04	0,31	0,00	0,17	0,04	0,33	0,22	0,49	0,17	0,48	0,23	0,53
N-Z	0,21	0,39	0,03	0,34	0,00	0,06	0,00	0,19	0,13	0,47	0,10	0,35	0,03	0,03
Philippines	0,29	0,63	0,05	0,33	0,14	0,53	0,00	0,15	0,10	0,54	0,17	0,64	0,13	0,45
Singapore	0,18	0,41	0,00	0,08	0,11	0,37	0,01	0,11	0,08	0,42	0,10	0,21	0,34	0,44
Switzerland	0,08	0,27	0,04	0,18	0,00	0,08	0,05	0,15	0,24	0,50	0,10	0,35	0,20	0,20
Thailand	0,19	0,49	0,00	0,12	0,00	0,39	0,04	0,11	0,10	0,44	0,13	0,60	0,43	0,79
Turkey	0,09	0,41	0,17	0,39	0,05	0,37	0,18	0,37	0,26	0,58	0,08	0,49	0,47	0,80
USA	0,20	0,33	0,13	0,23	0,00	0,06	0,12	0,19	0,24	0,48	0,17	0,60	0,03	0,03
EU*	0,20	0,35	0,09	0,20	0,00	0,07	0,09	0,16	0,19	0,39	0,13	0,33	0,11	0,18

* Simple average of Member States' indices

Source: Nguyen-Hong D. 2000, Restrictions on Trade in Professional Services, Productivity Commission Staff Research Paper, Ausinfo, Canberra, August.

- **Price and cost effect:** Econometric models are used to estimate the effects of restrictions on the price or the cost of services. The low level of current restrictions on European market either for domestic or foreign producers implies relatively low effects on prices or costs (see second table below). Moreover, these effects are relatively less important than in the US for engineering services.

Restrictions effects on prices and costs of some business-related services

	Engineering Services		Banking Services		Telecommunications Services	
	Foreign cost effect	Domestic cost effect	Domestic price effect	Foreign price effect	Domestic price effect	Foreign price effect
Australia	3%	2%	0%	9%	0%	0%
Canada	5%	3%	0%	5%	1%	3%
Hong Kong	5%	2%	3%	7%	1%	1%
Indonesia	10%	3%	5%	49%	71%	138%
Japan	7%	2%	10%	15%	0%	0%
Malaysia	12%	5%	22%	61%	7%	16%
Mexico	14%	2%	0%	13%	6%	14%
Singapore	5%	1%	8%	31%	2%	3%
South Africa	4%	1%	0%	15%	14%	21%
USA	7%	4%	0%	5%	0%	0%
EU average*	5%	2%	0%	5%	1%	1%

* Simple average of Member States' indices

Source: Nguyen-Hong D. 2000, Restrictions on Trade in Professional Services, Productivity Commission Staff Research Paper, Ausinfo, Canberra.

Conclusion on services:

Business-related services in the EU are very largely open to international competition. Therefore industries using such services as inputs likely do not face losses of competitiveness.

There are specific sectors, such as health-related and social services sectors and public utilities, where the current regime should remain unchanged. The EU is not proposing any new commitments in health-related and social services sector so that Member States fully retain the right to decide on the most appropriate organisation of their health and social system. Services considered as public utilities, such as infrastructure environmental services or health services, may be subject to government monopolies or to exclusive rights granted to private operators.

However, some room for more open markets remains in certain professional services, such as accounting and legal services. The EU's ambitious offer in the DDA goes in that direction. Substantial gains may be expected from further integration of the EU's internal market, intuitively more likely than with regard to external liberalisation.

2. REINFORCING EU COMPETITIVENESS THROUGH BETTER ACCESS TO THIRD MARKETS

The EU is one of the most open markets worldwide. But this openness is not matched elsewhere. Over the last decade, the Commission has had a much more proactive strategy to obtain better access for EU business across the globe. The “trade policy priorities” model developed by the CEPII (see below) illustrates this imbalance well: the two tables introduced below point to countries whose imports are most distorted, and those who are most open according to the trade discrimination index developed by CEPII. The EU features in the latter category, while large emerging countries such as Indonesia, Mexico, Brazil, Russia, India, Thailand, Egypt are the most protected markets – and thus offer significant potential increases in imports (traditionally associated to high levels of tariff protection).

Most distorted markets

	Current imports (K\$)	Increase in imports (K\$)	Increase in imports (%)	Increase due to tariff removal (K\$)	Share of tariff removal in total increase (%)	Mean tariff (%)	Discrimination **
China*	130 569 977	25 764 590	19,7%	19 273 315	74,8%	17,7%	-0,5
Russia	43 654 984	8 990 888	20,6%	6 009 646	66,8%	11,3%	-0,3
Indonesia	28 956 811	3 015 845	10,4%	1 516 249	50,3%	8,5%	-0,3
India	33 138 259	7 737 296	23,3%	6 873 201	88,8%	41,9%	-0,2
Mexico	108 366 443	21 440 295	19,8%	16 803 425	78,4%	22,7%	-0,1
Thailand	45 393 598	7 904 667	17,4%	6 797 255	86,0%	22,6%	0,0
Malaysia	66 802 189	5 772 375	8,6%	3 684 174	63,8%	10,2%	0,1
Brazil	50 083 600	9 328 539	18,6%	7 096 670	76,1%	15,9%	0,1
Philippines	29 825 767	3 170 271	10,6%	2 017 645	63,6%	10,0%	0,1
Egypt	18 071 582	3 053 047	16,9%	2 538 748	83,2%	21,0%	0,3

Source: CEPII, Trade policy priorities model.

* not significant (level measured prior to WTO accession)

** indicator of commercial discrimination : from -1 = very protected market to 2 = very open market

Less distorted markets

	Current imports (K\$)	Increase in imports (K\$)	Increase in imports (%)	Increase due to tariff removal (K\$)	Share of tariff removal in total increase (%)	Mean tariff (%)	Discrimination *
EU	677 552 014	54 622 765	8,1%	16 769 188	30,7%	4,4%	0,9
Canada	179 239 562	9 311 112	5,2%	4 815 423	51,7%	4,2%	0,7
Japan	230 091 379	23 753 536	10,3%	12 740 714	53,6%	5,7%	0,7
Taiwan	83 144 717	6 829 578	8,2%	5 338 841	78,2%	9,9%	0,6
USA	806 971 258	59 852 359	7,4%	23 061 125	38,5%	4,0%	0,5
Korea	88 605 311	7 171 152	8,1%	5 278 839	73,6%	9,5%	0,5
South Afr.	22 476 990	2 542 512	11,3%	2 031 673	79,9%	10,0%	0,5
Turkey	37 756 408	3 320 612	8,8%	2 428 163	73,1%	9,6%	0,4
Argentina	26 715 982	4 649 398	17,4%	3 834 000	82,5%	15,1%	0,3
Chile	14 101 338	1 821 368	12,9%	1 352 304	74,2%	9,9%	0,3

Source: CEPII, Trade policy priorities model.

* indicator of commercial discrimination : from -1 = very protected market to 2 = very open market

This openness asymmetry implies that EU trade interests are first and foremost outward-looking in nature.

