

EU PERFORMANCE
GLOBAL ECONOMY

GLOBAL EUROPE

EU performance in the global economy



EUROPEAN COMMISSION



DIRECTORATE GENERAL FOR TRADE

Foreword: Global Europe two years on

In 2006 the European Commission set out a broad new approach to European trade policy priorities entitled Global Europe. The case that the Commission made in 2006 was a simple one. In a globalised economy, in which Europe sources and sells goods down long global supply chains, Europe's economic strength at home depended on its competitiveness in the world.

But the Global Europe prescription was wide-ranging. It argued that we should focus our manufacturing and export industries on sectors in which we are internationally competitive, keep our own markets open to trade and focus our resources on ensuring that others were open to our trade. This matters in large established markets, but also in our fastest growing trading partners like China and the other growing Asian markets.

Over the last two years European trade policy has adapted to these new priorities. As well as being a firm defender of the WTO and the Doha Round of world trade talks, we have launched new free trade agreements with India, Korea and the South East Asian countries. We have focused new resources on important questions like ensuring that EU companies have fair access to supplies of raw materials for manufacturing, improving intellectual property rights protection and tackling the barriers to European exports on the ground in our most important markets. We have established a close new trade dialogue with China.

The purpose of this report is to assess the economic picture behind these policies after two years. What it finds is that the case for Global Europe remains as strong as ever. Europe continues to draw huge benefits from the global economy – sourcing products from around the world for transformation by manufacturers here, and dominating many global export markets. Our strengths remain as Global Europe described them: exports in which expert knowledge and skilled production are key.

The basic policy prescription must be that we continue to nurture these strengths. The global economy has entered a period of considerable uncertainty. This is the time to be focusing on Europe's long term economic future. Global Europe helps us do that.

EXECUTIVE SUMMARY

This report examines recent changes in the international performance of the EU in the context of the rise of China, India and other major economies. This creates both more competitive pressures and new opportunities. More specifically, the report looks at the changes in specialisation and market shares of the EU on external markets (excluding intra-EU trade flows) over a 10 year period.

The report highlights the following:

(i) Since the mid-1990s, there has been a major redistribution of market share between emerging and developed countries and among developed countries themselves. In this highly competitive environment, the EU¹ has managed to maintain its world market share at 19.5% for merchandise trade (excluding energy), losing only 1.3 percentage points over the period.

(ii) Market share losses are much greater in the case of the US and Japan, falling by 4.4 and 4.1 percentage points respectively. The US and Japan now respectively account for 13.0% and 9.5% of the world market.

(iii) Thanks to some of its key assets such as chemicals, pharmacy products, motor vehicles and non-electrical machinery, the European Union's trade balance for manufactured products is improving greatly, reaching a surplus of €162bn in 2007. The jump of €105bn since 2000 has helped to partially offset the rise in the energy bill, for which the deficit increased by €137bn over the same period.

(iv) In the meanwhile, developing countries have generally reinforced their position as global exporters. China is by far the most remarkable performer: it has almost doubled its overall market share since 1995, reaching 14.1% to overtake the US.

(v) The EU's good performance compared to the United States or Japan is due to an upgrading of the quality of its products, combined with the ability of EU companies to sell products at premium price because of quality, branding and related services. These "upmarket" products now account for a third of world demand and represent half of EU exports, not only in luxury consumer goods, but across the whole range of products, including intermediary goods, machinery and transport equipment. Building on this ability to sell products at premium price is the only way to uphold EU levels of social protection, employment and wages.

(vi) With 18.5% of the world market for high-tech products, the EU has become the principal exporter ahead of the US and Japan. The EU's performance is, however, disappointing in that its market share for this type of products is slightly lower than its overall market share. Given its level of development, the EU should do much better with high-tech products than for the rest of its exports. This raises concerns about the EU's capacity in the future to keep its products at the cutting edge of quality and innovation.

(vii) The EU's export performance is uneven, varying significantly between destination markets over the reference period. Worrying signs come from the fact that the EU has lost significant market share on some of the fast-growing emerging markets, particularly in Asia. In the long run, this underperformance on some of the most promising markets could undermine overall the EU's position in international trade.

(viii) Two thirds of EU extra-EU imports are incorporated as inputs in the production process. This very high share of inputs in total EU imports, even when energy products are excluded,

¹ In all the report.

demonstrates very clearly that the EU as a whole relies heavily on global sources for inputs incorporated in its production process.

(ix) In the field of exchange of services, the EU is the leading exporter with 26.9% of the world market against 19.7% for the US and 6.1% for Japan. Moreover, the EU has expanded its share of world trade in most broad service categories except transport services, in contrast to developments in the US.

(x) With regard to foreign investments, the European Union is the world's biggest investor and the principal host. When intra-EU stocks are excluded, the EU owns 33% and hosts 29% of world investment stocks.

(xi) The EU has higher ratios of inward and outward investments to GDP than the US and most other developed countries, which means that the EU is comparatively more open to foreign investments and more willing to invest abroad than countries of a similar level of development and in particular the US.



EU PERFORMANCE IN THE GLOBAL ECONOMY

1. INTRODUCTION

The Communication adopted by the Commission in October 2006 entitled "Global Europe: competing in the world"² marked the launch of the EU Global Europe strategy as an important step forward in European trade policy. Its main focus was on the wider picture beyond current WTO negotiations, with trade policy being seen as part of the wider globalisation agenda. The aim was to make sure that the most important challenges and pressures of the global age were addressed, and that EU trade instruments were fit for that purpose. This Communication set out an agenda for opening the most important markets, and for keeping the EU's markets open, competitive and protected against unfair trade. It represented an agenda based on positive reciprocity – reciprocal opening, not closing, of markets.

This agenda has already translated itself into concrete initiatives in virtually all areas of trade policy: free trade agreement negotiations are ongoing with South Korea, India, and ASEAN countries; the market access strategy has been reviewed, based on a new partnership with Member States and industry; an in-depth exercise has been launched with the US to tackle transatlantic obstacles to trade and investment; a vision for the EU's relationship with China has been set out with the result that a new partnership and cooperation agreement is being negotiated and a High Level Trade Mechanism is in place; a list of priority countries for intellectual property rights (IPR) enforcement has been published and new IPR dialogues have been set up with these countries; negotiation of the Anti-Counterfeit Trade Agreement, in which the EU should play a key role, will set a new international standard in terms of IPR enforcement; finally, a comprehensive review of the single market has been proposed to widen its regulatory reach outside the borders of the EU and ensure that European citizens share the benefits of globalisation through better standards, lower prices and greater choice.

² COM (2006) 567.

Two years after publication of the "Global Europe" Communication, the present report seeks to measure EU performance in the global competitive environment³. It should thus be possible to verify whether the 2006 Commission diagnosis that led to definition of the Global Europe trade policy agenda still holds regarding EU strengths and weaknesses in international trade.

The remainder of this report is organised as follows: The first section discusses EU specialisation in international trade. The second section analyses how market shares on a world scale have been redistributed among the major players, by import markets but also according to the technology content and the level of quality of the traded products. The following section looks at import of goods. Sections five and six deal respectively with the exchange of services and foreign direct investments. The last section sums up the main findings and draws conclusions.

