

Trade

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In the context of the preparation of the upcoming Communication on the EU's trade and investment strategy, this paper reviews the contribution that deepening relationships between the EU and its key trading partners can make to a comprehensive strategy to boost jobs and growth in Europe. It also looks at the actual benefits of those agreements that have already been implemented and the lessons that can be drawn for the future. However, it does not cover the full spectrum of trade relations, in particular the other aims of EU trade policy such as fostering development in poorer countries and projecting EU values in the world. That will be for the Communication itself.

- 1. THE POTENTIAL CONTRIBUTION OF TRADE AND INVESTMENT AND TRADE AND INVESTMENT AGREEMENTS TO THE EU ECONOMY
- 1.1. Trade and investment can be powerful engines for growth and job creation in Europe

President Juncker has made the conclusion of a reasonable and balanced Transatlantic Trade and Investment Partnership (TTIP) one of his top political priorities. In its *Strategic agenda for the Union in times of change* the European Council underlined the contribution that the current trade negotiations agenda can make to boost growth, jobs and competitiveness in the EU and reaffirmed its support for TTIP at its last meeting in March 2015.

The crisis has indeed spurred a realisation that trade has never been more important for the EU economy. It showed its worth as a stabilising source of growth for the EU, softening the recession considerably by channelling demand from other parts of the world with higher growth back to Europe at a time when domestic demand components, both public and private, remained weak. Boosting trade also appeared as one of the few ways to bolster economic growth without drawing on severely constrained public finances.

**Trade has a multiplier effect on the economy**, the gains in business competitiveness are multiplied when products and services are able to compete in world markets.

Some 31 million jobs in the EU - over 14% of total employment - depend on our sales to the rest of the world. That figure is up by two thirds or 12.5 million, since 1995, due to the expansion of the EU's exports¹. On average, each additional €1bn of exports supports 14 000 additional jobs across the EU. These jobs are in general more productive, more qualified and better paid than in the rest of the economy.

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<sup>&</sup>lt;sup>1</sup> European Commission, *EU exports: employment and income (1995-2011)*, Institute for Prospective Technological Studies/ DG TRADE, 2015 edition

Although large companies account for a majority of EU trade, SMEs are more important than our policies have generally acknowledged in the past. Over 600 000 EU SMEs export goods and services to the rest of the world (over 80% of the number of EU exporting firms), accounting for one third of total EU exports and employing over 6 million people in Europe<sup>2</sup>. Companies operating in world and domestic markets open to foreign competition improve their competitiveness. Internationalisation of companies reduces market dependency and broadens market diversification, reducing the effects of economic slowdown and currency fluctuation.

Yet even more SMEs are willing and prepared to trade across borders with third countries. Thanks to the internet, SMEs are going global, facilitating business contacts, having direct access to customers and suppliers, and reducing costs in marketing and distribution.

Trade's contribution to growth and jobs is more likely to increase than decrease in the future, as 90% of global economic growth in the next 10-15 years is expected to be generated outside Europe, one third of it in China alone<sup>3</sup>. To be sustainable, economic recovery will need to be consolidated through stronger links with these new centres of global growth.

More trade also benefits growth via the supply side of the economy. Opening up the EU economy to trade and investment is a major source of productivity gains and private investment, both of which the EU sorely needs. Trade liberalisation is a structural reform in itself, spreading new ideas and innovation, new technologies and the best research, leading to improvements in the products and services that people and companies use. It makes economies more efficient thanks to better allocation of resources based on the principle of comparative advantage. Long-term evidence from EU countries shows that a 1 % increase in the openness of the economy is associated with an increase of 0.6 % in labour productivity<sup>4</sup>. Trade is not a zero-sum game.

Consumers in the EU and worldwide have been the big beneficiaries of trade in past decades. Broader choice and cheaper prices have created an irreversible trend. While the benefits of trade are often focused on traditional export, less attention is paid to the benefits of imports for the economy, for consumers and job generation. Thousands of jobs have been created and now depend on retail, wholesale, port handling, logistics and transportation. It is not by accident that there are European leading companies in air and maritime transport, several EU ports are in the top ten of world ports by volume and value. A modern and

Lucian Cernat & al., "SMEs are more important than you think: Challenges and opportunities for EU exporting SMEs", *Chief Economist Note no. 3/2014*, DGTRADE.

Jean Fouré, Agnès Bénassy-Quéré, Lionel Fontagné, "The Great Shift: Macroeconomic projections for the world economy at the 2050 horizon", *CEPII Working Paper*, February 2012, n°2012-3

<sup>&</sup>lt;sup>4</sup> European Commission, European Competitiveness Report 2007

efficient transport infrastructure in the EU facilitates handling of goods and processing, reducing costs and facilitating just in time production. The geographical location of the EU, a modern infrastructure and efficient logistical chains have created important transport hubs generating new jobs. Similar impact in other services sectors such as financial services, information and telecommunication or engineering. The future trade policy should put more efforts in the liberalisation, including mobility of people, for those services essential to the marketing, commercialisation, installation and maintenance of exported goods.