2.1. EU position in international trade: a dynamic analysis

Trade policy should ensure EU producers are in a competitive position to sell their products on each market, but also to respond to world growing demand of imports be it from a geographic or a sectoral perspective.

Since the mid-1990s, there has been a major redistribution of market shares between emerging and developing countries and among developing countries themselves. EU market shares have declined by 6%. The situation is worse for Japan, which has lost 16,9% of its international market share. At the same time, US market shares have fallen slightly, by only 1,8%. This is for a part a logical effect of the growing number of exporters, but this is also linked to specific factors regarding each exporting country, especially the geographical and sectoral orientation of its exports and its trade performance on each elementary market.

A sophisticated analysis developed by CEPII to decompose the factors of these evolutions yields useful insights into EU industry's competitiveness on third markets. A quarter of the decline of EU market shares can be explained by the initial geographical focus of its trade. EU exports were strong in countries where demand is static but badly positioned in rapidly growing areas⁷. The US, and to a lesser extent Japan, have a better demand dynamic owing to the geographical focus of their trade.

This is also well illustrated in a simple analysis illustrated by the table below: while the EU conducts less than half of its trade with the ten markets which accounted for 93% of the growth in world imports between 1995 and 2002, that share is significantly higher for the US and Japan, with 79% and 76% respectively. Conversely, the EU is more oriented towards the least dynamic markets, which accounted for a negative contribution of 5% of the growth of world imports during the period.

Share of most/least dynamic markets in EU, US and Japan exports

	% of total exports going to the most/least dynamic markets			Contribution to the rise of world imports 1995-2002
	US	Japan	EU25	
On 10 most dynamic markets*	79%	76%	48%	93%
On 20 least dynamic markets**	8%	12%	13%	-5%

* In decreasing order, in absolute amounts (exporting country excluded): US, EU25, China, Canada, Mexico, India, South Korea, Turkey, Australia, Japan, Taiwan

** In decreasing order, in absolute amounts: Venezuela, Colombia, Argentina, Brazil, Peru, Chile, Iceland, Albania, Macedonia, South Africa, Gabon, Pakistan, Kirghizistan, Russia, Bielorusia, Brunei, Indonesia, Thailand, Hong Kong, Singapore

Source: Chelem data base

The sectoral orientation of European exports, i.e. the match between European supply and world demand at the beginning of the period, has a neutral effect. However, this effect is, by contrast, very positive for Japan (8.6%) and the US (4.0%), which are more specialised in products with high world demand.

Trade performance, defined as the difference between the variation in market shares and the geographical and sectoral effects of demand, has a markedly negative impact in Japan and in the US (-27.2% and -10.9% respectively), but a much less severe one in the EU (-4.7%, which is to be understood in the context of the growing number of competitors to traditional exporters). This shows that, in comparison to Japan and the US, the EU problem is more a problem of geographic orientation of its exports than a competitiveness problem stricto sensu.

Breakdown of variations in market shares : USA, Japan, EU (1995-2002)

	Market share Growth	Geographic demand effect	Sectoral demand effect	Trade Performance
	(1)	(2)	(3)	(4) = (1) - (2) - (3)
USA	-1.8%	5.2%	4.0%	-10.9%
Japan	-16.9%	1.6%	8.6%	-27.2%
EU	-6.0%	-1.5%	0.2%	-4.7%

It is useful to complement this broad picture by an analysis of the evolution of EU market shares in Asia, as it is the world's most rapidly growing area. This analysis (see table below) shows that, in a region currently accounting for half of the increase of world demand, European exporters are losing more market share than their American or Japanese counterparts. Looking at the three main markets of the region, the loss in market share experienced by the EU is always larger than those experienced by the US or Japan. ASEAN is the only exception where Japan market share decreased slightly more, but the general conclusion remains true. This is especially alarming in India, where in eight years time, the EU lost a third of its initial market share with a decrease of more than 12 points to be compared to a loss of less than 4 points for Japan firms and of 2 points for the US firms.

⁷ This is partly due to the intra-EU trade, which is taken into account, but this is obviously only part of the explanation (see comments below on EU position in Asia).

Evolution of EU, US and Japan market shares in India, China and Asean (1995-2002)

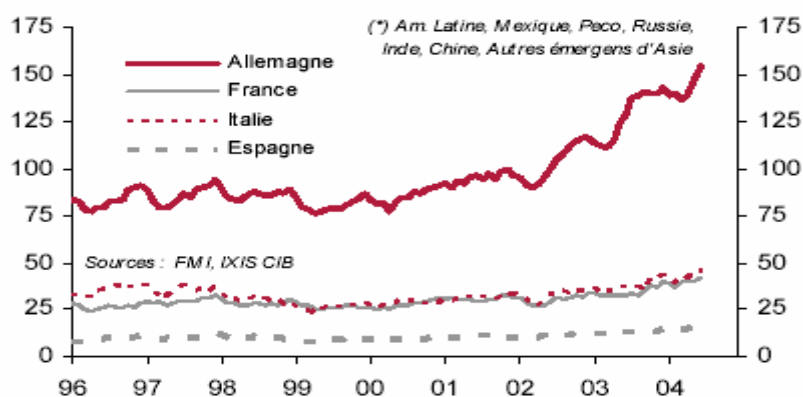
		1995	2002	Evolution in percentage points
INDIA	US	8,7%	6,6%	-2,0%
	Japan	7,1%	3,4%	-3,7%
	EU	33,2%	20,9%	-12,3%
CHINA	US	11,1%	9,4%	-1,7%
	Japan	22,5%	19,5%	-3,0%
	EU	17,2%	14,0%	-3,2%
ASEAN	US	11,6%	12,0%	0,5%
	Japan	25,2%	18,2%	-7,1%
	EU	15,5%	11,3%	-4,1%

Recent developments accentuate this evolution. Since 2002, Japan has managed to redirect its exports towards more dynamic areas, especially China, with which it has dramatically increased its integration (Japan exports to China rose by 75 % in two years). The Japanese recovery, which began in the second half of 2002, is largely due to the dynamics of its exports to China.

This is not the case of the EU. In the long term, if this situation persists, there is a risk for Europe to miss market opportunities in the most dynamic areas, which already account for half of world import growth.

However, conclusions must not be drawn too quickly: a similar analysis at the Member States level shows that countries like Sweden or Germany are actually seizing growth opportunities in emerging markets of Asia while France or Spain - which benefit from the same conditions as Germany - do not.

Exports to emerging markets (\$Bn per year)



These results are crucial to the dynamics of our foreign investment: it is in our fundamental interest to invest in those markets if we want to gain a foothold in them. This analysis thus has to be further developed according to the fact that a limited number of countries explains the bulk of the increase in world demand (see table below).