2. EUROPEAN SPECIALISATION

2.1. Changes in comparative advantages for the main economic sectors

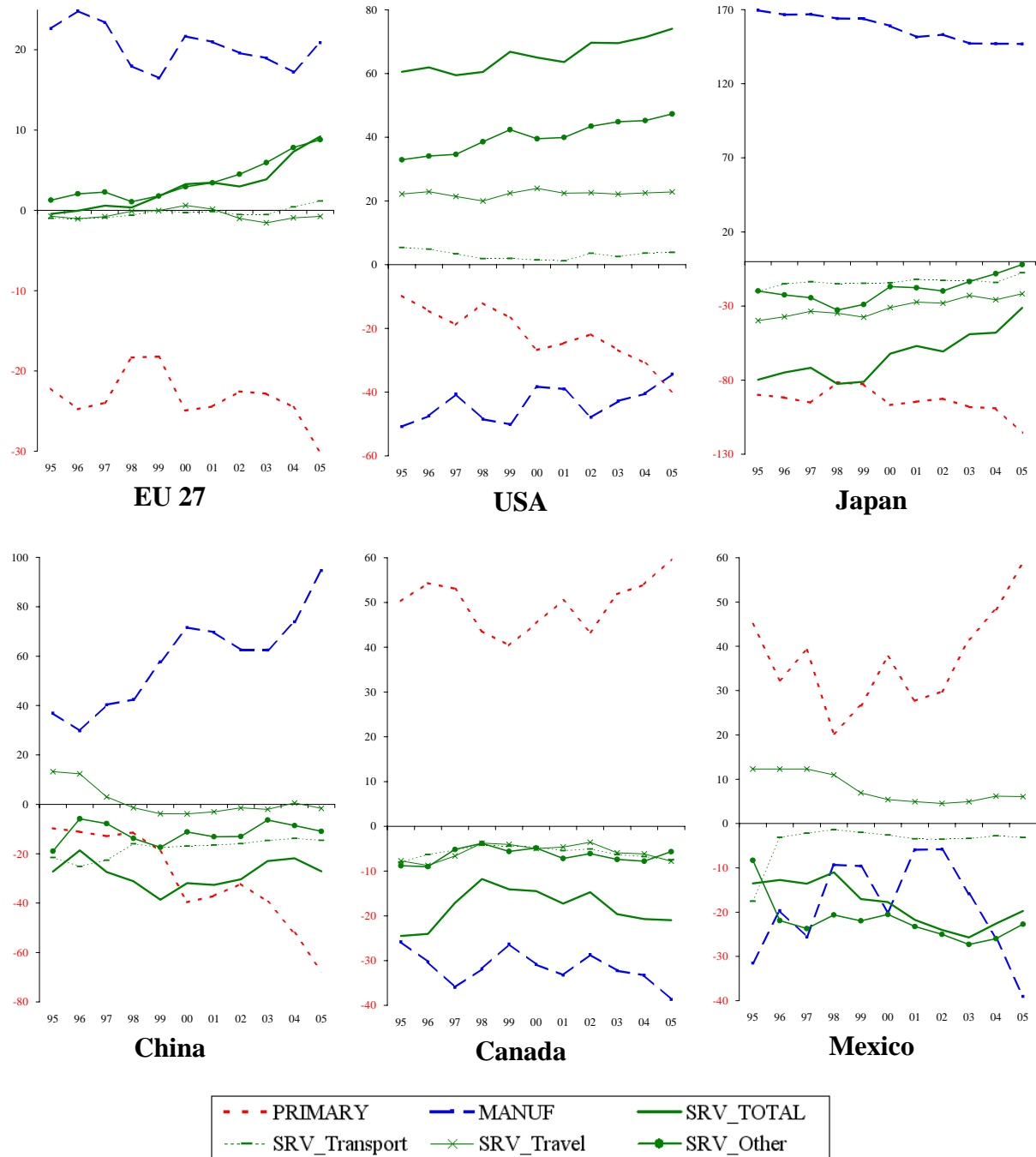
A traditional way of measuring the relative specialisation of a country by sector is to look at its comparative advantages and disadvantages⁴. Having a relative comparative advantage in a given sector means that the country concerned has a better export over import ratio in this sector than for the rest of its economic sectors. As such, the concept of comparative advantage does not provide information on the overall level of competitiveness of the country. This is the object of the market shares analysis illustrated in the next section.

Most developed countries exhibit a comparative disadvantage in the primary sector, in contrast to resource-based economies like Mexico, Canada, Russia or Brazil. More interestingly, the dividing line between economies that are advantaged or disadvantaged in the export of services does not correspond to the split in income levels. We observe a sharp contrast between economies with advantages in services, notably the US, Turkey or India, and countries specialised in manufacturing activities like Japan, China, India and the European Union. The index is expressed here in thousands of dollars of total trade and adds up to zero over the sectors. It can be interpreted as a measure of the "revealed" comparative advantage. A positive (negative) value for the indicator shows that the country has a comparative advantage (disadvantage) for the sector in question.

³ See also the 2008 European Competitiveness Report which constitutes the Commission's key annual document analysing the competitiveness of EU industry.

⁴ International specialisation is measured here using an indicator of the contribution of a given sector to the trade balance. This index compares the actual trade balance of a country for the sector, with a theoretical balance assuming the absence of specialisation. We are indebted to I. Bensidoun and D. Ünal-Kesenci for having computed these indicators of revealed comparative advantage based on the CEPII-CHELEM database. The related methodology is detailed in Bensidoun and Ünal-Kesenci (2007), CEPII Working Paper 2007-14. English version available as OECD Statistics Working Paper, January 2008, "Globalisation in services: from measurement to analysis".

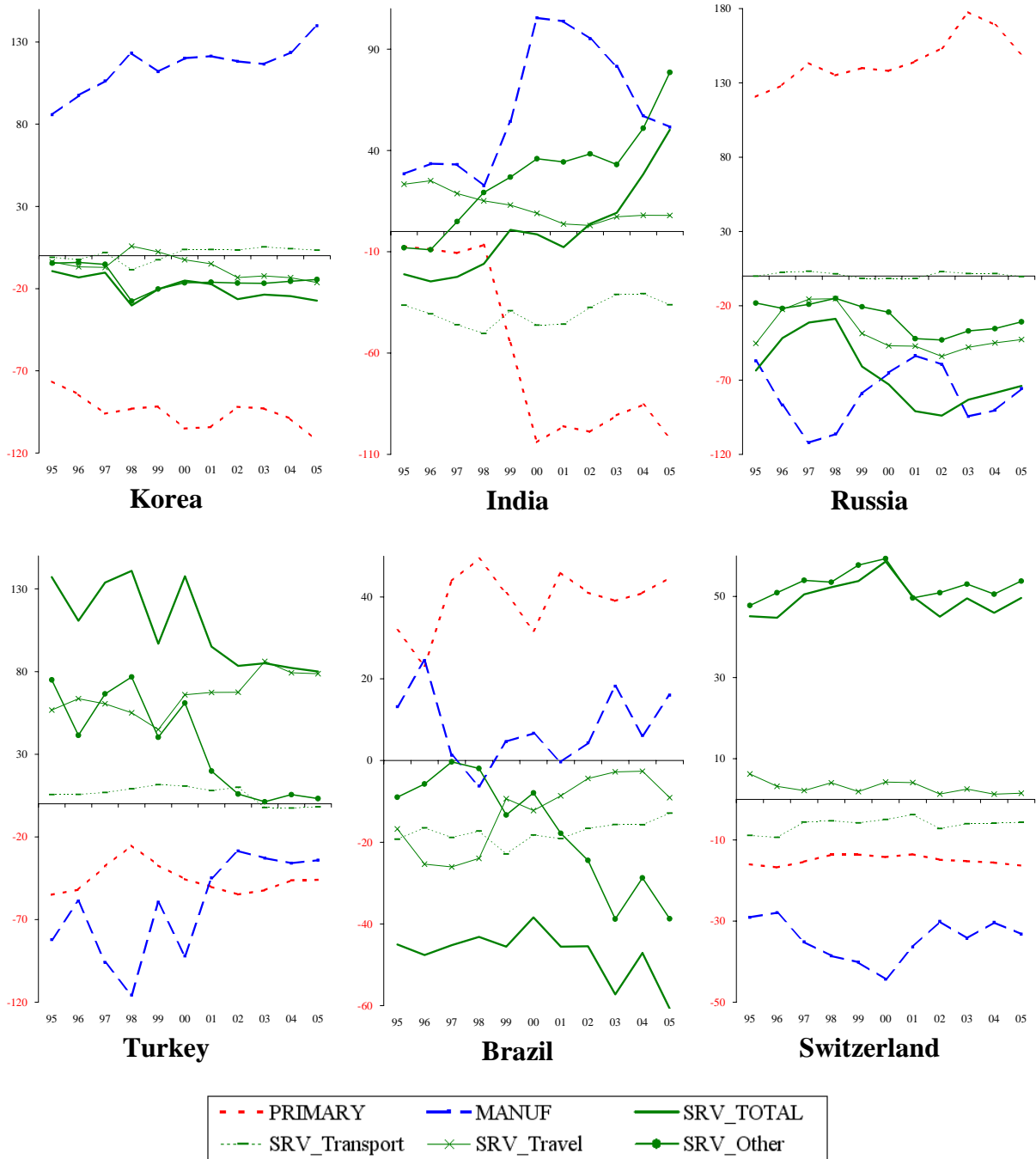
Figure 1
International specialisation of European Union and main competitors (1/2)
(contribution to the trade in goods & services balance, in thousands of total trade)