The development of global value chains implies that it is not just exports that are essential to economic growth and job creation but increasingly also imports. The EU is dependent on energy and raw material supplies, essential for production process. Two-thirds of EU imports are raw materials, intermediary goods and components needed for our companies' production processes. The share of foreign imports in the EU's exports has increased by more than half since 1995, to reach 13 %<sup>5</sup>. Reducing barriers to imports into the EU, eliminating restrictions to exports in third countries and improving the efficiency of logistics and transport services are key objectives to preserve the competitiveness of the EU supply chains.

Under these circumstances, raising the cost of imports reduces companies' competitiveness and ability to sell on global markets. This means that national exports and imports should not be approached from a narrow, mercantilist perspective. This is also an important reason for countries not to resort to protectionist measures, even in difficult economic circumstances like those we face today. We need to keep up our guard against such pressures, abroad but also at home.

Another insight of the value-added approach is the importance of trade for all Member States. The deepening of the supply chains following the creation of the Single Market and successive enlargements of the EU is one of the main drivers of the EU's success in international trade. All EU Member States contribute directly or indirectly. Intra-EU trade is about twice the value of extra EU trade. A German or Italian export very often incorporates value created in the Czech Republic, Belgium or Poland and vice versa. As a result, the benefits of trade are therefore spread much more deeply and widely than is often realised.

The same is true of services and the importance of services to manufacturing. Services today represent about 40% of the value we add to products exported from Europe. About a third of the jobs generated by exports of manufactured goods are actually located in companies that supply the exporters of goods with auxiliary services<sup>6</sup>. Better and cheaper services are a key variable in the industrial competitiveness equation. Integrated production

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World Input Output Database (WIOD)

<sup>6</sup> WIOD (op. cit.)

chains in the EU would benefit in competitiveness by reducing the barriers to free movement of services. Equally, the importance of trade, and retail in particular, through the e-commerce and online platforms has increased and will continue to grow in the coming years. While it is important to focus on the development of the EU's industry, it is equally important to focus on the development of services. There is still untapped potential through the removal of barriers to services in the internal market. The future EU Digital Single Market and the removal of existing services barriers in the internal market would boost imports and exports outside the EU. Gradually liberalising and facilitating international trade in services is a powerful tool as well.

**Finally, the importance of investment should not be overlooked**. Outward investment is a key component in the competitiveness strategies of EU firms while inward investment is a more direct source of jobs. Foreign-owned companies employ over 7.3 million people in the EU. These jobs are also more productive, more qualified and better paid than in the rest of the economy. Facilitating international investment flows is key to diversifying sources of finance available to enterprises and economies. In addition, international investment makes an essential contribution to the integration of the EU in global value chains. As a result, international investment contributes significantly to generating growth and jobs as well as to the widespread adoption of best business practices, most efficient technologies and product ranges.

# The EU remains the world's largest exporter and importer. It is less well known that despite the continuous rise of emerging countries over the 2000's, the EU managed to largely hold on to its share in world exports up to 2010, while respective shares of Japan and the US sharply declined. There was a noticeable decline in the EU's share of world exports in the more recent

EU companies are well placed to benefit from increased international engagement.

declined. There was a noticeable decline in the EU's share of world exports in the more recent past but this mainly reflects the underperformance on investment, linked to the economic crisis. Yet Member States' performances are extremely diverse, revealing differences in competitiveness showing that trade liberalisation must go hand in hand with structural reforms.

The EU is still the biggest foreign investor and recipient of foreign direct investment (FDI) worldwide. It accounts for 44% of investment outside of the EU and attracts 36% of total world investment (excluding the intra-EU). However, prior to the financial crisis in 2007, total FDI flows into the EU reached around €440bn annually. The current figure is €267bn based on comparable data for 2013. Therefore there is clearly scope for substantially more investment from both within the EU and outside the EU, in line with President Juncker's Investment Plan. This will contribute to a stronger economic recovery with increased job creation.

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#### 1.2. The EU's trade and investment agenda can intensify these forces

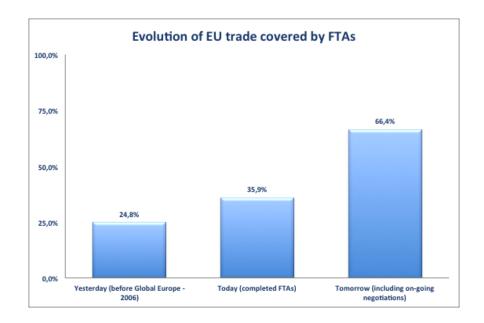
To boost the EU's capacity to benefit from trade and investment, the Commission has developed an ambitious bilateral agenda with significant potential. The trade agenda is indeed of an unprecedented scale. It covers two of the EU's largest trading partners (the US and Japan) and key emerging country partners alike (including India, several ASEAN countries and Mercosur, notwithstanding the difficulties to take some of these negotiations forward), where there is still untapped potential due to significant remaining barriers to trade and investment

We have developed this agenda in parallel to and on top of difficult talks at the WTO. Ultimately, it will be important to ensure that our bilateral trade agenda strengthens the multilateral trading system centred on the WTO, which remains Europe's most important asset in dealing with globalisation.