Main sources of world imports growth

	Import Values (2003) €Bn	Share of Total World's Import Growth (1998-2003)
USA	1.124	27%
China	321	18%
Asean	327	8%
Japan	326	7%
Korea	152	6%
Mexico	163	4%
Hong Kong	191	3%
Canada	230	3%
India	61	2%
Total for the selected countries	2.947	77%

2.2. EU trade policy instruments to tackle barriers to EU exports in third countries

Considering the market-opening interests detailed above, and despite our efforts over the last decade, there is still room for improvement in the opening of third countries markets, both on tariffs and non-tariff barriers, which include core NTBs but also non-traditional, behind-the-border practices limiting access for EU goods, services and FDI. This is the rationale for the DDA. The EU should keep ambitious goals regarding tariffs, NTBs, services, geographical indications (GIs), and rules (especially anti-dumping disciplines and trade facilitation). Protection of geographical indications is of high importance for EU exporting interests in wines, spirits, beers and other agri-food products, given the high degree of usurpation of EU GIs on third markets. Public procurement is probably the biggest trade sector escaping to multilateral rules despite its value (it represents up to 15% of GDP) often reserved to national goods or suppliers and difficult to penetrate for EU exports while the EU procurement market remains fairly open.

Regarding anti-dumping and anti-subsidy, European producers are affected in their competitiveness in third country markets by WTO-incompatible –and at times ill-founded– investigations (and anti-dumping use by third countries, especially the US and developing countries, is rising -see annex 3). Given the prudent and rigorous approach the EU is pursuing in its defensive cases, it has a credible contribution to make in raising the requirements associated to anti-dumping investigations and have its high standards adopted by other users. To that effect, the EU takes an increasingly active role in defending its economic operators in third country cases, not hesitating, if justified, to use the WTO-DSU route. This approach has an immediate and powerful impact on the position of the European economic operators. The DDA can not suffice, however, to tackle all barriers faced by EU industry. Other trade initiatives including RTAs with Mercosur and GCC and other bilateral initiatives such as TREATI with Asean and TIEA with Canada offer opportunities for the pursuit of a wide agenda. In addition, DDA possible improvements in certain sectors, such as GIs, have to be complemented by bilateral agreements, in order to strengthen rules and foster enforcement.

To tackle NTBs detrimental to EU industry, the EU should also reinforce international norms and standards as well as bilateral regulatory dialogues as established by the EU-US guidelines for regulatory co-operation and transparency and as foreseen in TREATI and TIEA (which in turn reinforce EU stance in favour of international norms and standards). To achieve success in overcoming NTBs for EU industry through dialogue, we must engage in a reciprocal process which requires us to also make an effort to recognise and reduce or eliminate barriers to our own market. The EU will not be regarded as a genuinely co-operative partner unless we are seen to be responsive to requests from our partners. A one-way dialogue will lead to us talking at each other rather than real co-operation. Technical assistance and capacity building, to which it devotes important resources, play also an important role in this area, which should be recognised. It would also be useful to strengthen EU position in international normative organisations as well as the coherence of its positions in different organisations.

New initiatives could also be launched to press improvement of market access in public procurement by applying reciprocity against third countries for failure of opening up their public procurement markets. It could take the form of a trade instrument restricting access to the EU market to goods and suppliers originating from a given country applying national preferences or, based on the US approach “Buy American”, by giving preference to EU goods and suppliers except when agreed bilaterally or plurilaterally.

This strategy is complemented by a systematic commitment to tackle and eliminate barriers to EU market access bilaterally, using the tool of the market access database. This database put the focus on understanding and registering effectively all the complaints of EU industry, of assessing their impact systematically, and where necessary and possible, tackling the barrier either through bilateral discussion / negotiation, or through the Trade Barriers Regulation. This commitment has already contributed to the elimination of more than 150 recorded obstacles. It has for instance enabled the elimination of restrictions on balance of payments which India had been applying on a large number of products since 1960 (the potential equivalent of 2 Mds\$ gains in extra exports for the European industry), as well as discriminatory registration taxes (a hundred times higher than those applicable to domestic goods) on medicine imported in the Ukraine. To further gain in efficiency, this “Market Access Strategy” could be reshaped to offer a better prioritisation of EU market access objectives.

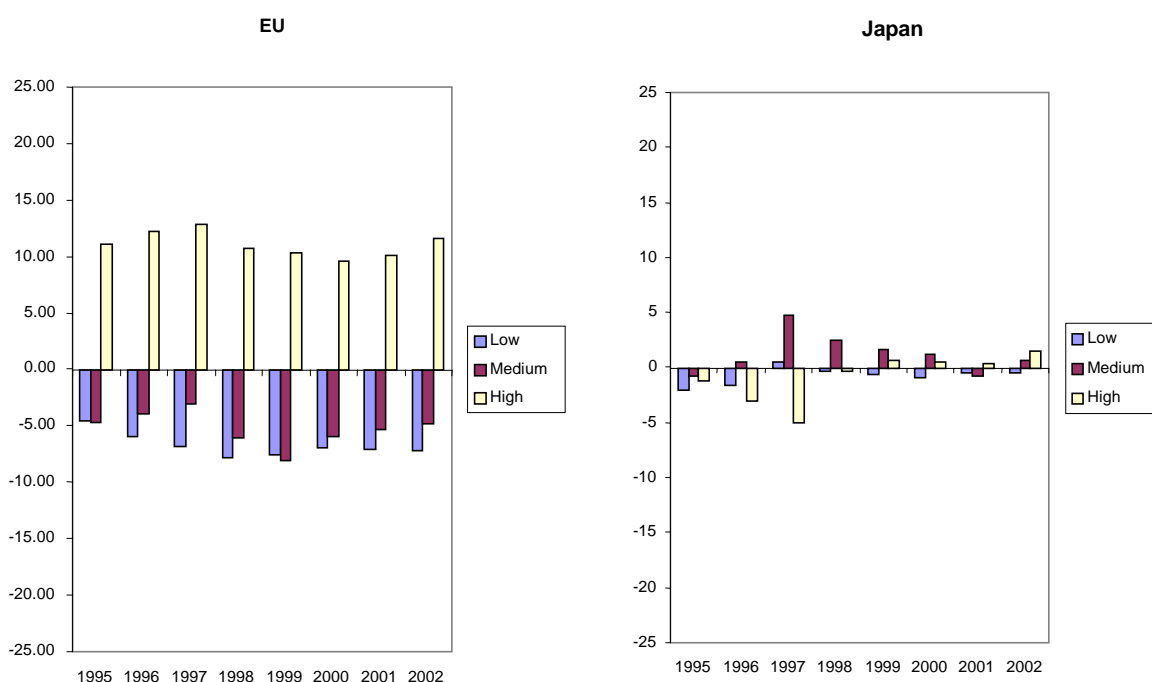
3. DRAWING UPON EU COMPARATIVE ADVANTAGES

3.1. A strong export performance in upmarket products, but at risk

Fostering competitiveness also supposes to reinforce the position of EU industry by drawing upon its strengths and defining EU trade policy accordingly. A recent CEPII report, commissioned by DG Trade⁸, on the situation and prospects for EU industry in the evolving international division of labour shows that if the EU industry's position on world markets is still good, it is due to its strong export performance in upmarket products. It is a striking fact that upmarket products now account for 50% of European exports and a third of world demand.