To allow for comparison, all the 27 Member States are artificially considered as members of the European Union over the entire period

Source: CHELEM database, CEPII (see footnote 1)

Figure 2
International specialisation of European Union and main competitors (2/2)
(contribution to the trade in goods & services balance, in thousands of total trade)

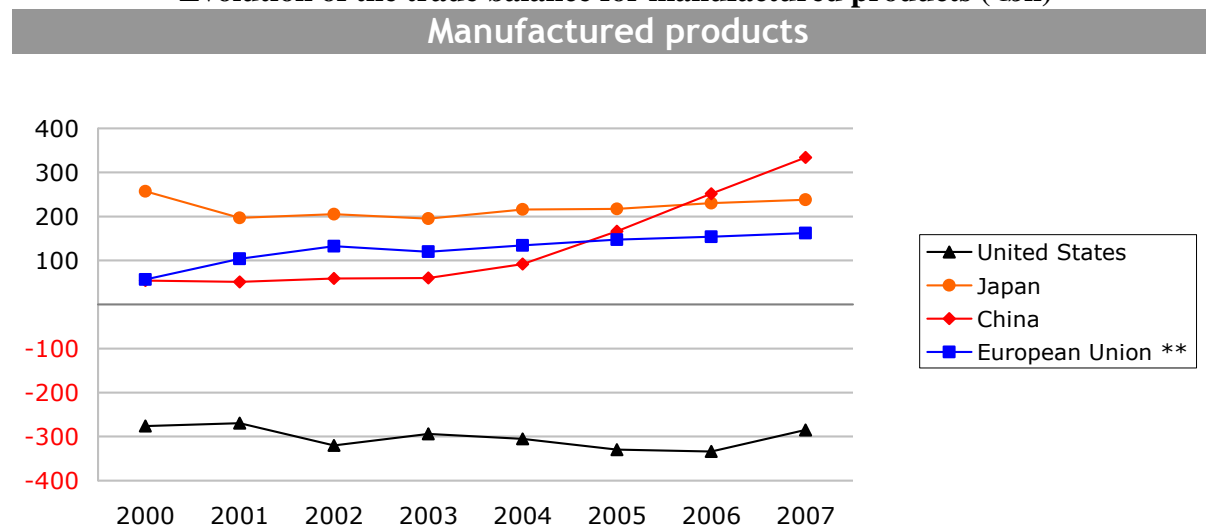


Source: CHELEM database, CEPII

2.2. Evolution of world trade in manufactured goods

The 2000-2007 period marks a clear turning point for the world economy. Emerging economies, most notably China, widened their investment base from textile to other industrial sectors. Most industrialised countries now face a trade deficit with China in the following sectors: office and telecommunication equipment and electrical machinery.

Figure 3
Evolution of the trade balance for manufactured products (€bn)



** To allow for comparison, all the 25 Member States are artificially considered as members of the European Union over the entire period.

Source: Eurostat

The European Union's trade balance for manufactured products is improving considerably, reaching €162bn. The jump of €105bn between 2000 and 2007 has helped to partially offset the rise in the energy bill, for which the deficit increased by €137bn. In parallel, the agricultural deficit rose from €20bn to €28bn.

In the manufacturing sector, the EU increases its surplus by relying on its proven assets. With export levels in the non-electrical machinery, motor vehicles, plastic products, pharmaceutical products, paper and paper articles sectors all being about twice as high as import levels, they account for the bulk of the EU's surplus in manufactured products. The balance on non-electrical machinery improved during the period by €68bn, motor vehicles by €25bn, pharmaceutical products by about €22bn, and plastic products by €7bn.

In contrast, the EU's trade deficit in office and telecommunication equipment worsened by €17.5bn, reaching the very high level of €88bn, with an import coverage ratio below 50%. The EU also experienced a severe decline in the textile and clothing sector, with a €16Bn worsening of its trade balance, which stands at €46bn.

Japan's massive surplus in manufactured products has been slightly reduced by €18bn, standing at €238bn. Concentrating on non-electrical machinery, motor vehicles and plastics, Japan is losing ground on office and telecommunication equipment and electrical machinery and apparatus, where its trade surplus has been halved.

Meanwhile, the United States' colossal deficit in manufactured goods has remained almost stable, with only a moderate increase by €9bn over the period, standing at €285bn. Starting

from massive imbalances, the automobile trade deficit has been reduced by €32bn and now stands at €108bn, while the office and telecom equipment deficit increased by €7bn, standing at €60bn. Furthermore, the US went from a trade balance to a deficit of €14bn in the pharmaceutical sector.

Overall, China's trade surplus is rocketing reaching €334bn in 2007, an increase of €280bn over the period. China has strengthened its global leadership in textile-clothing and other labour-intensive manufactured goods (furniture, toys, shoes, for instance), while also asserting itself in the office and telecommunication equipment sectors, and to a lesser extent in machinery and electrical goods.

The EU's deficit in manufactured goods with China grew from €47bn in 2000 to €159bn in 2007. Three sectors share the responsibility for this development: office and telecommunication equipment (EU deficit increased by €54bn), textiles and clothing (EU deficit increased by €17bn) and “manufactured items” (toys, shoes, furniture, etc., EU deficit increased by €33bn, standing at €57bn). Yet, some improvements took place in the non-electrical machinery sector as well as in motor vehicles and transport equipment (€8bn overall).

Trade imbalances between the US and China have intensified during the period for most industrial sectors. Again, office and telecommunication equipment, textile-clothing, “various manufactured goods”, electrical and non-electrical machinery contributed the most to a doubling of the US's deficit with this country between 2000 and 2007 in the manufacturing sector (€203bn in 2007).

Vis-à-vis China, Japan's experience is rather different. Japan's deficit for manufactured products has been reduced by €4bn, and stands at €14bn, despite a small but growing deficit in office and telecom equipment (€5bn) and a stable deficit in the textile and clothing sector at €15bn.

3. HOW HAVE GLOBAL MARKET SHARES BEEN REDISTRIBUTED ?

3.1. Evidence from the world market

In order to have an indication of EU competitiveness in third markets, this section concentrates on the evolutions of EU shares in goods trade (manufacturing and agro-food products) excluding energy products. Keeping these products in the trade data would blur the analysis as they are characterised by high volatility of prices with no direct link to the competitiveness of the producing economy.

Excluding mineral products, specific and non-classified products, and excluding intra-EU trade, the EU⁵ had a 20.8% world market share by value in 1995. This market share has only been slightly negatively affected by competitive pressures from emerging economies, falling to 19.8% in 2004 and 19.5% in 2005 (Table 1)⁶. It means that, despite the 8-point rise of

⁵ To allow for comparison, all the 27 Member States are artificially considered as members of the European Union over the entire period.

⁶ Market share is computed by CEPII on the basis of its newly available world database for international trade analysis at the product level "BACI". BACI provides the most disaggregated international trade database (more than 5000 products) for the largest number of countries (over 200) and years (from 1995), with special emphasis on the treatment of unit values. Original procedures are developed to

China over the same period, the EU market share remained almost stable, losing only 1.3 percentage points. In the meanwhile, Japan and the US lost market shares more rapidly, with 4.4 and 4.1 percentage point decline respectively. The US and Japan respectively now account for 13.0% and 9.5% of world market share.