In the past few years, we have negotiated two landmark agreements with Korea and with Canada, the former being applied for three and a half years. We have signed and implemented free trade agreements (FTAs) with six countries of Central America, with Peru and Colombia. We have negotiated and signed what are known as Deep and Comprehensive FTAs in the EU's neighbourhood with Ukraine, Moldova and Georgia (the two latter being provisionally applied as well). In the course of last year, we have concluded negotiations on no less than six new agreements: Canada; a comprehensive agreement with Singapore that is also a gateway for the rest of ASEAN; longstanding negotiations with sixteen countries of West Africa, five countries of East Africa and six countries of Southern Africa; and the extension of the agreement with Peru and Colombia to Ecuador. Negotiations with Vietnam could also be concluded soon.

This leads to a radical expansion of the coverage of EU trade by FTAs: while less than a quarter of EU trade was covered by FTAs before 2006; the current figure is around one third, rising to two-thirds of EU trade once all on-going negotiations are concluded. This is by far the most ambitious trade agenda in the world today.

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Given the EU's role as the world's largest home and host country for international investment, it is also in our interest to further promote investment liberalisation on the basis of agreed rules. This should ensure improved market access for EU investors abroad (including greater clarity on the conditions under which they are allowed to operate) and by securing these investments through investment protection provisions. At the same time, the EU will ensure that the right to regulate is guaranteed.

In 2014, the EU concluded negotiations for the first FTAs containing investment protection provisions with Canada and Singapore, and initiated negotiations for stand-alone investment agreements with China and Myanmar. On-going negotiations for FTAs with the US, Vietnam, Japan, Thailand, Malaysia, Morocco and India are also expected to include chapters on investment protection. This is a significant change from the EU practice in past FTAs, like Korea, Colombia, Peru, Central America, which only contained provisions on investment liberalisation, that reflects the changes of competence following the Lisbon treaty.

If concluded successfully, these bilateral negotiations could boost EU GDP by more than 2% or €250bn - equivalent to the size of the Austrian or Danish economy. The additional exports that they would create could support an increase of more than 2 million jobs related to trade across the EU<sup>7</sup>. These are serious potential gains. By way of reference, the Commission's October 2012 "Single Market II" Communication noted that between 1992 and 2008, the Single Market generated 2.77 million jobs in the EU and an additional 2.13% in EU GDP. Most of the benefits of trade agreements will occur in the medium term, with the

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<sup>&</sup>lt;sup>7</sup> European Commission, "External sources of growth – Progress report on EU trade and investment relationships with key economic partners", SWD (2012) 219, 18.7.2012

progressive implementation of agreements. In the short-term pursuing this agenda would send a strong signal that the EU is serious about reforming at home and securing markets abroad: both are crucial for investors' confidence.

However, we must recognise the potentially disruptive impacts of market opening for some regions and workers, particularly the less qualified. Structural change is not new, but it is accelerated by globalisation. Transition periods are systematically part of trade agreements to allow for smooth and progressive developments while safeguard clauses shelter EU producers from unexpected changes. But structural change is inevitable and part of the process that prepares the EU economy for the future. We need to do better in anticipating the effects of trade opening; in helping sectors, regions and the workforce adapt. Removing obstacles to adjustment in the internal market and moving resources to sectors where they can be used most effectively is essential to realising the benefits of trade and to creating jobs in Europe.

#### 2. THE ACTUAL BENEFITS OF EU FTAS: THE NEED FOR A REALITY CHECK

**Negotiating and concluding trade agreements is not an end in itself.** We must ensure that trade agreements are not just negotiated but effectively put on the books by ensuring ratification without undue delay. The current timelines between trade policy formulation, the actual launch of negotiations, conclusion and entry into force delay the benefits trade agreements bring to the economy. EU trade policy must respond faster to the economic needs and accelerate the formulation, negotiation and implementation of agreements. The cost on 'non-FTAs' —the missed benefits for a delayed entry into force or incomplete implementation should be estimated when preparing the ex-post evaluation of our agreements.

We must also make sure that trade agreements deliver actual benefits and monitor the impacts effectively. This is particularly acute in the present context since there is a significant public debate taking place on precisely the question of whether EU trade policy is working in EU citizens' interests. Supporters of open markets, including Member States and the Commission, therefore need to be able to clearly demonstrate the economic benefits of trade agreements, based on more concrete facts and figures. That requires a more detailed assessment of the real impact of trade on people and the economy. It should go beyond headline percentage numbers on the total GDP effects of trade agreements and look at how trade deals affect companies — particularly small companies — as well as workers and consumers.

Annex 2 looks at the actual benefits of our recent FTAs, mainly based on the EU-Korea FTA, as it was the first major "Global Europe" FTA to be negotiated, with a significant trading partner, and for which we now have three years of data on implementation. The analysis also draws upon a series of ex post studies on the FTAs with Mexico and Chile, in particular.

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#### 3. QUESTIONS FOR DISCUSSION

The Commission is currently preparing a Communication on its overall trade policy strategy that is due to be published in the Autumn. As such the aim of this paper was not to make any new policy proposals, but rather to raise issues for discussion that may then feed into the preparation of the Communication. In that context, Member States are invited to discuss:

- The facts contained in this document and overall assessment.
- The particular policies they would like to emphasize in view of the forthcoming EU Trade Policy Communication.