This is not just anecdotal. Indeed, this is the case not only in consumer goods, but on the whole range of EU specialisation including intermediary goods, machines and transport equipment. It actually reflects a new form of "vertical", qualitative, intra-sectoral international division of labour, according to the level of product range that distinguishes itself from the classical "horizontal" inter-sectoral specialisation. Whereas the EU globally seems to have lost its comparative advantages on some basic consumer goods, this analysis clearly shows that this is the case on low and medium-range products, but not on top-of-the range ones, for which the EU is in a very strong global position and which has not been eroded in the recent past. This is not the case for all developed countries: for instance, this contrasts markedly with the situation of the US, which experiences a deficit across all ranges.

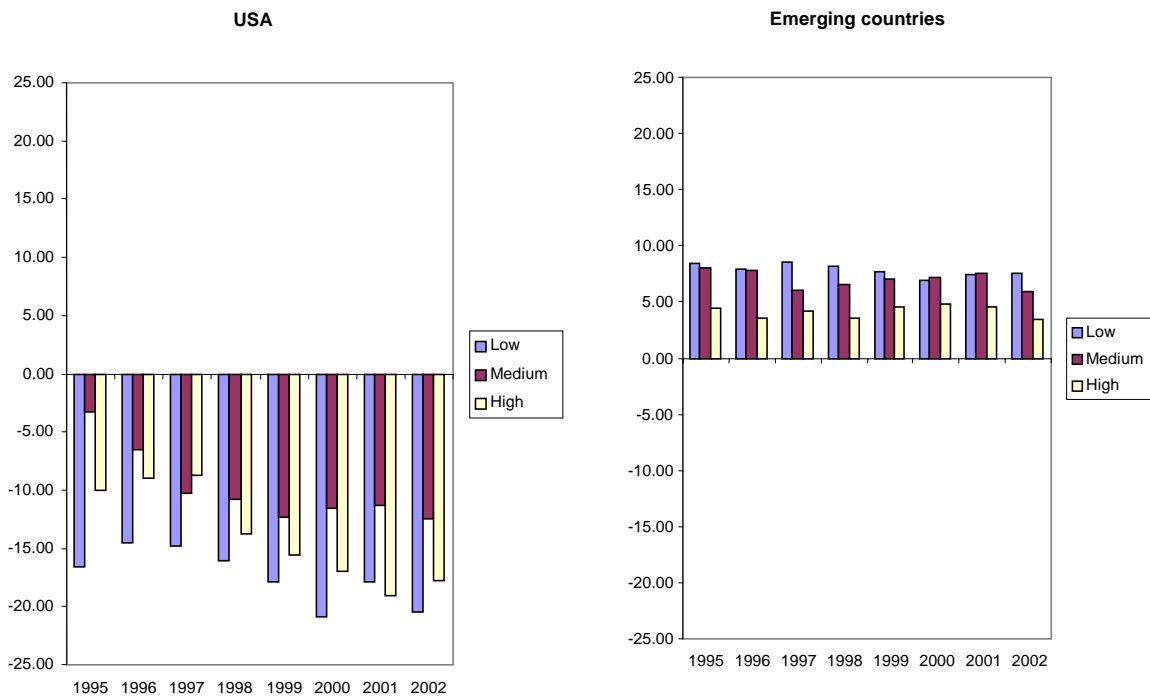
Market positions for consumer goods by range⁹ (as a percentage of the world market, 1995-2002)



Reading: EU market position in consumer goods in 2002 is highly positive for top-of-the range products, negative for low and medium-range products.

⁸ CEPII (2004), *European industry's place in the International Division of Labour: situation and prospects*.

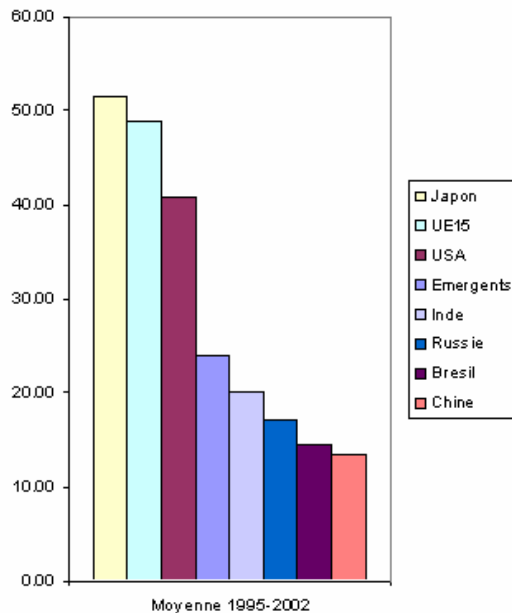
⁹ The analysis of market positions compares the imports and the exports of an economy at a specific production stage. This approach is suited to a situation in which the widespread fragmentation of international value-added chains is constantly increasing imports (components, semi-finished products, etc) in order to defend export market share: a country which maintains its share of export markets through a strategy of large-scale delocalisation of its supply of inputs could see its market position in the sector concerned worsen. This approach also enables an exporter's power in a given sector or branch of the world market to be measured.



Reading: US position in consumer goods in 2002 is negative regarding all categories of product (upmarket, medium-and low range products). It is better for medium-range products than for low-range or upmarket products.

Globally, the EU is in second place in the world just behind Japan but ahead of the US. Upmarket products account for 52% of Japanese exports and 48 % of European exports, but for only 41 % of US exports. In contrast, they still account for less than 15 % of Chinese exports.

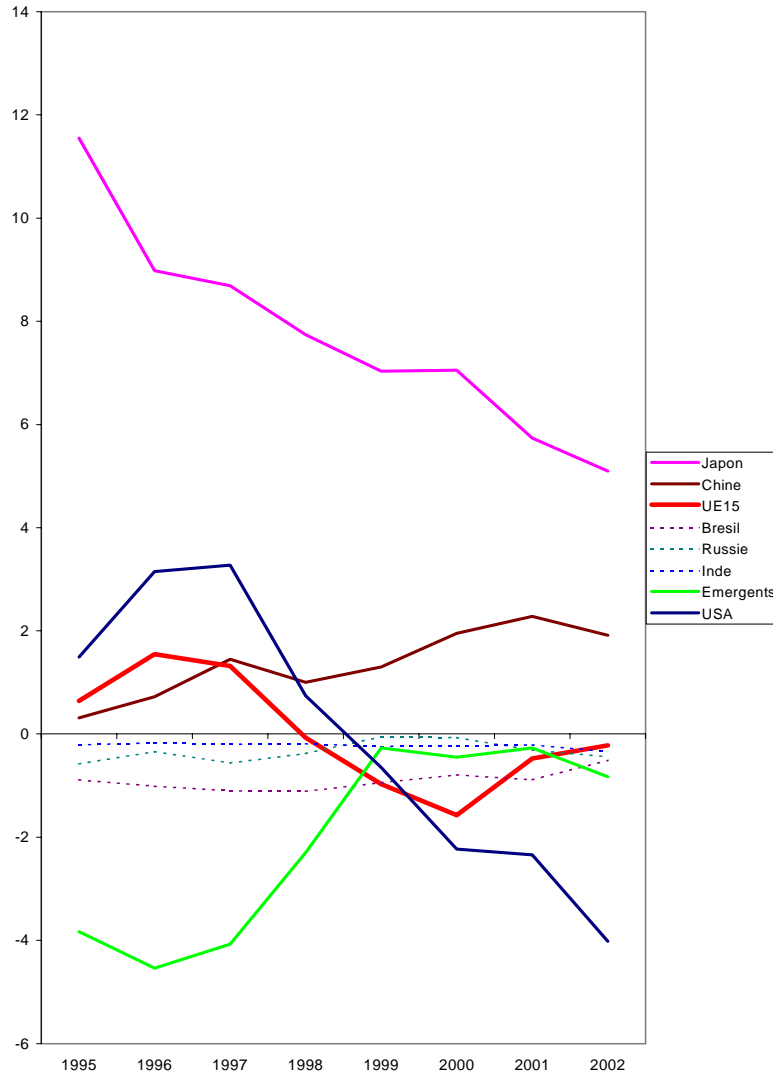
Proportion of exports accounted for by upmarket products (%)