In the meanwhile, developing countries have generally reinforced their position as global exporters. China is by far the most remarkable performer, having almost doubled its overall market share to 14.1% since 1995.

The EU's market share is decreasing more in volume terms than in value, pointing to an upgrading of EU exports over the period. In addition, the EU25 is doing slightly better than EU15, suggesting a better overall export performance by the new Member States.

Table 1

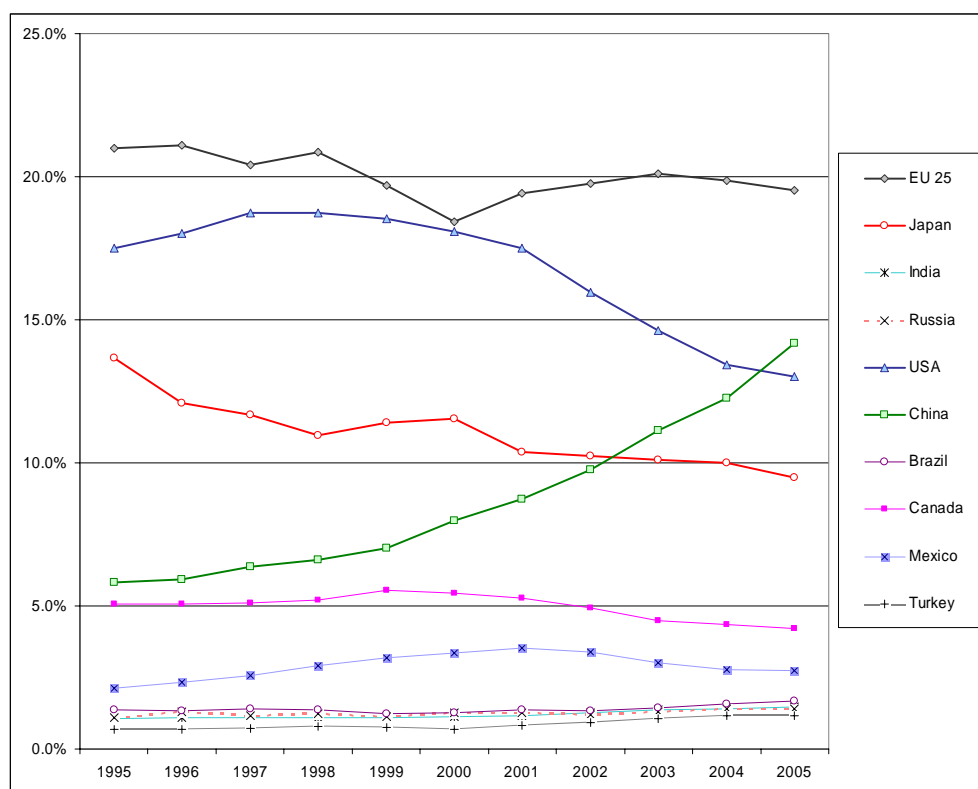
Change in EU 15/25 world market share 1995-2005, in value and volume terms

Exporter	Value terms						Volume terms		
	Market share (percent)				Percentage point change in market share		Market share (percent)		Percentage point change in market share
	1995	1996	2004	2005	1996-2004	1995-2005	1996	2004	1996-2004
EU25	20.8	21.0	19.8	19.5	-1.2	-1.3	19.2	17.5	-1.7
EU15	20.2	20.3	18.8	18.4	-1.5	-1.8	18.6	16.7	-1.9

Source: BACI, CEPII calculations

reconcile data reported by countries to United Nations COMTRADE. See: Gaulier, G. and S. Zignago (2008), "BACI: A World Database of International Trade at the Product-level", CEPII Working Paper, 2008. The last available year for data is 2005.

Figure 4
Evolution of market share, value terms, 1995-2005



Source: BACI, CEPII calculations

Table 2
Change in world market share 1995-2005, by exporter, in value and volume terms (%)

Exporter	Market share, p.p. change in		Market share p.p. change in		Market share p.p. change in	
	in value (USD)	market share in value	in value (USD)	market share in value	in volume	market share in volume
	2005	1995-2005	2004	1996-2004	2004	1996-2004
EU 15	18.4	-1.77	18.8	-1.47	16.7	-1.90
EU 25	19.5	-1.33	19.8	-1.17	17.5	-1.70
USA	13.0	-4.41	13.4	-4.53	15.1	-5.26
Canada	4.2	-0.83	4.3	-0.70	4.5	-1.12
Mexico	2.7	0.62	2.8	0.45	2.4	0.60
Japan	9.5	-4.12	10.0	-2.05	10.9	-1.87
China	14.1	8.37	12.2	6.32	12.9	7.05
Korea	4.3	0.68	4.4	0.85	4.2	0.74
India	1.5	0.44	1.4	0.29	1.5	0.43
ASEAN	8.7	0.13	8.7	-0.07	9.5	0.41
Russia	1.4	0.31	1.4	0.12	1.2	-0.03
Turkey	1.2	0.00	1.1	0.47	1.0	0.39
Other Mediterranean	1.3	0.00	1.3	0.22	1.3	0.23
Brazil	1.7	0.31	1.6	0.24	1.6	0.40
Other Mercosur	0.6	0.00	0.6	-0.15	0.6	-0.07
Rest of the world	16.4	-0.01	16.9	-0.29	15.9	-0.22

Source: BACI, CEPII calculations

3.2. Evidence by import market

The EU's export performance has been uneven, varying significantly between destination markets over the period (Table 3 and 4). Worrying signs come from the fact that the EU suffered significant losses on some of the most dynamic importing markets during the decade. This is in particular the case in Asian markets (11 percentage points loss in India, for instance) and in Russia (9 percentage points). Nonetheless, the EU's share on many of these key markets remains above its global market share.

The EU's market share in China is below its global market share and losses are slightly greater than those experienced by Japan or even the US over the period, despite a reverse trend at the global level. In the long run, this underperformance on some of the most promising markets could undermine overall the EU's position in international trade.

In contrast, EU market share in the US remained stable over the period (1.5 percentage point increase) at one fifth of the import market in 2005. This performance coincided with a shrinking share of Japanese exports in this market (-8 percentage points) and, to a lesser extent, those of some Asian competitors other than China.

Table 3

Change in market shares (in value terms) 1995-2005, by exporter, for selected markets (1/2)

Market	USA		Japan		China	
	Market share (%)	p.p. change	Market share (%)	p.p. change	Market share (%)	p.p. change
Exporter	2005	1995-2005	2005	1995-2005	2005	1995-2005
EU 15	20.1	1.17	15.6	-2.32	13.5	-2.02
EU 25	20.8	1.53	16.1	-2.06	14.0	-1.82
USA			16.3	-9.76	9.0	-1.28
Canada	16.2	-2.74	1.9	-1.12	1.2	-1.31
Mexico	10.6	2.29	0.6	0.22	0.3	0.17
Japan	10.1	-8.06			16.6	-1.41
China	16.1	10.46	28.8	16.70		
Korea	3.2	-0.43	6.0	-0.32	12.0	5.05
India	1.4	0.52	0.6	-0.28	0.8	0.53
ASEAN	7.3	-1.98	14.2	1.04	11.1	4.68
Russia	0.5	-0.08	0.9	-0.72	1.5	-0.85
Turkey	0.4	0.00	0.1	0.00	0.1	0.00
Other Mediterranean	1.5	0.00	0.4	0.00	0.3	0.00
Brazil	1.6	0.33	0.8	-0.30	1.0	0.06
Other Mercosur	0.2	0.00	0.1	0.00	0.7	0.00
Rest of the World	10.2	-0.02	13.3	-0.03	31.4	-0.04

Source: BACI, CEPII calculations

While remaining India's principal trade partner with 28% of imports of manufactured products, the EU experienced a large loss of 11 percentage points market share over the period in this very promising market. Similarly, the EU's share of the Russian market shrank by 9 percentage points but it remains at a very high level with 54% of the market for manufactured products.