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Annex 1: EU imports and exports of goods, services and investment by partner and trade agreement status

	Goods (2014)		Services	Services (2013)		FDI stocks (2013)	
	Share of EU	Share of EU	Share of EU	Share of EU	Share of EU	Share of EU	
	imports	exports	imports	exports	inward FDI	outward FDI	
	(%)	(%)	(%)	(%)	(%)	(%)	
1. Applied agreements	27.1%	31.1%	26.6%	29.1%	18.1%	24.3%	
Chile	0.5%	0.4%	0.3%	0.5%	0.1%	0.5%	
Mexico	1.1%	1.7%	0.7%	1.1%	0.6%	2.1%	
South Africa	1.1%	1.4%	0.8%	1.0%	0.2%	0.9%	
EFTA [1] and Turkey	14.3%	15.8%	15.9%	19.3%	13.9%	16.2%	
EPAs Caribbean, Pacific, ESA, Cameroon [2]	0.6%	0.8%	1.6%	1.0%	1.0%	0.5%	
Korea	2.3%	2.5%	1.1%	1.5%	0.5%	0.7%	
Mediterranean countries [4]	5.0%	6.0%	4.3%	2.9%	1.6%	2.0%	
Western Balkans [5]	0.9%	1.4%	0.7%	0.7%	0.0%	0.6%	
Georgia, Moldova	0.1%	0.3%	0.1%	0.1%	0.0%	0.1%	
Colombia and Peru	0.8%	0.6%	0.4%	0.5%	0.1%	0.5%	
Central America	0.4%	0.3%	0.5%	0.5%	0.1%	0.2%	
2. Concluded FTAs (not applied)	6.8%	7.2%	6.9%	8.1%	4.6%	8.8%	
Ukraine	0.8%	1.0%	0.5%	0.7%	0.0%	0.6%	
Singapore	1.0%	1.7%	2.5%	2.3%	1.2%	1.9%	
Canada	1.6%	1.9%	2.1%	2.5%	3.1%	4.6%	
Ecuador	0.2%	0.1%	0.1%	0.1%	0.0%	0.1%	
EPAs WA, EAC, SADC [6]	3.2%	2.5%	1.7%	2.5%	0.4%	1.6%	
3. On-going FTA negotiations	29.3%	31.6%	41.9%	37.9%	50.7%	45.5%	
Japan	3.2%	3.1%	2.7%	3.5%	4.2%	1.6%	
United States	12.2%	18.2%	30.1%	25.5%	43.7%	34.4%	
ASEAN [7]	5.0%	3.0%	2.8%	2.1%	0.4%	1.3%	
Malaysia	1.2%	0.8%	0.6%	0.6%	0.4%	0.4%	
Vietnam	1.3%	0.4%	0.3%	0.2%	0.0%	0.1%	
Thailand	1.1%	0.7%	1.1%	0.5%	0.0%	0.2%	
Mercosur	2.7%	3.0%	1.8%	3.3%	1.8%	6.6%	
India	2.2%	2.1%	2.3%	1.6%	0.2%	0.7%	
Central Africa	0.4%	0.3%	0.2%	0.5%	0.0%	0.2%	
4. Others	36.8%	30.0%	24.6%	24.9%	26.6%	21.5%	

<sup>[1]</sup> The European Free Trade Association includes Iceland, Liechtenstein, Norway and Switzerland. [2] The EPA Pacific includes Papua New Guinea and Fiji. The ESA agreement with Eastern and Southern Africa is provisionally applied by Mauritius, Seychelles, Zimbabwe and Madagascar. [4] Mediterranean countries include Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestinian Authority, Syria and

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Tunisia. The agreement with Syria is not applied. There is no FTA with Libya. [5] Western Balkans include Albania, Bosnia and Herzegovina, FYROM, Kosovo, Montenegro and Serbia. [6] Three agreements are concluded with West Africa (WA), Eastern African Community (EAC) and the Southern African Development Community (SADC) EPA Group (6 countries). [7] The Association of South East Asian Nations (ASEAN) region includes Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. Singapore is not included in this figure.

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#### Annex 2: The impact of the EU-Korea FTA and other recent FTAs

#### 1. The EU-Korea FTA: an example of an ambitious and reciprocal FTA

Applied since 1 July 2011, the agreement is the most ambitious trade deal ever implemented by the EU. It clearly established the credibility of the EU's commitment to engagement with Asia, while opening up a fast-growing East Asian market for EU exports.

The EU-Korea FTA is characterised by a high degree of reciprocity. While Korea's tariffs were twice as high as EU tariffs before the start of negotiations<sup>8</sup>, the agreement will eliminate almost 99% of duties on both sides in trade value terms for both industry and agriculture within five years. The remaining tariffs will be almost entirely eliminated over longer transitional periods, with the exception of a limited number of agricultural products. EU exporters should be able to save up to €1.6bn a year in duties once the FTA is fully implemented.

