

## A NEW CHALLENGE: MANAGING INTERDEPENDENCIES

During its 5<sup>th</sup> meeting on 12-13 June 2019 in Brussels, the tripartite, independent High Level Group on Innovation in Trade Policy continued to ‘think outside-the-box’ on how to innovate trade policy-making in the EU. This task was given to these temporary think tanks, set up following an initiative in the Competitiveness Council.<sup>1</sup>

The High Level Groups are an ‘open innovation’ approach between governments, business and academia, to inject innovative policy ideas into the EU system.<sup>2</sup>

### **Executive summary**

*Trade has become a subject of increased societal pressure, leading to more economic nationalism and protectionism. Europe needs to admit certain collateral effects yet communicate better the numerous benefits of international trade such as job creation and development of new technologies. At the same time, the EU needs to incorporate more sustainability and inclusiveness into its approach.*

*Furthermore, the EU needs to make trade policy more coherent with a common vision and become more assertive vis-à-vis other major players (US, China), also by finding ways how to better understand them. It also has to become better coordinated within its entities such as the EEAS and the Member States. Council’s Trade Policy Committee organization should be re-thought; a more effective communication needs to be pursued by moving from a consultation to an upfront dialogue. The EU has to adapt to the fourth industrial revolution and the growing importance of services, relative to goods. Impacts of globalization require new ways of measuring; climate change has to be addressed ideally with market-driven measures. This naturally leads to finding ways how to better understand Europe’s trading partners.*

*Globally, the EU needs to push for a reform of the World Trade Organization. Human and social right should be promoted via EU’s soft power; more robust monitoring and enforcement of trade policy needs to take place.*

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<sup>1</sup> Council of the EU, 5-6 December 2011, Presidency Note.

<sup>2</sup> Members participate in their personal capacity. All recommendations for action and all ideas for further consideration have not always been agreed on by all members, but advice is based on a very wide consensus. The final version is written under responsibility of the chairman and the secretary general.

## 1. The undeniable benefits of trade

In the current climate of increased protectionism, economic nationalism and fears about the impact of globalisation, there is a risk that the very notion of ‘trade’ has become discredited, or at least called into question, in many people’s minds. The challenge for Europe is to counter this risk by clearly and confidently communicating to its own citizens the idea that trade is good in itself, whether in terms of the EU internal market or internationally.

The division of labour, the opening up of markets, the minimisation of trade barriers and the operation of efficient value chains are all key ingredients in creating jobs, stimulating development of new technologies, and ensuring long-term growth and prosperity for everyone. As evidence of this, we only need to look at the progress made by the countries of Central and Eastern Europe since joining the EU in the middle of the last decade.<sup>3</sup> Trade even has the potential to become a genuine vehicle of sustainable development around the world thanks to the United Nations’ 17 Sustainable Development Goals (SDGs).

Moreover, the multilateral rules-based order has proven to be the best mechanism for establishing a global level-playing field, breaking down both tariff and non-tariff barriers, creating certainty for business operators, amplifying the voice of smaller less-developed countries, and providing a permanent forum for dialogue and collaboration. Conversely, the method of unilaterally imposing tariffs, currently in vogue in Washington D.C., has produced mainly negative consequences for ordinary citizens.<sup>4</sup> Upholding the multilateral rules-based order is therefore an imperative.

## 2. The need for inclusive steering mechanisms

But as important as better communicating the benefits of trade and multilateralism, Europe has to be honest and recognise that the EU and its Member States have insufficiently paid attention to collateral (social or ecological) effects. It also has to ensure its trade policy is fit for the 21<sup>st</sup> century. The spread of e-commerce and the growth of Trade Facilitation Agreements (TFAs) are major game-changers for our broader conception and implementation of trade policy.

The EU must work to design a more inclusive paradigm that is better adapted to the new contextual conditions: not the pursuit of trade for trade’s sake, but the *management of economic and ecological*

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<sup>3</sup> Darvas, “What is the financial balance of EU membership for central Europe?”, Bruegel Institute, 6 February 2018

<sup>4</sup> Amiti, Redding & Weinstein, “The Impact of the 2018 Trade War on U.S. Prices and Welfare”, National Bureau of Economic Research, Working Paper No. 25672, March 2019

*interdependence that serves the citizen first and foremost, while being done within the economic logic of business investments and trade.* Both must be given equal political importance.