Table 4

**Change in market shares (in value terms) 1995-2005, by exporter, for selected markets
(2/2)**

Market	India		Brazil		Russia	
	Market share (%)	share p.p. change 1995-2005	Market share (%)	share p.p. change 1995-2005	Market share (%)	share p.p. change 1995-2005
Exporter	2005	1995-2005	2005	1995-2005	2005	1995-2005
EU 15	27.2	-10.71	29.6	-1.74	45.5	-5.99
EU 25	28.0	-11.12	30.5	-1.17	54.0	-9.13
USA	9.0	-2.21	20.1	-4.44	3.7	-3.35
Canada	0.9	-0.16	1.4	-0.84	0.4	0.04
Mexico	0.1	-0.05	1.5	-0.32	0.1	0.03
Japan	3.9	-4.06	5.2	-0.45	4.2	1.35
China	10.0	7.53	8.9	7.97	7.1	2.85
Korea	4.9	1.22	4.0	1.04	3.5	0.01
India			0.9	0.66	0.7	-1.98
ASEAN	10.5	1.58	4.6	1.84	1.8	-2.11
Russia	2.6	0.05	1.1	0.82		
Turkey	0.3	0.00	0.2	0.00	1.8	-0.01
Other Mediterranean	2.4	-0.01	1.3	0.01	0.5	-0.01
Brazil	1.0	-0.04			2.5	1.03
Other Mercosur	0.7	0.00	9.8	-0.05	0.7	0.00
Rest of the world	25.5	0.08	10.5	-0.01	18.8	0.13

Source: BACI, CEPII calculations

South America in general, and Brazil in particular, as the largest country of the region, are historical trade partners of many European countries. The import market share enjoyed by the EU in Brazil therefore tends to significantly exceed its global market share. Here, the losses are quite limited (-1 percentage point). Note that the US losses on the Brazilian market are more pronounced than those of the EU. Not surprisingly, the gains of Asian exporters are impressive, with the exception of Japan.

3.3. Performances in high-tech and top range quality products

With 18.5% of the world market for high-tech products, the EU has become the principal exporter ahead of the US and Japan. The EU's market share for this type of product is, however, slightly lower than its overall market share, which constitutes poor performance. Given its level of development, the EU should do much better with high-tech products than with the rest of its exports. This raises concerns about the EU's capacity in the future to keep its products at the cutting edge of quality and innovation. In addition, the EU is losing more market share in high-tech products⁷ than in the other product categories: 2.4 percentage points compared to 1.3. However, the recorded losses are three to four times smaller than those of the United States or Japan (respectively 8 percentage points and 6 percentage points; Table 5).

Table 5

**Change in world market share (value terms) for high-tech products
EU25 and its main competitors**

	Market share value terms (%)	in p.p. change in market share
Exporter	2005	1995-2005
EU25	18.51	-2.39
Japan	10.33	-6.44
Korea	5.79	2.45
India	0.41	0.07
Russia	0.60	0.25
USA	16.47	-8.11
Canada	2.52	-0.96
Mexico	1.90	0.46
China	15.93	12.36
Other Mediterranean	0.84	0.04
Turkey	0.11	0.05
Other Mercosur	0.94	0.54
Brazil	0.84	0.53
ASEAN	11.96	0.73
Rest of the World	4.38	-1.36

Source: BACI, CEPII calculations

⁷ Defined by the joint Eurostat-OECD list of high-tech products.

China is rapidly catching up (market share gains of 12 percentage points over the period, now at 16% of world market share). It is, however, partly an optical illusion due to a massive relocation of product assembly to mainland China. In parallel, Korea has managed to increase its market share by 2.5 percentage points even in this very competitive environment.

Table 6
Change in world market share (value terms) by market segment
EU25 and its main competitors

	Low-market		Mid-market		Up-market	
	Market share	p.p. change	Market share	p.p. change	Market share	p.p. change
Exporter	2004	1995-2004	2004	1995-2004	2004	1995-2004
	(%)		(%)		(%)	
EU25	15.3	-2.27	17.5	-1.95	30.0	0.40
Japan	7.2	-2.55	10.9	-5.74	14.1	-4.45
Korea	4.8	0.20	5.0	1.38	4.4	0.47
India	2.2	0.82	1.4	0.42	0.8	0.36
Russia	1.5	0.45	2.1	0.58	0.8	0.47
USA	12.1	-4.42	12.7	-4.11	14.4	-3.47
Canada	4.2	-1.08	5.0	-0.68	3.1	0.16
Mexico	3.8	-0.37	3.5	1.41	1.6	0.91
China	19.5	10.56	9.1	4.84	4.1	2.42
Other Mediterranean	1.0	0.22	1.1	0.11	1.2	0.14
Turkey	1.2	0.44	1.5	0.62	1.0	0.41
Other Mercosur	0.7	-0.15	0.8	-0.11	0.4	-0.16
Brazil	2.0	0.32	2.2	0.21	0.8	0.01
ASEAN	8.7	-1.16	10.3	2.41	8.7	1.43
Rest of the World	15.7	-1.02	16.8	0.61	14.6	0.90

Source: BACI, CEPII calculations

A different dimension of competition on the world market is provided by the positioning of exported varieties in terms of vertical differentiation. Here, trade flows are classified into three large similar-size quality ranges according to the principle that high-quality products (upmarket) are also the more expensive ones, i.e. have the highest unit values⁸. Nevertheless, besides intrinsic quality this taxonomy reflects additional aspects, such as trademark effects or the capacity of a country to sell its products at higher prices than the world average thanks to quality, related service, branding or innovation.

The upmarket positioning of EU exporters is confirmed by such analysis. On the whole, the EU has a market share that is twice as high for top range products compared to those in the middle or lower range. To some extent, Japan exhibits a similar pattern. However, Japan is losing ground in all ranges of products, while the EU's losses in bottom and middle range products contrast with the gains albeit modest in market share for top range products. Chinese gains are concentrated in the bottom segment of the market, even if Chinese exporters (actually mostly foreign firms assembling in China) have started to gain market share in the upper segment of the market.

These "upmarket" products now account for a third of world demand and represent half of European exports, not only in luxury consumer goods, but across the whole range of EU exports, including intermediary goods, machinery and transport equipment. Building on this ability to sell products at premium price is the only way to uphold EU levels of social protection, employment and wages.

4. HOW ARE IMPORTS USED ?

EU imports matter: cheap imports from emerging economies potentially fuel the purchasing power of European households, while cheap components and capital goods reinforce the competitiveness of EU firms.

Even when excluding energy and primary products, two thirds of EU25 extra-EU imports are incorporated as inputs in the production process (Table 7). This very high share of inputs in total EU imports, even when energy products are excluded, demonstrates very clearly that the EU as a whole relies heavily on global sources for inputs incorporated in its production process. It confirms that the EU is importing a lot of goods destined for further processing pointing to the need for an open market where companies can compete fairly.

However, the trend toward localisation of the assembling steps of production in low-wage countries can reverse things, leading to an increase of the share of finished products in total imports. In particular, German producers are increasingly relying on imports of inputs from third countries to preserve their competitiveness.

Both types of linkage of the EU economy with producers located in third countries (many of which are in fact foreign affiliates of EU multinationals) point to the necessity of having an open market as it conditions EU competitiveness in the global market.

⁸ Upmarket products are the ones traded at a price exceeding the world average by at least one quarter.