The agreement also provides effective openness, not limited to tariffs. Beyond the elimination of almost all tariffs on EU exports, it includes comprehensive provisions on non-tariff barriers (NTBs). Cumbersome and expensive testing and certification requirements are being reduced. Transparency and predictability in regulatory issues are being increased, in particular in view of the regular meetings of the implementation bodies established by the FTA which provide a forum to engage in closer regulatory cooperation. The sectoral annexes on electronics, motor vehicles and parts, pharmaceuticals, medical devices and chemicals provide additional tools to tackle any emerging issue. The agreement will also bring new opportunities in the services sector, as well as enhanced access to government procurement markets.

#### Box 1: The opening up of public procurement markets through FTAs

**Public procurement is an area of significant untapped potential for EU exporters**. EU companies are world leaders in areas such as transport equipment, public works and utilities. But they face discriminatory practices in almost all markets, which effectively close off exporting opportunities.

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The simple average bound MFN rates for all goods are 6.6% in the EU and 17.6% in Korea. For the EU essentially all applied rates equal the bound rates. The Korea the applied MFN rate is 13.3%.

The new economic reality, with pressure on governments to provide more value for money, reduce public expenditure and increased transparency, are new dynamics favourable to a more open and non-discriminatory access to government procurement. Cheaper products and services procured by governments increase also their capacity to increase the volume of purchases without increasing public expenditure; another example that trade is not a zero sum game and benefits may spread through open procurement markets. The development of internet has increased transparency and access to procurement even in distant locations at sub-central government, multiplying the possibilities to participate in international tenders reducing costs on intermediaries and commercial presence. These developments may increase the benefits of opening procurement markets in particular at sub-central government level, where the main obstacles remain.

**Recent developments have shown progress with several key partners**. FTAs with Korea and Singapore secured a broad coverage of public procurement markets. The outcome of negotiations with Canada is much more significant.

The EU secured commitments on the Canadian market that were unprecedented, covering sub-federal government entities and going much beyond what was achieved among North American economies in NAFTA. The large asymmetry between the respective level of openness of the EU and Canada has actually been removed. It is interesting to recall that this asymmetry was the trigger for the Commission's proposal for a specific instrument to open up procurement markets.

Opening up procurement markets is now a key objective of negotiations with both the US and Japan.

The agreement also contributes to sustainable development in all its dimensions; It is the first FTA ever to include a comprehensive chapter on trade and sustainable development. Its implementation supports sound labour conditions and to the environment. It has set up a dedicated dialogue that has already reinforced interactions with the International Labour Organisation and empowered EU and Korean business associations, trade unions and other civil society organisations.

The EU FTA with Korea goes beyond what was achieved by the US in its negotiations with Korea. The US concluded an agreement with Korea before the EU but could not pass it before Congress and reopened negotiations after the signature of Korea's agreement with the EU. In some cases – particularly in automotive NTBs and safeguards – negotiators sought to

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raise standards in reaction to the achievements of the EU FTA. Even after this renegotiation, the EU-Korea FTA remains more ambitious than the US-Korea FTA on several points<sup>9</sup>.

#### Box 2: The promotion of Geographical Indications (GIs) through FTAs

Geographical Indications are another important issue on which progress has been possible in recent years via FTAs. The total value of GI products exported outside the EU is estimated at €11.5bn, representing 15% of all EU food and beverage exports. Once again taking the EU Korea FTA as a benchmark, it provides a list of 162 commercially important agricultural GIs from the EU and includes detailed provisions on the recognition of GIs listed in the annexes, the scope of protection and the relationship with trademarks. The agreement also sets up a register listing GIs protected in the Parties and an administrative process verifying GIs nature.

**Progress on GIs was similarly achieved in other FTAs**, including Peru-Colombia and Central America. The FTA with Singapore in 2012 succeeded in having Singapore establish a GI register, in spite of no previous GI tradition in its legal order. Singapore is already the EU's number two global GI export market after the US. Even if parts of EU GI exports to Singapore are possibly re-exported to other parts of Asia, the affluence of the consumer base in Singapore makes it a key market for certain GI products. We have also managed to start a process with China on GIs issues.

The recent agreement with Canada is probably the most significant one. Canada has accepted that all types of food products will be protected at a comparable level to that offered by EU law and that additional GIs can be added in the future. Canada has granted this protection to our priority list of 145 names. For 21 names where conflicts existed with pre-existing uses in the Canadian market, innovative and tailor-made solutions have been found. This is an important achievement in itself, in one of our leading GIs export markets, but at the same time also a useful precedent for future negotiations with other countries.

Getting results on GIs is now a key objective of negotiations with both the US and Japan. Modernising the FTAs with Mexico and Chile would also improve the level of protection, reduce conflicts and increase the market share of EU GIs.

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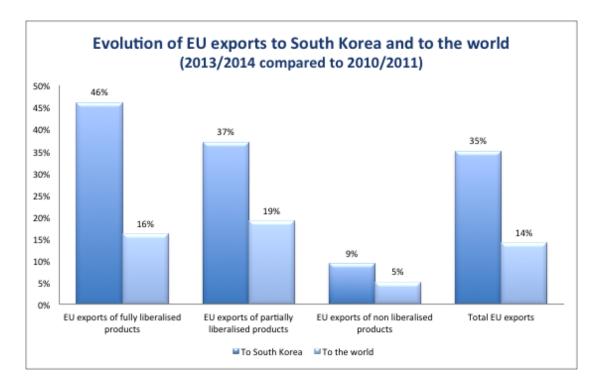
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Essentially NTBs on cars and engineering products but also environmental, telecoms, transportation and financial services; legally binding prohibition of the most-distorting types of subsidies; coverage of sub-central procurement entities.