This shows the EU capacity to not only produce but also sell expensive upmarket products, which can be sold at a higher price than those of its competitors due to a set of non-price factors such as innovative feature, quality, reputation, continuity over time or related services. This is a key point for the linkage between competitiveness and the EU social model: the EU should not waste time trying to compete with cheap labour countries on low-range products but consolidate its positions on upmarket products by upgrading the level of qualification of its workforce and improving its innovative performance.

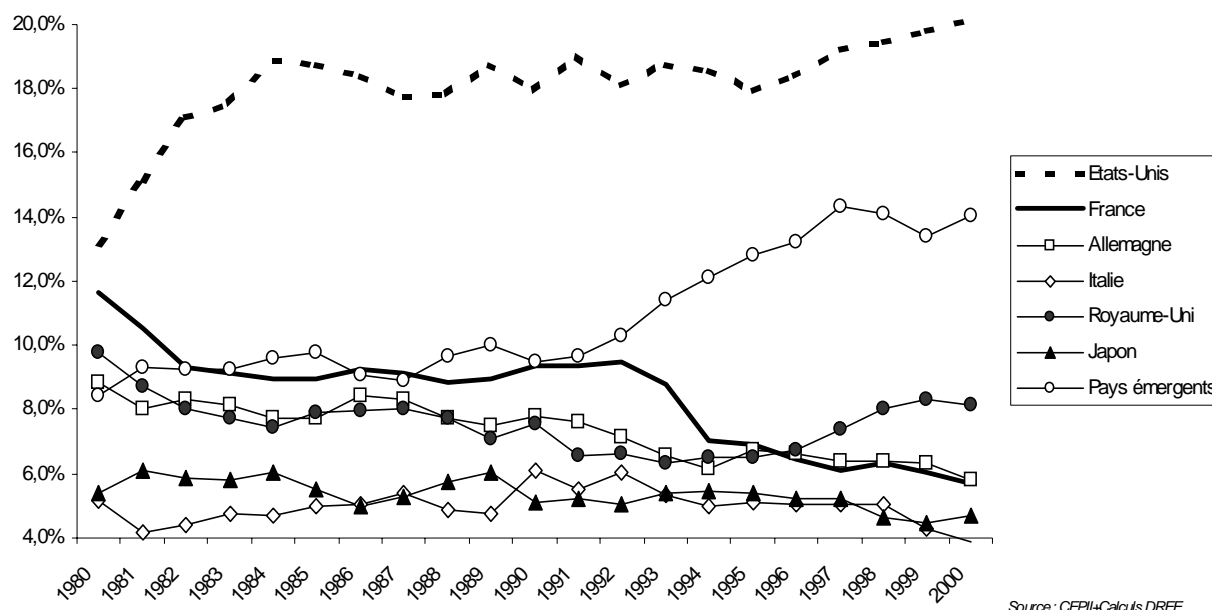
This is indeed an unsteady equilibrium, because simultaneously the European industry, together with Japan and the US, is losing ground in high technology products. While the EU may be improving its market share in locomotives, man-made fibres, or medical cameras, it is doing better in pork and poultry fat! It is lagging behind in several high tech products - air launchers, turbines, insulating glazing, telephones, turbine parts – whereas, according to CEPII calculations, China is catching up with the US in high technology exports.

Evolution of market positions in the area of high technology (1995-2002)



A similar analysis applies to European positions in trade in services. Current EU's services sector is strong, but also faces challenges for the years ahead : over the last ten years, the EU MS who are the main services exporters (UK, France, Germany) have been losing market shares in trade in services, whereas the US market share has remained more or less constant (see table hereunder). This fact should underline that the EU should push negotiations in sectors where it has a comparative advantage and where little commitments have been made so far by third countries (maritime, environmental services, distribution are good examples).

Parts de marché dans les échanges de services selon les pays et zones



3.2. Implications for intellectual property rights (IPR) protection

Maintaining the EU's position in top-of-the-range products is not just a matter of technological advance, as stated above. The quality of products, their reputation, their continuity over time and their related services are all decisive factors in determining prices. However, innovation remains a key component of this model. While such observations call for a burst of investment in R&D and innovation, they also justify a strong protection of intellectual property rights (IPR).

IPR protection has both an internal and external dimension. From the internal standpoint, the objective must be to set the right level of protection within the Single Market in order to enhance creativity and innovation.

From the external standpoint, which is the focus of this paper, it is of primary importance for the EU to defend a better recognition of intellectual property rights and work for their implementation according to the commercial interests of the EU. In this context, one should note that:

- The EU is the leading exporter of top-of-the-range brand products and therefore has a strong interest in the protection of Trademarks and Geographical Indications.
- Given the MFN and national treatment principles of the TRIPs Agreement, all IPR rules enshrined in EU legislation also benefit non-EU right-holders and all IP provisions enshrined in bilateral trade agreements benefit right-holders from third countries. Conversely, EU nationals can benefit from IP provisions contained in bilateral agreements between third countries.
- Given the high level of IPR within the Single Market, it is of much interest that the protection offered by third countries to their domestic firms (and by extension to their European competitors) matches an equally high level of protection. IPR can also be a key element for the development of industry in developing countries themselves, the growth of IPR-protected sectors in these countries provides more opportunities to European industry to conduct business.

As a rule, it is appropriate to promote IPR protection through International Conventions rather than through bilateral deals. However, in areas where progress is difficult to achieve at the WTO level (for

example, on Geographical Indications), bilateral initiatives and the conclusion of plurilateral agreements may be considered alternative ways forward.

The enforcement of IPR remains a matter of serious concern, particularly in a number of countries with emerging economies. The implementation of the IPR enforcement strategy adopted in November 2004 by the Commission is key in this respect. The strategy focuses on the effective implementation and enforcement of existing IPR laws. It proposes to identify priority countries where the efforts and resources of the EU must concentrate. Stress will be put on technical cooperation and assistance to help third countries, and bilateral and multilateral sanction mechanisms would be considered against countries involved in systematic violations. The EU also proposes a more systematic promotion of IPR mechanisms in multilateral, bi-regional and bilateral frameworks, as well as to raise awareness among users and consumers in third countries and to support the creation of public-private partnerships to address the issue. Neighbouring countries and China are key in this respect.