Table 7
Share of goods used in production in total extra-EU imports (%)

country	1995	2005
EU 25	65.6	65.3
Austria	64.2	64.8
Belgium-Luxembourg	62.0	60.3
Denmark	58.0	56.0
Finland	73.9	68.3
France	65.9	63.5
Germany	63.9	68.4
Greece	63.7	60.2
Ireland	86.4	77.1
Italy	65.8	62.9
Netherlands	68.0	73.5
Portugal	56.5	69.1
Spain	57.9	56.9
Sweden	67.2	64.0
United Kingdom	68.1	59.4
Cyprus	59.0	75.1
Czech Republic	65.9	72.8
Estonia	61.3	70.4
Hungary	69.0	84.7
Latvia	71.4	65.2
Lithuania	67.0	65.6
Malta	81.0	88.1
Poland	59.2	72.8
Slovakia	67.4	74.8
Slovenia	62.7	64.3

Source: BACI, CEPII calculations⁹

⁹ The table is based on a simple classification of products according to the Broad Economic Categories (BEC) classification of the United Nations. Primary products are excluded in order to bypass the problems associated with fluctuations in their prices (e.g. energy).

5. SERVICES

From the foregoing, one should not infer that if the EU were to lose market shares in manufacturing at the global level, it would necessarily be bad for the EU. This would not be the case if in parallel the EU were to concentrate more on services and gaining market share in this field. It is therefore important to look at the EU's performance in the field of exchange of services.

However, statistics on trade in services are generally more tenuous than data available for merchandise trade, not only because data collection systems are less developed in some countries but also because a substantial proportion of services are supplied via foreign direct investment (e.g. local branch offices). Nonetheless, the available statistics for cross-border trade highlight a number of trends. Foreign direct investments are examined in the following section.

Table 8

EU Services* Trade Balance

2006	(billions of euros)		
	Exports	Imports	Balance
Total	441.6	373.1	68.5
United States	131.9	119.7	12.1
Canada	10.1	8.1	2.0
EFTA (4)	70.3	49.0	21.4
Russia	14.1	10.7	3.4
South Korea	6.4	4.0	2.4
Mexico	4.1	2.7	1.4
Candidates (2)	8.0	15.5	-7.6
Medit. countries	7.9	14.5	-6.7
China	12.5	11.2	1.3
Japan	18.9	12.9	6.0
Other L. America	7.9	6.5	1.4
India	6.7	5.5	1.2
ASEAN (10)	17.8	15.7	2.2
Mercosur	7.9	6.4	1.5
Sub-Saharan Africa	17.6	13.6	4.0
Australia & New Zealand	10.8	7.4	3.4

Source: Eurostat, DG TRADE. * Excluding government services.

Services account for a significant proportion of EU trade. In 2007, the value of services exported outside the EU was equivalent to approximately 40% of the value of goods exports. Generally, services play a particularly important role in trade between industrialised economies: EU services exports to the United States were equivalent to 49% of goods exports, whereas the corresponding ratio for EU-China trade was only 20%. The EU runs service trade surpluses with nearly all major world regions, including countries where the EU trade balance for goods is negative (Table 8).

The European Union continues to be the biggest global player in international trade in services. In 2006, the EU-27's international trade in services recorded a surplus of €68.5 billion, compared to €3bn in 2005 and 46bn in 2004. The US remains the EU's main trading partner.

Table 9
Evolution of Export of Services for the EU and the world (2001 – 2006)

millions of euros	World (excl. Intra EU)			EU exports		
	2001	2006	2006/2001	2001	2006	2006/2001
SERVICES	1 273 500	1 658 232	30.2%	316 927	445 638	40.6%
TRANSPORTATION	297 038	381 200	28.3%	77 758	110 762	42.4%
TRAVEL	371 502	407 826	9.8%	70 057	71 746	2.4%
OTHER SERVICES	562 261	822 761	46.3%	161 945	255 124	57.5%
GOVERNMENT SERVICES	42 698	46 444	8.8%	7 167	8 006	11.7%
COMMERCIAL SERVICES	1 230 802	1 611 787	31.0%	309 760	437 632	41.3%

Source: WTO, Eurostat, DG TRADE

EU exports of services have grown faster than the world average except for travel services (Table 9). As a consequence, the EU expanded its share of world trade in most broad service categories between 2001 and 2006 (except in travel services; see Table 10). It has also by this measure outperformed the US, which has lost market share in services exports. Japan broadly maintained its market share during the 2001-2006 period, whereas China's share has grown significantly.

Table 10
Evolution of market share in services

	EU			USA			Japan			China		
	2006	2006	Variation	2006	2006	Variation	2006	2006	Variation	2006	2006	Variation
	Value	Share of	2001/2006	Value	Market	2001/2006	Value	Market	2001/2006	Value	Market	2001/2006
	(Millions of	World	in p.p.	(Millions of	Share	in p.p.	(Millions of	Share	in p.p.	(Millions of	Share	in p.p.
	euros)	Market		euros)			euros)			euros)		
Commercial Services	433 623	26.9%	1.8	316 847	19.7%	-3.7	97 598	6.1%	0.0	72 810	4.5%	1.6
Transport	109 747	28.3%	2.5	54 542	14.1%	-2.6	29 984	7.7%	-0.9	16 737	4.3%	2.7
Travel	71 089	17.0%	-1.2	85 008	20.3%	-4.6	12 643	3.0%	0.7	27 038	6.5%	1.5
Others	252 787	31.4%	1.8	177 297	22.2%	-3.8	54 971	6.9%	-0.3	29 035	3.6%	1.6

Source: WTO, Eurostat, DG TRADE

The EU's export performance in services has, however, deteriorated recently, showing a decline in market share from 2004 to 2006. Also, both exports and imports of services by the

EU have grown more slowly than goods trade recently (Table 11). This means that the EU's international cross-border trade in services has not mirrored the strong and growing role of services in the EU economy. To what extent the recent trend is indicative of a deterioration in the international competitiveness of EU service providers, owing to trade barriers, to structural factors (e.g. substitution of exports by FDI) or to data problems, requires further analysis.

Table 11

Growth of EU services versus goods trade 2004-2006

		Services	Goods
	Annual Growth		
Exports	Rate:	9,52%	10,3%
	Annual Growth		
Imports	Rate:	7,69%	14,7%

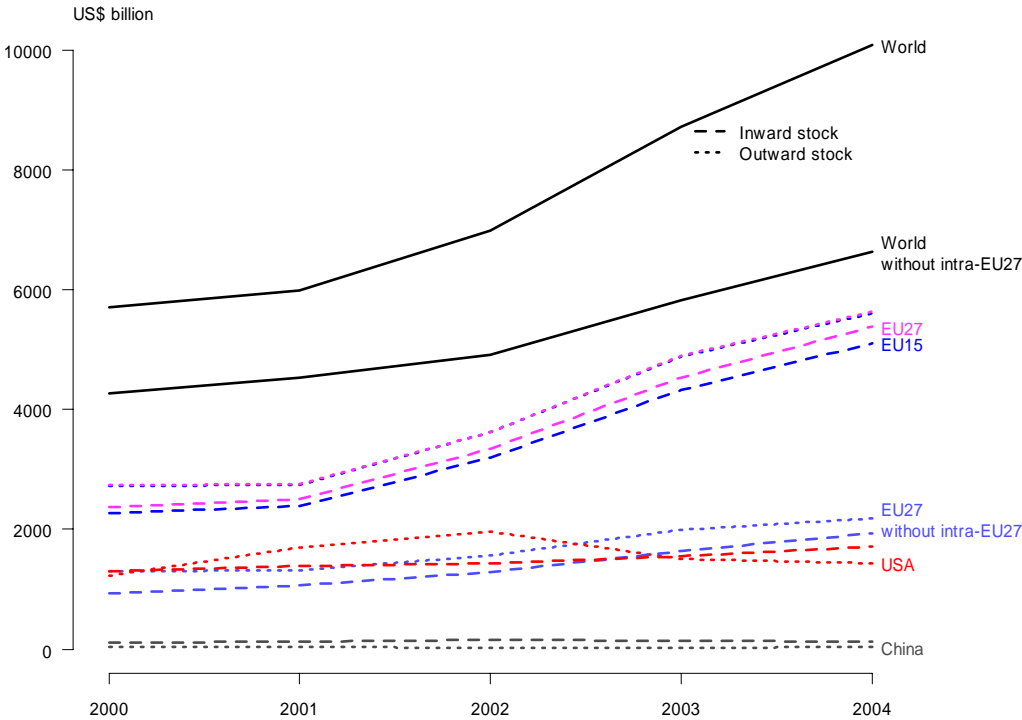
Source: Eurostat, DG TRADE

6. FOREIGN DIRECT INVESTMENTS

The European Union represents the world's biggest investor. EU27 both own and host a third of world FDI stock when intra-EU investments are removed from the total and a half when they are included¹⁰.