#### 2. Trade and investment impact of the EU-Korea FTA

The headline data demonstrate that the agreement has changed realities on the ground:

- EU exports of goods to Korea increased by 35% in the third year of FTA implementation, compared to the 12-month period before the FTA took effect. EU imports from Korea were broadly stable over the same period, albeit with a 6% increase between 2013 and 2014. The main reason for the weaker performance of the imports from South Korea was the decreased demand in the EU due to the financial crisis. As a result of both effects, the EU's longstanding trade deficit with Korea which reached €11bn in 2010 and well over €16bn in 2007 became a trade surplus of €3.6bn in 2013.
- The growth in trade was weighted towards products where tariff liberalisation has been the greatest. On the EU side, exports of fully and partially liberalised goods have also increased more than exports overall, with an increase of 46% for fully liberalised goods and 37% for partially liberalised goods. By comparison, exports of the same fully liberalised products to the world at large have increased by 16%. The growth differential between the exports of these products to Korea and to the rest of the world indicates that the FTA has already potentially generated €3.7bn extra exports. In partially liberalised products, the growth rate of exports was 37% to Korea versus 19% to the rest of the world. In these products, the FTA has therefore delivered approximately an extra €1bn of exports, making a total of €4.7bn additional exports annually.



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- Despite the continuous rise of China, the EU's share in Korea's global imports increased from 9% in 2010 before the entry into force of the agreement to 12% in 2014. The US has been less successful following the application of the Korea-US FTA (from 9.5% to 8.7%). And Japan has lost as much as five percentage points in five years (FTA negotiations are on-hold).
- Results at sectoral level are also positive:
  - EU-Korea trade is mainly concentrated in machinery and appliances, transport equipment and chemical products, where EU increased by 23%, 56% and 9% respectively. The figures for Korean exports to the EU in the same sectors are broadly stable, although there was a big drop in machinery and appliances in the first year of implementation, probably due to one-off factors.
  - EU exports of motor vehicles have increased by 90% from €2bn (74 600 vehicles) to €3.8bn (141 800 vehicles) during the third year of the FTA being in force. Over the same period, EU imports from Korea have increased 53% in value from €2.6bn to €4bn. This equates to a roughly 25% increase from 300 000 vehicles to 375 000 in volume terms. Motor vehicles represent 11% of total EU imports from Korea, a sector in which EU imports from the rest of the world fell by 7% over the same three-year period. EU exports of car parts to Korea have increased by 6% to €1.1bn. EU imports from Korea have increased by over 20% from €2,2bn to €2.6bn.
  - Services exports from the EU to Korea increased by 18% in 2013 to reach
     €10.6bn. EU imports of services from Korea increased by 11% in 2013 to €5.6bn.
- Despite concerns before its entry into force, the agreement did not lead to a surge
  in imports that would damage EU industry. There was neither a need to activate the
  surveillance mechanism foreseen in the agreement nor to initiate any safeguard
  investigation.
- South Korean investments in the EU have increased substantially from €13.1bn in 2010 to €18.5bn in 2012, representing 0.5% of the total inward foreign direct investment (FDI) in the EU. Over the same period, EU investments in South Korea increased moderately from €37.5bn to €39.5bn, representing 34.5% of the total FDI in South Korea.

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#### Box 3: The case of EU agreements with Mexico and Chile

An ex post evaluation report (on-going) of the EU Mexico FTA, which entered into force in 2000 shows that exports of the EU to Mexico almost trebled from below \$15bn in 2000 to around \$40bn in 2013. The relative share of the EU and Mexico in each other's overall trade increased steadily over the same period. The report also provides indicative evidence that the FTA boosted the bilateral investment relationship, with significant EU FDI into Mexico during the 2000s, something which is also linked to NAFTA. Further, the structure of the enhanced trading relationship seems to be relatively complementary. EU exports were boosted in particular in: pulp, paper and publishing; education; renting machinery and other business activities. Mexican exports to the EU rose in particular in chemicals, electrical and optical equipment and wholesale trade.

A similar ex post evaluation report on the EU Chile FTA includes analysis that the agreement has given a structural boost to EU exports to Chile of around 20% ( $\epsilon$ 665 million per annum) and Chilean exports to the EU of approximately 15% ( $\epsilon$ 500 million). Once again, the increase in trade flows is of a rather complementary nature. On the EU side, machinery, transport equipment and chemical industries have been the main beneficiaries. On the Chilean side, the fruit, wine, fisheries and fish processing sectors have benefited most. Bilateral trade in services also expanded at a rapid rate following the entry into force of the agreement, more than doubling in each direction, even taking account of the negative impact of the financial crisis, and showing a large structural surplus in the EU's favour. Concretely, EU services exports to Chile rose from  $\epsilon$ 588 million in 2001 to  $\epsilon$ 2483 million in 2007. Chilean services exports rose from  $\epsilon$ 621 million in 2001 to  $\epsilon$ 1870 million in 2008. Both sets of flows attenuated somewhat following the financial crisis, but remained very significantly higher than prior to the agreement's entry into force.