4. FACILITATING CHANGE IN EUROPE AND BEYOND

4.1. Inside the EU: the need to address adverse effects of market opening

While the process of market opening may be beneficial overall to growth and employment, it also brings about transformations which are disruptive for some in the EU. These transformations are necessary for openness to yield to full benefits, through a better specialisation. But they are more costly for the less qualified and most vulnerable workers. Openness to trade thus implies a form of hidden redistribution that should be corrected: this is an imperative of fairness. Addressing these adverse effects is also a political imperative because of the wide asymmetry between these costs - which are quite limited at an aggregate level but very visible, tangible and concentrated in the specific areas they occur - and the overall benefits of openness, which, even at a high level, often appear intangible and are usually diffuse: this asymmetry directly feeds opposition to market opening. Finally, this is also an economic imperative insofar as a targeted anticipation policy helps in minimising costs of change, facilitates and accelerates transitions (for example by limiting duration of unemployment or the scope of wage losses), and ensures that market opening can effectively take place and have full effect.

Costs vs. benefits of trade openness

Empirical studies generally show that the magnitude of these costs, albeit difficult to assess, remains very limited as compared with the potential gains of trade openness (in most cases, the ratio of costs to benefits is around one to twenty). However, the impact of costs can be much greater for several reasons:

- They are generally concentrated in several sectors or regions, therefore their impact can be much more magnified than if they were uniformly distributed across the whole population;
- The nature of these costs (difficulties experienced within given sectors or regions) implies they are not directly offset by the gains from trade openness (price decreases for consumers, gains in variety and efficiency, diffusion of technologies, economies of scale...);
- Costs and benefits materialise on a different time scale: costs tend to be more significant in the first years following openness (the effects of increased foreign competition are felt rapidly in least competitive sectors), while most gains (notably efficiency gains resulting from an improved allocation of factors of production) require more time to take full effect. Empirical studies generally show that in the years following openness, costs amount to about 10-15% of gains, i.e. a ratio twice to three times higher than that mentioned above;
- Costs and benefits are typically dissociated in space: since the ability of sectors to derive benefits from international trade openness depends on their international competitiveness, the overall picture is thus marked by contrast. The spatial concentration of industrial and services activities (in particular the production of exchanged goods), together with the correlative specialisation of regions convert these sectoral disparities into spatial disparities. Some regions suffer from the adjustments induced by trade opening in certain sectors, while others benefit from the expansion of sectors based in their area. The spatial dimension is thus critical: in declining regions, job losses constitute a clear cost; benefits derived from comparative advantages are only apparent in dynamic regions.

These adverse effects are of course taken into account in the definition of trade policy: sectors which are weak or vulnerable to international competition deserve particular treatment; and transition periods are systematically part of every trade agreement. However, whatever the precautions taken, structural adjustment is inherent to trade openness and this must be tackled. DG Trade has been conducting, since 1999, Sustainability Impact Assessments (SIAs) of all major trade negotiations which i.a. help identify adverse social effects of trade opening in Europe and third countries. SIAs also identify possible remedies or flanking measures necessary to minimize such adverse effects.

Adverse effects should be addressed both with more flexible labour markets and safety nets. Measures to increase human capital endowment and to promote the diffusion of technology throughout the EU economy also help. But the EU should also adjust internal policies, in particular the structural funds, to help anticipate these changes and prepare for them at the regional level. The preparation of financial perspectives for 2007-2013 in the second half of the Prodi Commission provided the opportunity for mature consideration within the Commission which has resulted in a proposal of effective mobilisation of structural funds for this purpose from 2007. Redressing imbalances is in effect an essential dimension in cohesion policy, as is the regional dimension, which is particularly important when managing the effects of market opening (transition costs are disproportionate in those regions that have underdeveloped and undiversified economies). Adjustment to changes induced by the Single Market was the key reason for the inception of cohesion policy at the end of the 80's. The adjustment to changes induced by international trade opening and division of labour, which are of similar significance, should now become a key component of it.

The Commission's proposals for the period from 2007 onwards are therefore intended to mean that the effects of market opening will be anticipated at a regional level, albeit operated within the framework of the structural funds programme, and with a reserve fund (1% of Objective 1 funds, 3% of Objective 2) being put aside for intervention in case of unexpected shocks. In addition, the Commission proposed the creation of a 'growth adjustment fund' expected to total about 1 billion euros per annum, which is mainly intended to protect against unexpected trade shocks. Thus, if Member States agree to this approach, the EU would be equipped with a mechanism for anticipating and managing transition, in the medium term (via regional policies), and a mechanism for dealing with crises (via the 'growth adjustment fund').

These proposals are yet to be secured in the negotiation with the Council and the Parliament and above all to be put into practice. There is a need for a close cooperation both within the Commission between DG Trade and DG Regio and beyond between the Commission and national and regional authorities. This should be based on detailed analytical work on the regional effect of trade opening, such as a strengthened focus on the intra-EU regional consequences of trade liberalization in DG Trades Sustainability Impact Assessments (SIAs).

4.2. On emerging markets: ensuring inclusive development

Making sure that structural changes do occur and are not blocked by lack of anticipation or opposition from sectoral interests and institutional deficiencies is critical for Europe not only regarding its domestic constituency but also regarding its emerging countries partners.

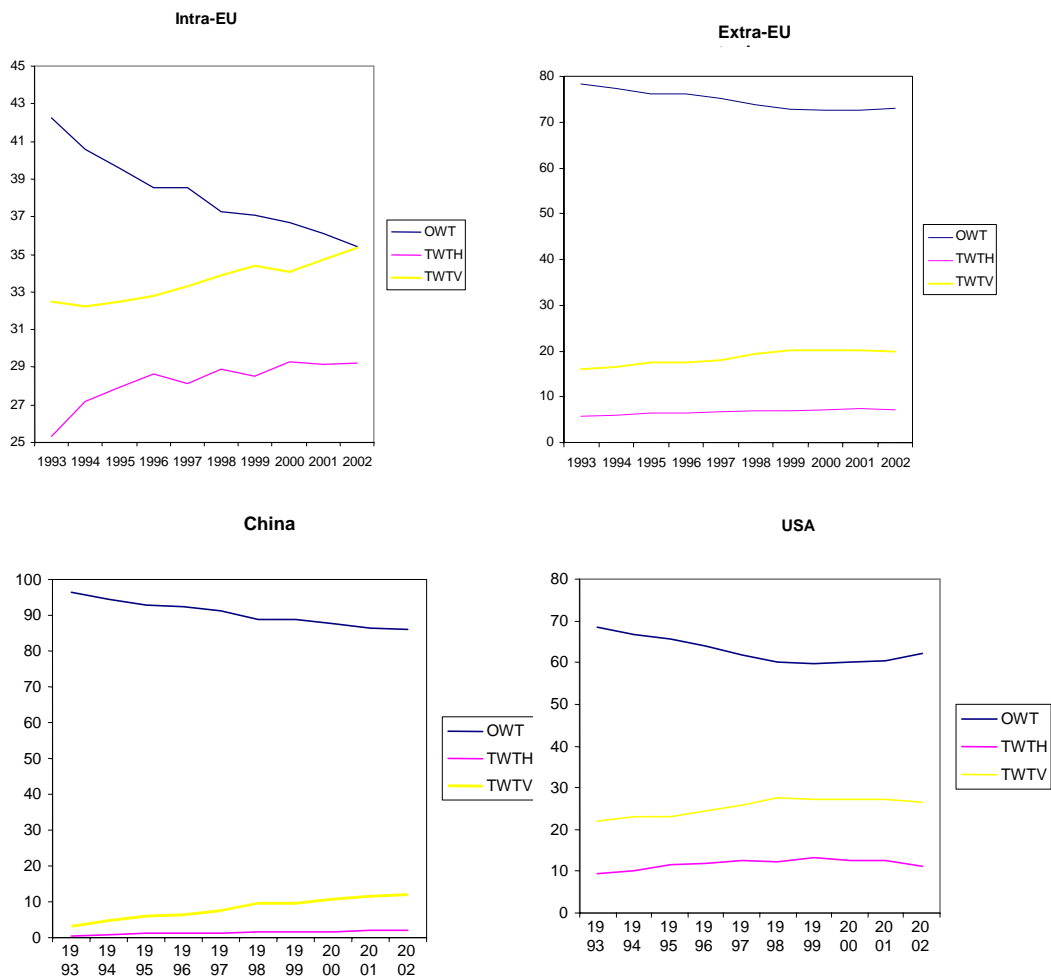
This latter point is indeed decisive for the type of trade Europe will conduct with them in the future and its ability to benefit from their growth without having to operate dramatic adjustments of its own industrial structures. While the exploitation of comparative advantages (related to the differences in relative factor endowments) is a crucial component of the potential for trade growth between Europe and the developing economies in the short and medium run, in the long-run adjustment costs will be minimized if economic growth eventually lead to a shift in the nature of trade between them.