Figure 5

Trends in global FDI stock



Source: CEPII

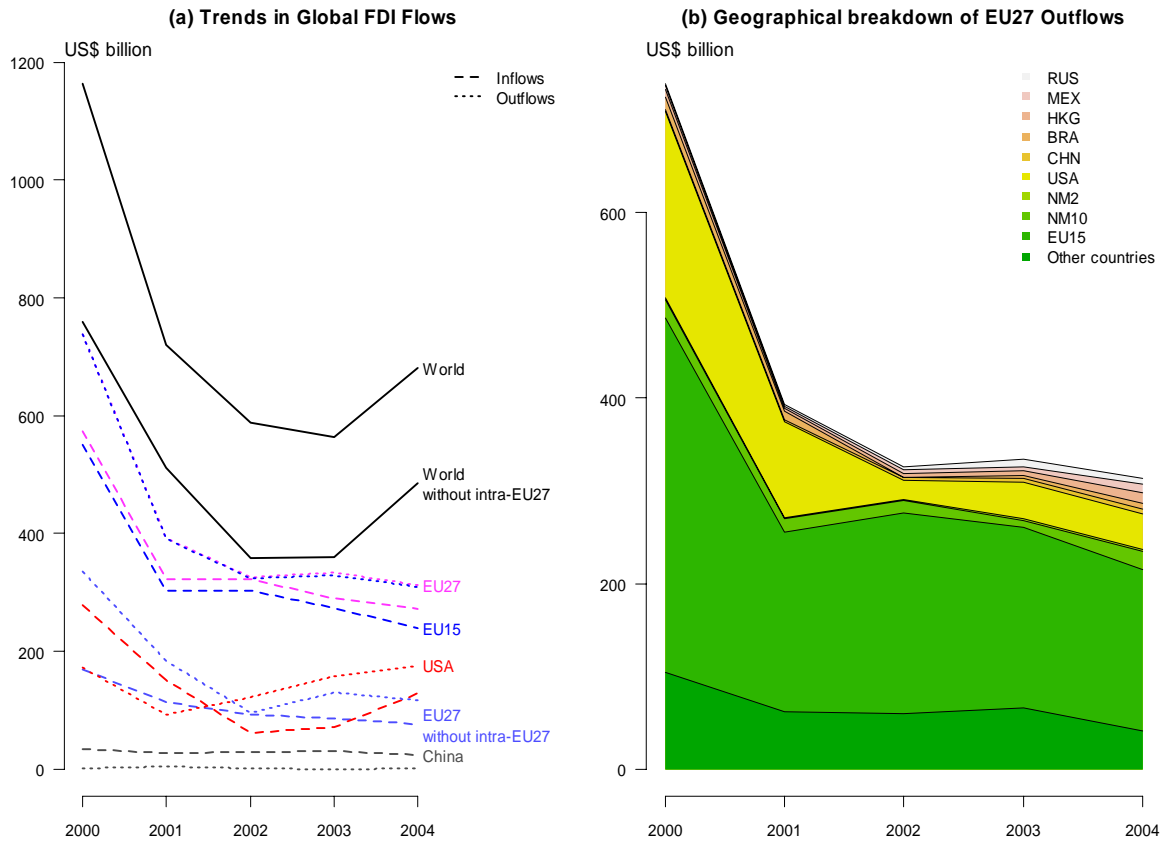
Intra-EU investments represent 34% of world stocks (\$3,500bn out of a total of \$10,000bn). When intra-EU investments are excluded, EU stocks of outward investments amount to \$2,200bn (33% of world stocks), against \$1,400bn for the US (22%).

For their part, EU inward investments amount to \$1,900bn (29% of world total) against \$1,700bn for the US (26%). These proportions hold for the EU15 alone and for EU27 as the new Member States still account for a limited share of world FDI.

¹⁰ This section draws on a newly available database by CEPII which provides consistent data on FDI bilateral and sectoral flows and stocks by country. It is to be kept in mind that this database is constructed from real values *and* from estimates, and figures must therefore be viewed with caution.

Figure 6

Trends in FDI Flows



Source: CEPII

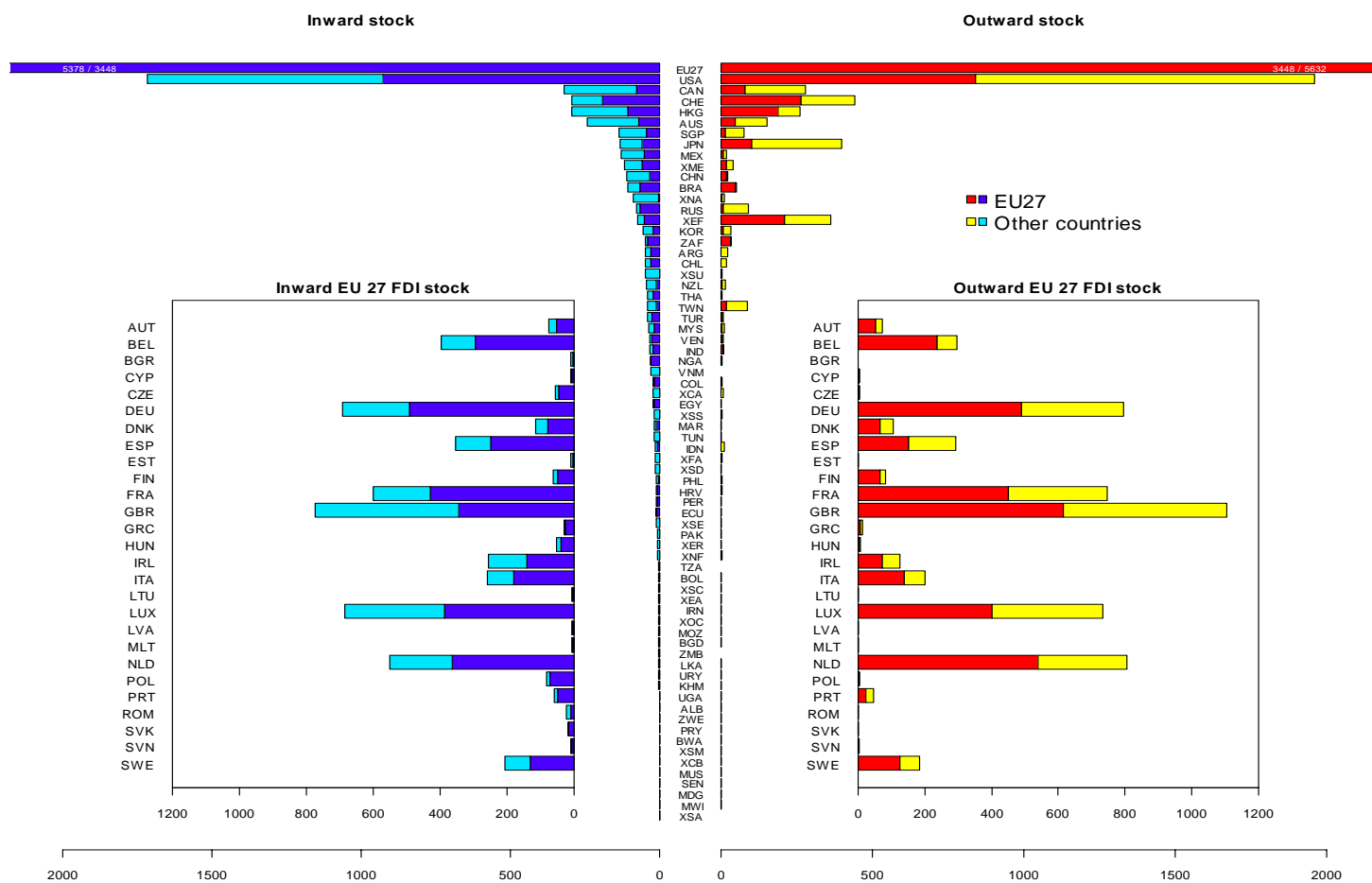
Figure 7 displays inward and outward FDI stock in each country. Darker colours (blue and red) stand for stocks from or to the EU. For example, two fifths of the US's outward stock is invested in the EU (red part), the rest being in other countries (yellow part). Two inserts disaggregate the EU on a smaller scale. They reveal that most inward and outward stocks of the EU Member States come from or are invested in other EU Member States.

