EUROPEAN COMMISSION
Directorate-General for Trade

Brussels, 20 March 2006

TRADE SIA OF THE EC-GCC NEGOTIATIONS: POSITION PAPER

Trade Sustainability Impact Assessment of the trade negotiations between the EC and the Gulf Cooperation Council

I. Introduction

Since 2002, a Sustainability Impact Assessment (SIA) of the negotiations of the trade agreement between the EC and the Countries of the Cooperation Council for the Arab States of the Gulf (GCC) has been carried out by an external consortium with financial support from the European Commission. A Trade SIA informs negotiators of the potential economic, social and environmental impacts of a given trade negotiation, using analytical assessments and consultation processes. A Trade SIA also proposes flanking policy measures which could be implemented to mitigate negative impacts and enhance positive ones.

The final report of the Trade SIA on negotiations between the EC and GCC was released in 2004.[1] While the report presents the consultant's analysis and opinion, the Commission has committed itself to integrate Trade SIA outcomes into its policy making process. For this purpose, the Commission has drawn up this draft position paper which presents its official position on the challenges identified in this Trade SIA.

This position paper builds on the findings included in the above report and on the outcomes of a consultation process undertaken on this report by the Commission with EC Member States and civil society. After consultation of civil society, the position paper will be formally endorsed by the Commission.

[1] **Final report and full set of results are available on line at: www.Trade SIA-gcc.org/**

II. The Trade SIA Framework

A. Negotiations

The objective of the EC-GCC FTA is to agree on a far-reaching liberalisation of trade in goods and services including the reduction of non tariff barriers through public procurement commitments and on trade rules e.g. intellectual property, rules of origin, competition. The trade effects that are assessed in the Trade SIA are based on the implementation of this mandate. The Trade SIA consisted in one overview analysis and two sector analyses addressing the petrochemical and aluminium sectors.

B. Geographical Scope and Assessment

The Trade SIA looks at two country groups: the EC and GCC countries, namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

The analysis is based on a causal chain analysis (CCA) using evidence and information (computable trade simulation, case studies, literature review, expert opinion). CCA sheds light on the potential effects of trade measures (tariff reduction, non-tariff measures) on market incentives and opportunities leading to economic, social and environmental impacts. Significance criteria and sustainable development indicators (real income, fixed capital formation, employment, poverty, health and education, equity, biodiversity, environmental quality, natural resources stocks) are used to characterise the potential impacts.

C. Support Measures

The Trade SIA also aims to identify support measures (not restricted to the trade policy area) which could be implemented to mitigate any negative impacts or enhance positive ones.

III. Trade SIA results

A. Overview of the Consultant's study

1. Economic

Overall, the liberalisation of trade under the Free Trade Agreement (FTA) leads to increased economic welfare in GCC countries has negligible overall welfare effects on the European Union (EC) and will not be negative for other developing countries. The Trade SIA confirms the very positive effect of the GCC Customs Union which is likely to boost internal trade. While this may indeed be the case, the question arises about the additional effect of the FTA between the GCC and the EC over and above the GCC Customs Union. Globally, the main winners in the GCC are the labour-intensive sectors such as clothing and textiles and more energy intensive sectors that require skilled labour such as petrochemicals and metal products. Given the dominance of petroleum in the exports of the GCC countries, adjustment of trade in this sector dominates much of the quantitative results. Export gains for the EC under the FTA into the GCC are also likely, predominantly in high-tech sectors, agricultural or industrial sectors (machinery). The Trade SIA expects also positive effects due to liberalisation of services, for which substantial growth potential is noticed. Finally the Trade SIA stresses that the FTA gains would significantly be improved by joint enhancement of market access for investments (notably more liberal ownership rules) and liberalisation of public procurement.