This means steering trade policy with the right principles and mechanisms, and incorporating inclusive, sustainable requirements into our mental and operational approaches. In concrete terms, this would imply for example:

- Faster adaptations of national social welfare systems and use of EU regional and cohesion policy to manage potential collateral effects, with the aim to accompany the persons displaced and suffering collateral effects of globalisations,
- The protection of environment should be coherent with what we do in terms of trade policies.
- Doing more work on the longer-term perspective of trade and its gains, evaluating how trade stimulates competitiveness and growth, research & development, etc.,
- Better co-ordination between the different services of the European Commission, thus recognising that EU trade policy has multiple dimensions to it (DG TRADE, DG DEVCO, DG REGIO, DG TAXUD, DG GROW), and with the European External Action Service (EEAS). The future energy security of Europe also cannot be excluded from this analysis,
- A multi-disciplinary body assisting the Trade Policy Committee to formulate EU trade policy in a more transparent, inclusive and evidence-based manner (described in more detail below),
- Greater focus on the customs dimension, which is often the biggest cost and impediment to trade. The structure of EU customs rules can sometimes amount to protectionism, especially from the perspective of SMEs. This should be re-considered given the increasing focus on granting market access to Africans.

### 3. What must change and how to do it

#### **Defend and strengthen the multilateral rules-based order via reform of the World Trade Organisation (WTO)**

This should be regarded as the over-arching goal in all considerations of EU trade policy. As outlined above, the multilateral rules-based system as embodied in the WTO has brought many benefits, but it is currently under great strain due to certain policies and practices of the US, China and others.

As a first step, existing rules and mechanisms should be strengthened to bolster the level-playing field. Studies and analyses should be conducted to define a framework for WTO reform that addresses the various problematic issues. In particular:

- On the **Dispute Settlement Mechanism**, a more offensive and less panicked approach, should be adopted. The EU must not agree to any US proposal or threat that empties the Appellate Body of its substance as an enforcement tool;
- Rules for **developing country status** would benefit from changes aimed at greater differentiation of the benefits. One interesting idea to explore would be to determine developing status on a more territorial (e.g. poorer regions within a country) or sectoral (e.g. agriculture) basis, using accurate data and control;
- Updated and clearer rules on **Most Favoured Nation (MFN) status, non-discrimination, technology transfer, state-owned enterprises and subsidisation**. On the latter in particular, there must be enhanced transparency of notification and a more precise line between legitimate state subsidies and those that are distortive;
- Ensure **better monitoring and enforcement** of agreements through various mechanisms, ranging from independent audits to peer reviews, and using such mechanisms when it is strategically desirable;
- Using the **'building block' model**, recall that a sufficient network of bilateral free trade agreements can facilitate WTO reform. Bilateral rules can be "multilateralized", making it easier to amend WTO rules at a later stage.
- **More ambition on the part of the EU** regarding what it can bring to the table and where it can find common ground with partners
- More ambition on the part of the EU for inclusion of ecological issues.

Secondly, the WTO framework must be adapted to make it fit for the 21<sup>st</sup> century. This means:

- More coherence between WTO rules and the **objectives of the Paris Climate Agreement**;
- Building a corpus of rules to **facilitate digitalised trade and e-commerce**. This is still a blind spot for the WTO whose rules were conceived primarily to regulate trade in goods. Thanks to digitalisation, unique business models have sprung up where the impediments to trade are not tariffs, but things like standards and operating licences. As the European Commission itself has argued, the WTO should establish disciplines aimed at removing unjustified barriers to electronic trade, bringing legal certainty for businesses, and guaranteeing a secure online

environment for consumers. This necessarily encompasses a host of other issues, from regulation to data ownership and privacy and localisation.

### **Define common and coherent 'EU Missions'**

Above all, making an effective and inclusive trade policy **requires coherence and a common economic vision**. Trade policy is only part of a bigger picture, and there are a number of distinct EU policies which are interdependent yet remain insufficiently aligned.

The following inter-related strands should be highlighted:

- 1) Foreign policy
- 2) Trade policy
- 3) Internal market & competition policy
- 4) Security policy
- 5) Energy policy
- 6) Solidarity and SDGs
- 7) Common agricultural policy
- 8) Industry policy
- 9) Environmental policies

Coherence in trade policy requires a common vision about the role of trade, the supporting role of foreign policy, and vice versa. In particular, trade policy and internal market policy ought to go hand in hand. If the EU had a properly functioning internal market, it would be able to better capture the high value added segments of global value chains and at least to some extent repatriate parts where the EU is not at the moment providing an ideal business environment. We equally must take into account areas that nonetheless have high importance for citizens: environment, employment, education, regional policy and migration.