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#### Box 4: Sizable and profitable opportunities for SMEs exporting dairy products

The EU is a major player in the world dairy market as the leading exporter of many dairy products, most notably cheeses. With close to €55bn, the dairy sector represents 15% of the total EU agricultural output. Milk is produced in every single EU Member State without exception in around 650 000 dairy farms. On top of that, there are about 5 400 dairy processing companies in the EU employing 300 000 people. 25% of the companies are located in Italy, followed by Greece and Spain. Most of them are SMEs. Larger scale processors are mainly located in France, the UK, Germany and the Netherlands. The French Lactalis is the world leader, while Danone (France) is third and FrieslandCampina (the Netherlands) is fourth.

Opening up new opportunities for dairy products in FTA partner countries is particularly important today. The EU dairy sector is indeed in a very challenging situation due to the upcoming expiry of the milk quota system and the Russian import ban has also had a heavy negative impact on some Member States with strong Russian trading links in particular.

Once again, the EU-Korea FTA provides opportunities that EU producers have already managed to seize. The FTA progressively removes import tariffs (which are as high as 176% in some cases outside the agreement) <sup>10</sup>, makes it easier for EU operators to fulfil sanitary and phytosanitary requirements and provides effective protection of 19 European GIs. EU exports of dairy products to Korea have more than doubled between 2010 and 2014 from €99mn to €235mn. This corresponds to an increase in the EU's share of Korean dairy imports from 28% to 37% over the same period. Interestingly, FTAs seem to have made an important contribution to other trading partners' export performance: both the US and Chile, which have also implemented FTAs with Korea, have gained ground (the US almost doubled its market share over the same period from 22% to 43% and Chile has started to develop from scratch a strand of exports to Korea) whereas Australia, Canada and New Zealand – which until very recently did not have FTAs with Korea<sup>11</sup> – have lost market share.

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Outside the agreement, Korea MFN applied tariffs are as high as 36% for cheese, 20% to 40% for powders, 20% for whey and 40% for butter, with much higher bound tariffs (176% for powders). Following the agreement, Korea grants duty free access with incremental increase of quotas for cheeses (starting with 4 560 tons, over 15 years), butter (350 tons, over 10 years) and whey (3 350 tons, over 10 years). Access will be fully liberalised after the expiry of the transitional quotas. For milk powder the duty free access starts with a quota of 1000 tons, growing to 1512 tons and becoming permanent from year 16 onwards.

Korea has completed FTA negotiations with all of them but the Korea-Australia FTA entered into force in December last year only; the Korea-New Zealand FTA was only initialled in December last year; and the Korea-Canada FTA entered into force on January 1, 2015.

The FTA with Korea will provide further opportunities in the next years, with the further liberalisation of Korea's tariffs on dairy products. The existence of the FTA also implies continuous dialogue which also provides additional results: for instance, Korea has just lifted its ban on imports of Parmigiano Reggiano and Grana Padano cheeses and we continue our efforts to widen the scope of authorized unpasteurized cheeses in Korea as well as to shorten the approval procedures for dairy product applications from Member States. We are also pushing Korea to recognise 7 more GIs covering dairy products (cheese).

Other FTAs, in particular with Canada, Japan and the US, will provide additional impetus to EU dairy exports. The Canadian dairy market has historically been heavily protected, but under CETA the EU's expanded tariff rate quota should increase access to the Canadian dairy market by around 130%. This is a considerable achievement when taking into consideration that the Canadian dairy market is traditionally protected through the so-called 'supply management', that is based on public management of supply, prices and imports. Japan has just changed its standard for Listeria monocytogenes, now reflecting the international standard applied in the EU, which should make exports of cheese to Japan much easier. TTIP also bears a lot of potential for EU dairy exports, with tariff peaks above 50% on the US market and major SPS obstacles (e.g. grade-A milk measures limiting exports of fresh perishable dairy products including for example liquid milk, cream, cottage cheese).

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#### 3. Lessons from the implementation of the EU-Korea FTA

#### 3.1. A focus on implementation and regulatory issues

The EU-Korea FTA puts new emphasis on implementation and enforcement: in addition to seven thematic committees, seven specific working groups were set up to ensure proper implementation, while previous agreements left this to a single committee which met only once a year. In the past year, these committees and working groups have discussed for example the forthcoming Korean legislation on fuel economy and tyre marking standards; Korean pharmaceutical pricing systems; REACH implementation in the EU and K-REACH implementation in Korea and how to assist SMEs in this context. A particular success story was the agreement that processed organic products certified in the EU may be sold as organic in Korea. This equivalence agreement which entered into force on 1 February 2015 will provide a strong foundation for development of the organic sector.

On the other hand, the experience with automotive components has shown that full implementation requires constant monitoring and the capacity to take up quickly any issues that arise. This has shown the challenges of regulating NTBs in detail. We must recognise that these issues are typically complex and driven by legal approaches and traditions that differ between trading partners. Just like the establishment of the EU's own internal market, making real progress typically requires engagement over a number of years and the cooperation between economic operators, regulators, the Commission and Member States authorities. Yet the structure provided by the agreement made it possible to get Korea accept tyres marked with the UN E-mark rather than the Korean domestic "KC" mark and the work put in to implementation in this area provided useful pointers for automotive chapters in the following FTAs.