2. Social

The social impact assessment of the FTA concentrated on the GCC and more in particular on the job market in the GCC. No social impact assessment of the FTA was carried out for the EC. The GCC employment market shows a clear double standard between GCC citizens who occupy high skilled posts and expatriates from Asia, other Arabic states and Western Countries who are mainly low skilled workers. In the GCC, the manufacturing sectors that might experience the biggest positive employment impacts are the textile sector and the petrochemical sector. Employment in these sectors is likely to increase significantly. Due to the low skilled labour employed in the textile sector the potential benefits for the employment of GCC citizens are expected to be rather limited. Reversely the influx of low skilled expatriates could increase, which could lead to increased concerns in the textile industry linked to poor working conditions, decent work opportunities and respect of core labour standards.
Positive employment impacts of the EC-GCC FTA are likely to occur in relation to liberalisation of services e.g. business services, communication services, construction and related engineering services, distribution services, environmental services, financial services, and transport services. These are all sectors where medium to high skilled manpower is required. The Trade SIA foresees considerable employment opportunities in medium/high skilled occupations for nationals which would better match the GCC citizens' skill profiles and expectations. Women are also expected to reap benefits from the liberalisation in services. Because of these opportunities, the employment impact of liberalisation of trade in services is likely to be greater to the citizens than will be the liberalisation of trade in goods, making it a crucial part for a successful outcome of the FTA. Liberalisation of services is also likely to impact positively on education, consumer security, health and cultural diversity. The potential impact on productivity or potential risks related to income inequality and social cohesion have not been assessed.

One other win-win effect was identified by the Trade SIA: liberalisation of public procurement is likely to promote social development in GCC countries, notably thanks to a positive effect on the job market.

3. Environmental

The Trade SIA identified clear environmental risks but also clear win-win effects. Generally speaking, trade expansion of industrial sectors is expected to create a burden through increased consumption of natural resources, including energy, water and other resources (the so called scale effect). Particularly important threats were identified for textiles and apparel sectors which are likely to induce short term negative effects and the petrochemicals sector for which negative effects on the environment are foreseen in the medium and longer term.

More specifically, the Trade SIA produced evidence of potential threats as follows:

- the availability of freshwater resources is probably the most important environmental challenge facing all the GCC countries; any increases in scale of production, resulting from trade-induced industry growth could, unless properly handled, result in increasing levels of water pollution;

- the degradation of the coastlines and of marine ecosystems due to marine pollution; A increasing threat linked to trade opening is likely to occur through: increased transportation activities (especially shipping), increased marine-based sources of marine pollution (oil spills, discharge of oily waste and ballast waters), increased land-based sources of pollution (s.a. oil pollution, solid waste, sewage, land-based effluents, heavy metals, and hot brine.) and increased pressures of industrial activity and human settlements;

- the limitation of available lands and deterioration of land resources; there are a number of variables that could pose risks to land in the GCC region as a result of increased industrial activity induced by EC related trade in the specified sectors; in particular, the characteristics of the production process including the use of hazardous products, the over-extraction of water, and the disposal of waste materials are relevant; there may also be a need for increasing infrastructure for production and transportation which can have environmental impacts; where transported goods are inherently dangerous products, such as chemicals, this increases the risks of spillage and the resulting threats to contaminate soil, damage habitats and pose a threat to human health;

- the increased consumption of natural resources, including energy and other resources: increases in trade in various industrial sectors is expected to have impacts along the production chain beginning with the extraction of natural resources and including the use of resources (such as water and energy) in their production processes and in their ultimate transportation.

Conversely, win-win situations were identified, especially in the case of liberalisation of services. There is evidence that the liberalisation of a number of categories of business services could have positive environmental impacts. These include specific areas of expertise related to environmental liability and law-making and regulation, auditing, design and building codes, urban planning, engineering services, measuring and monitoring services, environmental risk analysis, environmental management processes, expertise on environmental impact assessment and other areas of expertise. Liberalisation of financial services is likely to indirectly help improve the management of damage spills caused by accident by the promotion of environmental and social responsibility. Liberalisation of environment services (waste and water management, water treatment…) is expected to have clear and direct environmental benefits.

Finally, the Trade SIA identified innovation and transfer of technology as key factors to ensure mutual supportiveness between the increased production linked to market opening and the limitation of increased environmental pressure; it also stressed the significant contribution that foreign direct investment could have on these two factors. Accordingly, the Trade SIA advocates for the integration of investment provision in the FTA and for joint commitments in the field of public procurement.

B. Sector Specific Assessments

1. Petrochemical sector

Petrochemical production depends mainly on high volume scale production using proven technologies, and on assured access to low or no-cost priced feed stocks within close proximity to reduce transportation costs. On this basis, the Trade SIA suggests that GCC petrochemical exports to the EC should expand once a FTA takes effect. The petrochemical sectors itself, and the connected sectors have the potential of having important economic, environmental and social impacts in the GCC region if increasing exports from the GCC are realized in the coming years.

The Trade SIA identified a range of environmental threats associated with the increased petrochemical production, related to extraction issues of crude oil and natural gas, to the production processes, to the hazardous nature of the products themselves and to risks associated during their lifecycle i.e. the transportation, use, disposal and recycling of these products

The Trade SIA also stressed the likely negative social impacts of increased production on human and worker health linked to the hazardous nature of the substances involved in the petrochemical sector. Reversely, possible positive social effects can be expected through increases in employment in this sector that could benefit notably to GCC citizens.