Since the principal task of the Heads of State and Government is to provide impetus to the EU's overarching political and economic direction, the European Council ought to play a central role in framing the EU strategic economic cooperation goals (trade) more coherently. These goals have to be centred around various interdependent external areas: foreign policy, trade policy, security, energy policy and SDGs and solidarity.

### **Protect the EU's ability to manage trade policy as it wishes**

Coherence of policy necessarily implies that the EU must be in a position to protect its own policy-making space and its own stakeholders.

At present, European companies are under pressure from the extra-territorial effect of US sanctions adopted against countries like Iran and Russia (primarily due to the preponderance of the dollar in international markets). The EU must oppose this 'going-alone' strategy by insisting that such measures be agreed upon mutually (in particular determining upfront what the intention is) and having in place an effective counter-mechanism to uphold its own companies' interests (Cuba counter-sanctions are a good model for inspiration).

In addition, the EU is faced with growing investment and acquisitions by Chinese players, often involving very opaque financing conditions and technology transfer. At the very least, a stronger system of economic intelligence, mutual transparency and peer review is required to make Europe better prepared to deal with this. It cannot be that countries benefiting from EU subsidies also undermine its collective interests. Better economic intelligence is also needed for dealing with the US.

### **Better co-ordination between Commission entities, and between the Commission and Member States**

It is important to remember that the European Union is a complex machine with many parts. In order to achieve a more inclusive and sustainable trade policy, the different levels of Europe, from the top echelons of Brussels down to the national and regional bodies of each Member State, have to work together with a common goal and a clear division of responsibilities. This is known as the **principle of complementarity, and is in fact of equal importance to the principle of subsidiarity in a single market and monetary union.**

Within the EU executive, a thorough review of strategy design and implementation should be carried out jointly in the EEAS and Commission, with independent external support. Currently, there are over sixty topics in the EEAS, each with at least one strategy attached to it and hotchpot of structures and procedures.

This is most visible in the sphere of Africa, where a clear lack of internal strategy exists; some elements favour the traditional aid-based model, while others prefer a shift towards the new Continental Free Trade Area (CFTA). Instead, we should define a few key strategic principles, based on common European values and interests, and a limited number of 'missions'. African policy would also benefit greatly from a more streamlined political structure: there should be a Commissioner (or at least a Vice-president) with an exclusive portfolio devoted to Africa.

Formulation of EU trade policy must absolutely involve the national and regional parliaments of Member States on a systematic basis. Lack of representativeness is a common complaint of EU populations, who feel the oft-presumed link between parliament and people has been broken. With a more pyramidal system of dialogue, national interests can be better aligned with European interests to prevent blockages downstream.

### **Boost the Trade Policy Committee**

Enshrined in the Treaties, the Trade Policy Committee (TPC) plays a crucial role within the Council as the main forum where the collective EU position on trade including WTO issues is determined. However, the TPC has become too technocratic while being insufficiently transparent and inclusive.

The work of the TPC would be enhanced by providing for a complementary body; a non-technocratic counterpart to the TPC covering market innovations, investment, trade, internal market policy and the UN Sustainable Development Goals. It should be composed of different officials with competence in higher-level economic strategic issues, with the ability to brainstorm and be innovative. Inspiration can be drawn from existing bodies like the Swedish National Board of Trade. This new body could include working parties (if necessary involving business, NGOs and academics) and a Forward Studies/Foresight Unit. A neutral chairman could participate in the TPC as a non-voting participant.

As for the TPC itself, the present system of rotating of the chairperson of the TPC should be reviewed in favour of the Eurozone system whereby the chairperson is chosen for a longer period of time (2 years, once renewable), ensuring greater continuity. Better work-sharing and more resources are also recommended.

### **Move from 'consultation' to upfront dialogue**

A basic weakness of the traditional trade paradigm is the widespread feeling among stakeholders and citizens that their views are not being heard and taken into account sufficiently. A lack of upfront engagement with the public and stakeholders on trade policy invites the danger of collateral repercussions going unnoticed until it is too late to react. It also creates a breakdown of trust between the Commission and Member States, and between Member States.

A more collaborative mode of governance is necessary, whereby consultation is replaced with dialogue. EU consultation methods as practised by the Commission are a hierarchical, linear process; whereas dialogue is non-hierarchical engagement with stakeholders. Consultation is one-off, dialogue is permanent. It has to be learned. External specialist advice will help to do so.