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#### 3.2. The level of preference utilisation revealed room for improvement

There have been issues with the take up of the opportunities created by the EU-Korea FTA with Korean companies being quicker off the mark than many of their EU counterparts, as revealed by the level of preference utilisation. The rate of utilisation remained low on the EU side during the first year of implementation of the agreement when it was only between 30 and 40% while it was already around 70% on the Korean side. The Commission services monitored the situation very closely and identified difficulties with regards to the implementation of a new "approved exporter status" requirement that was perceived as time and resource consuming, especially by European SMEs. We have worked with industry representatives and customs to address this issue. One important element that this process revealed was differences in the response time to grant approved exporter status across Member States. The situation has now improved: the latest data available from July 2013 to June 2014 indicate a preference utilisation rate of 65.9%.

However, there is still room for improvement in the future — which means that there are yet more benefits to draw from the agreement. Indeed, the preference utilisation rate on the EU side remains lower than on the Korean side since the Korean preference utilisation rate reached 81.3% in 2013 and there is still a wide range of preference utilisation rates, at Member States level. Utilisation rates are above 80% in countries like Cyprus, Latvia, Austria and Lithuania while they remain below 40% in Estonia, Malta and Bulgaria (see table 1 below). There is also a wide range of preference utilization rate at sectoral level with higher values in agriculture (81%) than for industrial goods (65%). In the latter, there is a very good take up of preferences in transport equipment (94%) while it is much lower (around 50%) in sectors such base metals hides and skins and machinery. The relatively low use of preference in some sections does not seem to be explained by the restrictiveness of the rules of origin, or the EU exporters' preferential margins vis-à-vis Korea's MFN rate but are rather linked to remaining issues with the approved exporter status, stringent customs controls by the Korean authorities of shipments claiming preferences and the direct transport clause that prevents exporters from using regional hubs such as Taiwan or Singapore.

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Table 1: Preference utilisation rates, Korea-EU FTA, by Member State

Member State	Agriculture	Industry	All goods
Cyprus	98,4	89,4	90,6
Latvia	73,6	83,3	83,0
Austria	97,1	81,7	82,7
Lithuania	43,5	83,2	80,4
Romania	75,4	78,7	78,7
Slovakia	45,8	77,4	77,3
Portugal	75,9	75,9	75,9
United Kingdom	80,6	73,6	73,9
Germany	65,1	73,1	72,9
Slovenia	79,6	69,3	69,3
Greece	77,2	62,9	68,7
Poland	91,6	66,6	68,3
Sweden	91,5	67,4	67,7
Belgium	90,0	64,9	66,9
Luxembourg	22,4	66,6	66,6
Hungary	88,9	65,2	66,3
Czech Republic	80,6	63,6	63,9
Ireland	83,0	58,5	62,6
Netherlands	87,6	52,1	57,5
Spain	80,7	52,3	55,4
France	87,0	52,0	55,0
Italy	77,1	52,5	53,7
Denmark	96,4	38,8	45,0
Finland	99,8	40,9	42,4
Bulgaria	77,8	27,5	32,3
Malta	49,8	11,5	13,1
Estonia	79,4	7,2	7,5
Croatia	0,0	1,8	1,4
EU28	81,0	65,1	65,9

Source: Korean customs administration

#### 3.3. The importance of awareness-raising with business and especially SMEs

In order for economic operators to be able to benefit from the preferences that have been negotiated, they have to be aware of them. Our FTA partners often do a better job at alerting their business communities than we have so far collectively managed within the EU. This is understandable given the size of the EU market and its importance for countries like Korea or Canada but has a direct impact on the take up of FTA opportunities. This is a structural asymmetry that needs to be compensated and that requires an extra effort in terms of awareness raising to make sure that the opportunities of our FTAs are fully understood by all exporters and potential exporters. Member States authorities have a particular role to play in this respect given their close relations with their economic operators.

#### Box 5: Enabling SMEs to fully benefit from the opportunities created by FTAs

The improvement in trading conditions provided by FTAs benefits relatively more to SMEs than large companies, since many trade barriers - particularly NTBs - represent a fixed cost and weigh more heavily on those that export smaller amount. They already benefit from existing FTAs eg more than 90% of Spanish exporters to Central America and the Caribbean (two regions with which Europe has concluded bilateral free trade agreements) are SMEs, accounting for more than half of the value of Spanish exports to the region.

The TTIP should benefit SMEs, since it is heavily focused on the kind of obstacles that are particularly difficult to overcome by SMEs. TTIP will also tackle challenges for SMEs head on, in a dedicated SME chapter. For a small company, just getting a reliable understanding of the trade rules that apply in a given market acts a trade barrier in itself. The cost of hiring lawyers and consultants keeps many small companies from getting involved in trade. TTIP will address this by including commitments to improve access to information for SMEs. The EU is proposing that each party will set up a one-stop-shop website, which will make clear all the rules and regulations that companies have to follow if they want to sell their products.

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