2. Aluminium sector

This sector SIA focuses on the primary aluminium production. The Trade SIA concludes that unlike in the EC, the production of aluminium in the GCC is expected to increase substantially. It predicts almost a tripling of production in the medium term, with no significant price effect and with some trade diversion e.g. reduction of imports from Russia.

In the long run, due to the FTA and the already planned production increases in the GCC, market penetration by the GCC in the EC is likely to increase. On the short term the FTA is not expected to lead to delocalisation of existing production capacity outside the EC.

According to the Trade SIA this shift of production is likely to have negative effects on global environment through increased emissions of greenhouse gases and positive social effects in the GCC countries notably on employment.

Potential negative social impacts (employment) of the FTA in the EC can be expected in the long run linked to reduced potential for production expansions.

IV. Discussion of the results by the Commission

A. General Remarks

The Trade SIA results are globally coherent with the Commission's own view of the impact of the FTA, both in the EC and in GCC. In particular, the Trade SIA confirms the importance of ensuring that the FTA is negotiated and subsequently implemented in such way as to contribute to sustainable development in both regions – both in social-economic and environmental terms.

While the Commission thus shares the overall results of the Trade SIA, it does have a number of more specific remarks on the study. One shortcoming is that, generally speaking, the Trade SIA focuses mainly on market access in goods and fails to give a robust and comprehensive picture of the impacts of the EC-GCC negotiations in other areas. The Trade SIA falls short of analysing the effect of the negotiation in the following areas:

- The Trade SIA does not acknowledge the existence of the 1989 Cooperation agreement between the EC and the GCC and hence makes a certain number of proposals that fall outside the scope of the FTA in areas such as social development, good governance or environment. In addition, the paper omits to note that the GCC cannot benefit from financial resources from the Community budget given their high level of economic development. While the Commission will be submitting proposals to redress this situation under the new financial perspectives, any future cooperation will be limited in scope and ambition. At any rate, co-operation or enhanced dialogue on various areas highlighted in the text would fall under the framework of the 1989 Cooperation agreement.

- Services: Notwithstanding the favourable impact of service liberalisation described in paragraph III A 2, the report falls short of providing an adequate and balanced assessment of the possible effects of the FTA on sustainable development in relation to services. In particular, the economic prospects do not take services into account at all. The repeated, disperse references to financial services contrast sharply with the limited dedication to most other service sectors (such as telecom, tourism, postal).

- Sanitary and phyto-sanitary measures: the Trade SIA report does not assess the SPS measures in a comprehensible manner and fails to cover the SPS situation in the EC at all.

- Customs Union: the references to the Customs Union do not address what has been put in place in legal and administrative terms since 1993. The control/enforcement side of customs cooperation is not addressed.

- Rules: the competition chapter of the study consists mainly of abstract and rather negative remarks that bring nothing new, although it should be noted that Trade SIA methodology in this area needs further elaboration. Trade Defence Instruments are not mentioned in the report.

- Social impact: the Trade SIA focuses its social impact analysis on employment related issues only. Yet, other factors, such as an increasingly free movement of goods, services and people, which is likely to have a strong modernizing impact on the intra GCC social fabric and will contribute to lowering barriers for example on the free-flow of information, will have to be taken into consideration as well.

B. Economic

The modelling exercise relates only to trade in goods, which is an important limitation as stated above. Beyond this, the analysis provided by the modelling appears sometimes partial and fails to integrate external elements which can be a critical market driver. For instance, reference is made frequently to the growth potential of the textiles sector in the GCC *inter alia* as a consequence of the FTA with the EC. However, the projections made in the Trade SIA for this sector do not seem to recognize the role of China in this sector, especially after its accession to the WTO, nor does it assess the consequences of the full textile liberalisation and end of textile quotas in 2005. In other words, the FTA might have all the consequences the Trade SIA projects, provided that there would still be space for growth (and consequently a market share in the EC) after textiles are fully liberalised in 2005.

The Commission agrees with the finding relating to the advantage of liberalizing public procurement: preferential buying policies directed to local companies and obligations of subcontracting local entities have a negative impact on consumer welfare and on the global economic efficiency.