The question of the nature of this trade is the following: will we move towards trade in very different products according to a sectoral specialisation, as is still largely the case today? Or will we move instead towards a model closer to current trade between European countries themselves, which is mainly trade in similar products differentiated by their variety or their quality? The first option implies a focus on a small number of sectors, whereas the second option keeps alive a sizeable manufacturing industry among all the trading partners.

The latter case is the way European economies followed in the context of the Single Market. The deepening of integration did not lead to more sectoral specialisation and trade of different products (inter-branch trade such as Airbus planes for T-shirts), which would necessarily have been synonymous with a more limited number of sectors in each country, but to an increase in trade of similar products, either differentiated by their variety (i.e. horizontally differentiated, for example: Renault cars for Fiat cars) or their quality (i.e. vertically differentiated, for example: Audi cars for Seat cars).

Such a process is actually under way with China where inter-branch trade is being gradually replaced by vertically differentiated intra-branch trade. Such a process did not even exist between the EU and China ten years ago, and now accounts for almost 10% of trade flows. On the other hand, the difference in standard of living still prevents any development of horizontally differentiated intra-branch trade.

Based on these considerations, the set of scenarios presented by CEPII in its study on the future of EU industry in the evolving division of labour clearly concludes that a technological burst in the EU, while necessary, does not constitute a sufficient condition for ensuring a sustainable development of EU industry and employment.



Key: OWT: One-Way Trade (inter-branch), TWTH: Two-Way Trade (intra-branch) Horizontal, TWTV: Two-Way Trade (intra-branch) Vertical

Indeed, if institutional obstacles in emerging countries hamper the catch-up of living-standards and wages, intra-industry trade is very likely to stagnate (due to remaining gaps in standards of living, which limit horizontal intra-industry trade, and to the narrowness of the market for EU upmarket products, which limits vertical intra-industry trade). Inter-industry trade is then far more likely to develop, leading EU industry to an extreme specialisation in high-technology products, synonymous with the giving up of large parts of its current activity, thus implying very high adjustment costs.

CEPII's analysis calls for a response which is both internal and external: technological advance and a continued commitment to quality, but also development in the South and enhanced institutional frameworks. A comprehensive approach is therefore required, which involves all European policies, not just industrial policy in the narrow sense of the term. Trade policy, which is the interface between Europe's development model and that of its trading partners, clearly lies at the heart of these challenges. It should notably support reforms in third countries by combining in an integrated fashion,

liberalisation efforts with the joint determination to achieve common sustainable development. But this is above all a major challenge for other external policies, in particular for economic and development cooperation, and in particular their governance dimension¹⁰.

CONCLUSION

It is not the aim of this issue paper to define a policy line, but a number of elements highlighted in the analysis could be considered in this prospect:

- (1) The most important challenge in terms of competitiveness is not on the imports side of trade policy: the analysis shows that the EU trade regime undoubtedly helps more than hinders EU competitiveness. The EU is the largest and, by and large, the most open economy in the world and there is no border protection for the vast majority of inputs used by European industries. There are only limited pockets of distortions regarding a limited number of inputs for industrial products, which are likely to be removed within the DDA and which are, in the meantime, partly addressed with tariff suspensions and quotas. Regarding anti-dumping duties, they do not appear to imply significant costs to downstream industries even if they are concentrated on products which are usually used as inputs. In any event, the “Community interest” clause is systematically applied to avoid exercise anti-competitive impacts. The same applies to services: while measuring restrictions is here more difficult than for goods, the general conclusion is that there are no costly restrictions to foreign supply of business-related services. There are some exceptions to this picture in the agriculture sector, where some significant inputs for the EU food industry, such as sugar or dairy, are still highly protected. But the comparison with the US and Japan indicates that this is not a special European feature, which limits its effect on competitiveness – even if other manufacturers e.g. Brazil have access to agricultural raw materials at much lower prices. Further opening within the DDA will have to strike a balance between agricultural sensitivities and competitiveness requirements. In any case, the CAP reform adopted last year and subsequent proposals especially on sugar, which implies a substantial decrease of sugar price inside the EU, certainly go in the right direction both in terms of price reductions and quality improvements, and should be further supported. Globally speaking, despite some of the problems mentioned above, the EU processed food industry is considered to be highly competitive with strong domestic and international brand names quality recognition. The EU should press for further overseas market opening in this sector.
- (2) Addressing barriers to EU exports in third countries clearly accounts for the bulk of the potential to improve the competitive position of the EU industry within the framework of trade policy. The EU is one of the most open markets worldwide. Its leading trading partners are less open. This implies that EU trade interests are first and foremost outward-looking in nature. The analysis and our experience in the Market Access Strategy show that there is still room for improvement in the opening of third countries markets, both on tariffs and non-tariff barriers, which include core NTBs but also non-traditional, behind-the-border practices limiting access for EU goods, services and FDI. A very dynamic programme putting pressure on third country restrictions therefore should be developed. This is the rationale for the DDA and the ambitious EU stance in this context. Essential improvements can be made in this framework, regarding tariffs, NTBs, services, geographical indications and rules, especially

¹⁰ The Association of South East Asian Nations (ASEAN) provides a useful example, where 10 countries, already members of a free trade area, have agreed to establish an EU-style Economic Community with a market of 520 million people together by 2025. This is an opportunity for the EU to focus our dialogue and co-operation to develop a new relationship with an important region, based on sharing experiences in establishing a common market and removing internal trade barriers. We should be able to provide practical, but neutral support to ASEAN’s own integration efforts, recognising that in helping them to strengthen their institutions and consolidate their own achievements, we are contributing to an integration process in a manner which will also be decisive for the future good functioning of our region-to-region economic relations.

anti-dumping disciplines which are often misused in third countries. This should be complemented by bilateral or regional initiatives, such as RTAs with Mercosur and the Gulf Cooperation Council, which allow the pursuit of a wide agenda. New initiatives could also be launched to press improvement of market access in public procurement, which is probably the biggest “sector” of the economy sheltered from multilateral disciplines. Our idea, currently under review, would consist in applying reciprocity against third countries for failure of opening up their public procurement markets. To tackle NTBs detrimental to EU industry also requires to develop international norms and standards, reinforce bilateral regulatory dialogue and cooperation (such as the EU-US guidelines for regulatory co-operation and transparency, TREATI with Asean and TIEA with Canada) and strengthen EU representation in international normative organisations. Lastly, this strategy is to be accompanied with a case-by-case registration and treatment of trade barriers which impede EU industry access to third countries, as it is done through the market access database.