While there are numerous countries receiving FDI, there is a high concentration of both inward and outward stocks among 10 major players. Investor countries are even more concentrated than receiving ones. After the EU and the US, the main creditor countries are Switzerland (4.4%), Japan (3.9%), rest of EFTA (Iceland, Liechtenstein, Norway, 3.6%), Canada (2.8%), Hong-Kong (2.6%) and Australia (1.5%). Remaining countries hold less than \$100bn each.

A different pattern emerges when we consider the ratio of FDI to GDP (Figure 8). As regards inward FDI, country profiles are much more homogeneous and there is no clear-cut distinction between developed and developing countries. Except for some countries or regions with fiscally attractive regimes, the ratio for receiving countries is usually under 50%. For outward FDI, the ratio is biased in favour of developed countries. Globally, much fewer countries invest abroad than receive investments.

In comparison to the US and other developed countries, the EU has higher ratios of inward and outward investments to GDP. This means that the EU is rather more open to foreign investments and more willing to invest abroad than countries of a similar level of development and in particular the US.

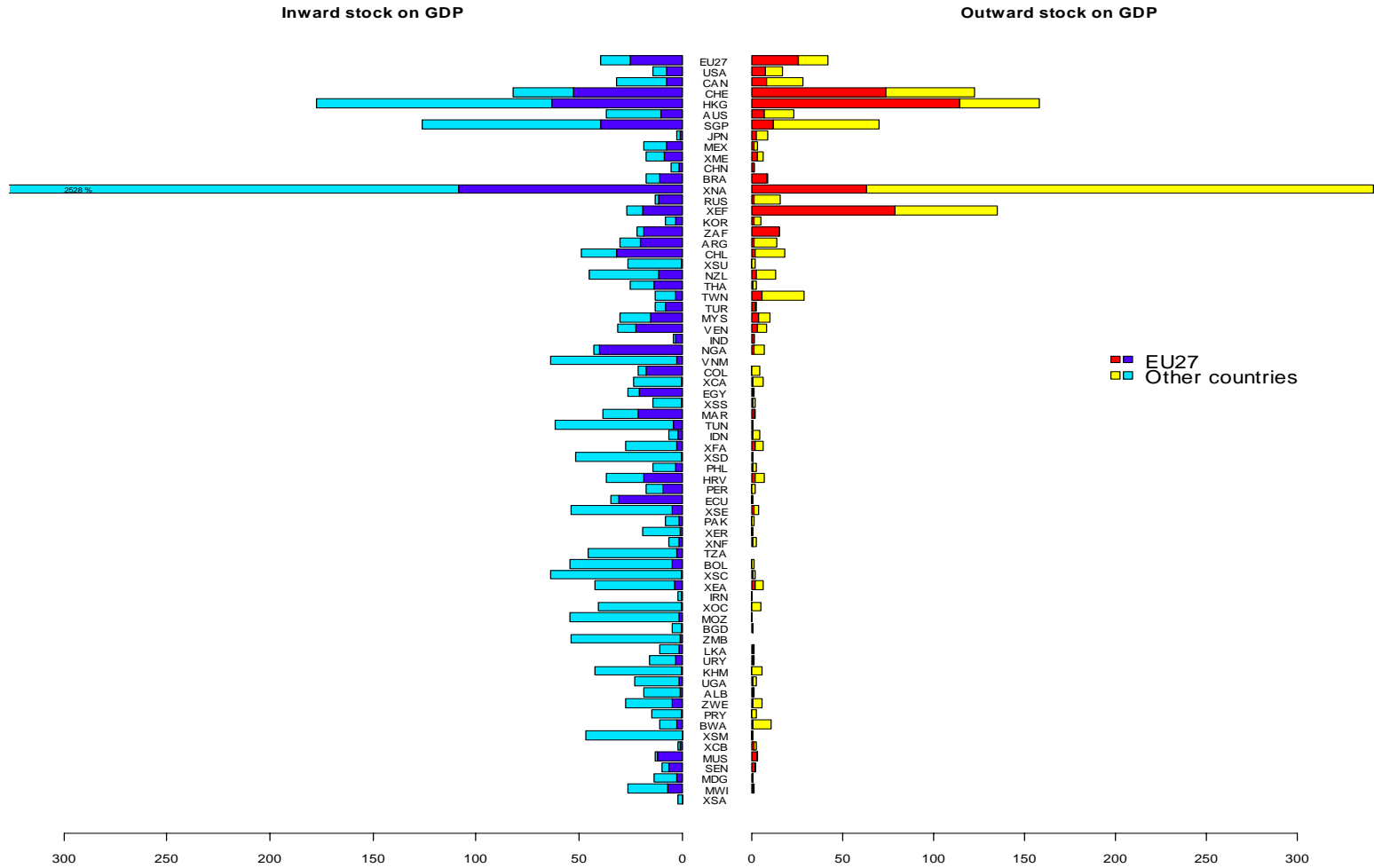
Figure 7
Global and EU FDI stocks (2004 - \$USbn)



Note: Darker colours represent FDI from or to EU27. The scale is too short for all EU27 stocks to appear, so stock values (intra-EU27 and total) are written at the end of the bars.

Source: CEPII

Figure 8
Global and EU FDI stock (in percent of GDP -2004)



Source: CEPII

7. CONCLUSION

This report confirms the 2006 Commission analysis regarding EU strengths and weaknesses in global competition which led to the introduction of the Global Europe agenda for trade policy. In particular, the report makes it clear that as the principal exporter and the second largest importer of merchandises, the primary trading power in services, and the major source and host of world direct investments, the EU has a crucial stake and responsibility in maintaining and strengthening a set of transparent and balanced rules for global trade. The EU's commitment to the WTO and the current Doha Development Agenda is therefore vital.

The EU as a whole relies heavily on global sources for inputs incorporated in its production process as they represent two thirds of extra-EU imports excluding energy products. This points very clearly to the need to remain open to imports. Combined with this necessity, it follows from the EU's major position on world markets that EU trade interests are first and foremost outward-looking in nature. This explains why the renewed Market Access Strategy should tackle both tariffs and behind-the-border practices limiting access for EU goods, services and FDI.

The report concludes also that the EU's performance in merchandise trade remains good with a stable market share in comparison to a net decline for American and Japanese exports. It translates into a growing surplus for manufacturing products which has partially offset the rise in the energy bill over the last decade.

This relatively good EU performance in the context of a growing number of competitors is driven by the great ability of European exporters to sell high-quality products at premium price due to quality, branding and related services. As such, it represents a key link between competitiveness and the EU social model: the EU cannot compete with cheap labour countries on low-range products but needs to consolidate its positions on upmarket products by upgrading the skills level of its workforce and improving its innovative performance.

Innovation undoubtedly remains a key component of EU competitiveness but this is an unstable equilibrium because European industry, together with Japan and the US, is losing ground in high-technology products.

This calls for a burst of investment in R&D and innovation as envisaged in the Growth and Jobs strategy. It justifies also, together with the EU's leading position as exporter of high-end products, the strong emphasis put by the Global Europe agenda on protection of intellectual property rights (IPR) in third countries.

In parallel, EU underperformance in some of the most dynamic markets, particularly in Asia, gives strong justification for the trade agreements currently being negotiated with these countries with the aim of going beyond what can be achieved at the multilateral level.

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