C. Social

The Commission agrees with the conclusions on the likely positive impact of the liberalization of trade in services for the GCC workforce but questions whether improved employment opportunities for high-skilled nationals due to trade liberalisation in the services sector would be unambiguously positive. The analysis is limited, however, to GCC countries and is not always convincing. In particular the partial lack of data, of clear causal chain analysis, or again of robust economic analysis of the textile sector result in misleading conclusions on the social dimension. No evidence is further provided on the social impact along a number of crucial dimensions such as working conditions, wages and productivity and income distribution and social cohesion. A discussion on related migration flows and its potential economic and social impacts is also missing.

D. Environmental

This report, compared with other Trade SIA studies, shows some progress in defining the "environmental context" and the "environmental priorities". The report significantly focuses on the pressures currently exerted on the GCC countries' environment. This description is pertinent but fails to prioritise impacts and to characterise the significant degree of these potential impacts.

One other weakness is that the risks are not quantified, nor are the impacts estimated or quantified.

Moreover, mitigation and enhancement measures to avoid negative impacts and promote positive trends are not comprehensively described. Furthermore, the cost of such measures is not estimated. The consultants put the focus on stringent environmental regulations and do not put sufficient emphasis on the importance of technology transfer and on capacity building to overcome some of the environmental problems identified in the study.

The Commission believes that not enough attention has been devoted to the issue of <u>greenhouse gas emissions</u>. There is a growing consensus that greenhouse gas emissions must be reduced of an order of 70% globally this century, to avoid the worst effects of climate change. Thus, measures that further increase petroleum production and export are not sustainable. In the discussions under the UNFCCC (United Nations Framework Convention on Climate Change) it has been recommended that the Gulf countries should <u>diversify</u> their economies away from petroleum (and petroleum products) in prevision to the long term reduction in petroleum use worldwide. The issue of climate change is also very significant for aluminium if the climate change costs are not internalised.

E. Sector Specific Impact Assessments

1. Petrochemical Sector

The Commission shares to a certain extent the analysis of the consultant. However, on the one hand, the economic consequences for the EC petrochemical industry should be further analysed and taken into account in the current tariff and price context.

In addition, given the period when the study was carried out, it does not take into account the economic impact of the bilateral trade agreements between Gulf countries and the US, which are currently being negotiated or put into force. On the other hand, the analysis of the positive effect of the FTA in this sector on female employment would deserve a more detailed and thorough analysis. One could wonder whether the increase of activity in this sector will rather result in a more significant number of foreign employees. Further evidence would also be needed on the likely impact on productivity and wages as well as on working conditions.

2. Aluminium Sector

The section on aluminium fails to provide an in-depth industrial analysis and a strategic and dynamic vision of the sector in the mid- and long-term. In addition, the model used is inadequate for this sector e.g. the report ignores the specificities of the aluminium price building mechanism in Europe and assumes instead that prices follow the “normal” logic of supply and demand changes.

In the mid-term, GCC producers will increasingly face Chinese competition on the whole Asian market. It is clear that Chinese capacities are developing extremely rapidly. In this context, an open EC market will become a strategic market for GCC countries which will be granted preferential market access.

In broad terms, the consultant reaches the conclusion that the EC producers will lose slightly with the liberalisation and that EC consumers will gain slightly, but that overall profits will be higher than the losses in terms of welfare. This is a rather general conclusion and applicable to any liberalisation whatever the sector, rather than specific to this sector. To come to solid conclusions, a much more detailed assessment on the impact of the FTA on current EC primary producers, EC consumers, current trading partners, trading companies, the LME price and the EC premium system would be required. Because of a lack of clear and convincing evidences, the Trade SIA fails to make the case that the FTA will bring about a decrease of EC production and reversely an increase of GCC imports.

On the social impact, the reasoning is that European production will remain stable (even if it is no longer competitive), due to the fact that internal demand increases. This is also not sufficiently supported by evidence.

V. Commission view of the Trade SIA results: ensuring policy coherence and sustainable development

As stated under point IV above, the Trade SIA results are globally coherent with the Commission’s own analysis of the impact of the FTA both in the EC and in GCC. To ensure that the planned FTA will genuinely contribute to achieving sustainable development (both in socio-economic and environmental terms) the Commission will pay particular attention of the Trade SIA results in the following areas:

A) The text of the FTA

1. Explicit provisions regarding sustainable development

The Trade SIA stresses the need to integrate ambitious social and environmental provisions in the FTA in order to reflect the shared commitment of the EC and GCC to the three pillars of sustainable development and to optimise the contribution of the FTA to sustainable development. The Commission shares this analysis, and proposes to reflect it in the preamble of the FTA which describes the strategic objectives and recalls the context of the agreement.