- (3) Turning to EU assets and performances on world markets, the analysis shows that the EU position is still good mainly due to its ability to sell upmarket products, but that it is an unstable equilibrium because the European industry is losing ground in high technology products, even if this in turn is in part an optical distortion: whenever an EU or US company has its most recent invention assembled in Asia, this appears as an Asian trade gain and our loss. While such observations call for a burst of investment in R&D and innovation, they also justify a strengthening of intellectual property rights (IPR) protection in third countries, notably China, where it is of primary importance for the EU to defend a better recognition of intellectual property rights and an improved enforcement of IPR protection (hence the IPR enforcement strategy adopted in November 2004 by the Commission).
- (4) The full effects of trade opening on growth and competitiveness will only be felt provided deliberate measures are taken, both internally and externally. First, while the process of market opening may be overall beneficial, it undoubtedly brings about transformations which are costly and disruptive for some in the EU, particularly for the less qualified and most vulnerable workers. This requirement of fairness is also an economic imperative insofar as anticipating structural changes and facilitating and accelerating transitions helps in minimising the costs of change and therefore in being an enabling factor of change. This should be addressed with more flexible labour markets and active safety nets, but this also supposes taking anticipative measures. The Commission proposal to take the likely impact of openness into account within the programming of structural funds should be further developed. Second, the very scope of structural adjustment depends on the type of trade Europe will conduct with emerging countries in the future: in this respect, strengthened institutional framework in the South and a rapid catching-up in terms of living standards seems to be key for the development of trade of similar products differentiated either by quality or by variety, which allows the preservation of a wide industrial base and limits the scope of internal adjustments induced by trade opening. All EU external instruments should converge in supporting such an inclusive model of development.

ANNEXES

Annex 1: Australian Productivity Commission estimates of the cost of restrictions on trade in services

Annex 2: Third countries use of TDI - theEU as a target

Annex 1: Australian Productivity Commission estimates of the cost of restrictions on trade in services

The methodology developed by the Australian Productivity Commission to estimate the direct price and/or cost effect of restrictions on trade in services involves two steps: first, qualitative information about regulations is converted into a quantitative 'restrictiveness index'; second, the effect of this measure of restrictions on prices and/or costs is estimated.

1. **Trade restrictiveness indices** summarise the nature and extent of restrictions on trade in services for each economy. Information is collected for each economy on the government regulation of a particular service and classified according to whether the restrictions are imposed on establishment or ongoing operations; and non-discriminatory (treat domestic and foreign service suppliers equally) or discriminatory (treat foreign service suppliers differently from -typically less favourably than- domestic service suppliers).

Restrictions on establishment often include licensing requirements for new firms, restrictions on direct investment in existing firms and restrictions on the permanent movement of people. Restrictions on ongoing operations often include restrictions on firms conducting their core business, the pricing of services and the temporary movement of people. Depending on how each of these restrictions applies to domestic and foreign service suppliers, they could be non-discriminatory or discriminatory.

A trade restrictiveness index score is calculated by the Australian Productivity Commission for each economy using a methodology of scores and weights. Restrictions that are common to a number of economies are grouped into restriction categories. Scores are then assigned to each restriction on the basis of a judgement about how stringent it is. The more stringent the restriction, the higher the score. Scores range from 0 to 1. The restriction categories are then weighted together according to a judgement about their relative economic cost. The weights are generally chosen so that the total restrictiveness index score for an economy ranges from 0 to 1.

An index score is then calculated separately for domestic and foreign service suppliers. A foreign index is calculated to measure all the restrictions that hinder foreign firms from entering and operating in an economy. It covers both discriminatory and non-discriminatory restrictions. A domestic index represents restrictions that are applied to domestic firms and it generally only covers non-discriminatory restrictions. The difference between the foreign and domestic index scores is a measure of discrimination against foreigners.

2. **Price and cost effect of trade in service restrictions** are calculated using econometric models to estimate the effects of restrictions on the price or the cost of services. These models have been developed from economic theory and include all the relevant determinants of economic performance (e.g. price, profit margin, cost or quantity) of service firms in that service sector - industry and economy-wide influences - plus a measure of trade restrictions, as measured by the trade restrictiveness index.

The econometric model is then used to estimate the determinants of economic performance in that service sector. Price and cost measures are calculated from the results of the econometrics and where necessary, a profit or quantity effect is converted to a price or cost effect. Depending on the performance measure chosen, the results provide an indication of the extent to which restrictions affect price-cost margins, and therefore create economic rents, or raise costs above what they otherwise would be in the absence of restrictions. The price and/or cost effect measures are classified in the same way as under the trade restrictiveness index, namely, according to whether they are on establishment or ongoing operations, and according to whether they are discriminatory or non-discriminatory.

One should note that figures displayed for the EU as a whole are simple averages of available data for Member States. As a result, inter-Member States discriminatory regulations which may remain are taken into account into the foreign trade restrictiveness indices rather than into the domestic ones. Moreover, the weight of external trade is much lower in the EU's GDP than in Member States' GDP. Consequently, the restriction effects on prices and costs are over-emphasised by the current study.

Annex 2: Third countries use of TDI – the EU as a target

In 2003, the EU has fallen to the rank of 4th largest world user of antidumping, but the increasing trend in the number of commercial defence cases being opened against Community exporters has been confirmed. The number of definitive measures against the Community has increased from 169 at the end of 2002 to 192 at the end of 2003. As shown in the following table, the biggest target of anti-dumping cases initiated in 2003 continues to be China followed by the EC. This has been the case for the last four years.

Major targets of anti-dumping investigations (ranked by 2003)

Target	No of Cases					
	1998	1999	2000	2001	2002	2003
China	24	40	33	48	48	47
EC ²	30	29	23	28	27	21
USA	12	13	9	15	10	18
Korea	22	33	19	21	18	17
Japan	9	23	9	14	9	14
India	11	13	10	12	13	13
Chinese Taipei	8	20	14	20	13	12
Malaysia	4	60	7	5	4	9
Indonesia	12	19	11	15	12	8
Thailand	2	18	10	16	10	7
Mexico	9	4	1	4	2	4
South Africa	5	4	6	9	9	4
Turkey	3	6	7	5	7	4

The US had in 2003, as in the two previous years, the largest number of measures in force (53) against the Community, followed by India (32).