2. Foreign Direct Investments

The Trade SIA concludes that liberalisation of FDI and in particular of ownership rules would have a clear positive effect on economic growth and social development as well as on environmental resources. In particular, the Trade SIA report notes the positive effect of FDI liberalisation on the GCC's economy and environment through increased transfer of environmentally-friendly technology and diversification of GCC economies away from the oil sector. This effect is highlighted in general but also for the two sectors that will benefit from the highest growth due to the FTA i.e. aluminium and petrochemicals.

By and large, the Commission agrees with this analysis and is seeking to secure investment commitments within the FTA as well as liberalisation in the financial services sector which plays a key role in the management of FDI.

3. Public Procurement

The Trade SIA reports that the economic and social benefits of liberalization in the services and good sectors would be strongly enhanced by a parallel liberalization of public procurement.

The analysis confirms the relevance of reciprocal and progressive liberalisation of public procurement aimed at ensuring comparable and effective access to their procurement markets on the basis of the principles of non-discrimination and national treatment. The Commission intends therefore to pursue its efforts within the negotiations to reach this objective

4. Services

The Trade SIA points out the positive impacts of a further liberalisation of services on sustainable growth notably through better environmental management capacities and increased job opportunities for GCC citizens. The impact of increased economic activity on water resources, coastal and marine areas, and land use could clearly be mitigated through environmental services like water and wastewater treatment, remediation of contaminated land, waste management, environmental monitoring and implementation. Commitments in sectors where medium to high skilled manpower is required would provide suitable jobs for nationals and opportunities to the highly educated female workforce.

In this context, the Commission is seeking to negotiate the broadest coverage possible of service commitments and ensure that all relevant services sectors i.e. business services, communication services, construction and related engineering services, distribution services, environmental services, financial services, and transport services are addressed by significant commitments.

B) <u>Implementation of the FTA</u>

The Trade SIA shows that negotiating a good agreement is not enough: sufficient attention should in due course be paid to its implementation and to coordination with cooperation and regulatory policies.

1. Social and environmental considerations

The Trade SIA report points out that long term benefits of the trade liberalisation between the EC and GCC countries will depend in particular on the institutional and governance framework – including in the environmental and social fields. The Trade SIA stresses that the agreement should prevent that countries gain or defend market shares or improve comparative advantage by depriving workers of basic labour rights or by disregarding or weakening social or environmental standards in the context of market opening.

Against this background, the Commission's position is that the FTA should not cause health, safety or environmental standards to be compromised in order to increase exports or attract foreign investment and that existing laws should be enforced.

On the basis of the Trade SIA outcomes, the following avenues could be explored:

1) **monitoring** the FTA implementation and in particular its sustainability;

2) **focussing on an effective dialogue** on regulation, standards and shared commitments in the framework of the FTA implementation.

While not formally part of the FTA, the Commission will also seek to promote a dialogue with GCC on labour rights, social development, good governance, environmental and health protection. The dialogue could emphasise the importance of core labour standards, appropriate labour market policies and educational systems targeting the private sector's needs in order to secure that employment increases following the liberalisation of services will in fact benefit the national labour force in the GCC countries.

2. Monitoring the FTA implementation

In the implementation of the FTA, the Commission will seek to ensure that due attention is paid to the pertinent outcomes of the Trade SIA and will consider an ex-post Trade SIA to take stock of the situation. Nevertheless, the expected costs and benefits of an ex-post Trade SIA should be seriously considered before launching one.

3. Focussing on an effective regulatory dialogue

The Trade SIA highlights the significant potential of an effective regulatory dialogue to promote trade and investment flows between the EC and GCC while taking into account economic, social and environmental impacts and strengthening sustainable development and the social dimension of globalisation. The agreement would provide a stable framework for such a dialogue.

In the framework of the GCC Customs Union, GCC member countries are working toward unifying their standards system or developing a single standards organization, in accordance with the desire to harmonise to ensure the effective functioning of the new Customs Union.

In the context of the FTA implementation, the Commission will seek to promote a regular dialogue with the GCC namely on SPS and TBT with a view to foster mutual understanding on SD, better sharing of expertises and building confidence.

4. Cooperation

The Trade SIA strongly advocates joint cooperation projects that would enable to address some environmental and social challenges arising from the FTA and promote joint action to promote sustainable development and to strengthen the social dimension of globalisation. In any case, points made in Section IV.A on cooperation activities are to be taken into account.