Research has shown that there is a positive correlation between a society's or institution's degree of tolerance for the independent, unorthodox, creative and entrepreneurial-minded and its economic success and/or social beneficitation.<sup>5</sup> Therefore, outside-the box thinkers and sceptical and critical stakeholders may have positive effects if they are listened to instead of being excluded upfront.

Of utmost importance in dialogue is the involvement of the real economic and social actors: those responsible in business, education, and civil society. The role of the economic advisory group should be reviewed in this context too, and made more transparent and open to real exchanges and creative thinking. This will help to contribute to coherence and inclusiveness of policies and regulations, and putting the focus on outcome (instead of procedure). They may bring fresh thinking and useful experiences and in general are more up-to-date with the use of new media technologies too.

The Nordic or Dutch models can serve as inspiration for the EU: civil society, industry and local government are engaged at an early stage in the policy-making process, which creates a better atmosphere for technical negotiations downstream and pre-empts the kind of vehement criticism that derailed the TTIP talks.

### **Address climate change with market-driven measures**

Despite the withdrawal of the United States, Europe must uphold the Paris Agreement and implement its commitments. Indeed, the Paris Climate Agreement participation should be an essential prerequisite to any bilateral trade agreement involving the EU. The move to a more environmentally sustainable model is the EU's future competitive advantage.

Attention should be given to developing market-driven measures to achieve our climate goals. Private initiatives like certification can provide useful inspiration<sup>6</sup>. For example, an ISO standard on quantification and reporting of a product's carbon footprint is under development.<sup>7</sup>

Carbon pricing is an essential market instrument to internalise climate and environmental costs into financial costs, and thus to enable market incentives and sanctions to the benefit of low-carbon or decarbonised economic activities. There is a growing recognition at the international level on the need to set a high and predictable carbon price in order to reach the Paris Agreement targets<sup>8</sup>; yet there are various possible ways to implement it. Emission trading schemes, taxation and offset mechanisms are among the most common tools<sup>9</sup>.

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<sup>5</sup> Richard Florida, *The rise of the creative class*, 2002

<sup>6</sup> See for example the forestry sector: the Programme for Enhanced Forest Certification and the Forest Stewardship Council.

<sup>7</sup> ISO 14067:2018

<sup>8</sup> According to CPLC, carbon pricing should be set between 40-80 USD (35-70 EUR)/tCO<sub>2</sub> in 2020 and 50-100 USD (44-88 EUR)/tCO<sub>2</sub> in 2030 to reach the goals of the Paris Agreement (CPLC, *Report of the high-level commission on carbon pricing*, 29 May 2017).

<sup>9</sup> See World Bank, *Carbon Pricing Dashboard*: <https://carbonpricingdashboard.worldbank.org/what-carbon-pricing>

Although a successful global carbon trading scheme is still unlikely to emerge on the short term, the EU and its international partners should consider agreeing at the multilateral level on a common understanding to harmonise the various existing carbon pricing instruments. More than the nature of the mechanism chosen, it is necessary to focus on the desired outcome, i.e. a harmonised global carbon price for a fair and climate-neutral international trading environment.

While trying to implement this global solution, the EU should design already an alternative unilateral equalization mechanism to both correct the competitive-burden of environmental policy on its domestic production and incentivize partners to join the global quota system or a similar scheme.

Unlike tariffs, market-driven measures have the advantage that they cannot be attacked by other countries in retaliation. We recall however that such measures are not sufficient alone to deal with climate change consequences, and to ensure that all countries internalise it and create a real 'climate level-playing field'.

### **Boost the EU's soft power in promoting human and social rights**

While the EU cannot necessarily impose its societal vision on other countries and blocs, the EU should nonetheless rely on its 'soft power' by being attentive to particularly severe and systematic violations of human rights by trading partners. More and more we are seeing the importance of reputational issues for companies when they are considering commercial investment in certain parts of the world.

In some circumstances (e.g. persistent failure to implement ILO Conventions or the UN Declaration on Human rights), such violations should act as brakes on further economic relations. Other examples include massive cultural and social repression, genocide or apartheid-style policies.

Certain NGOs (Freedom House, Amnesty International and others) should be regularly consulted where the most serious violations are happening and on what the EU could do, through soft diplomacy, intervention of third parties or, when these do not help, trade measures. The EU should potentially nominate a high representative for human and social rights to take care of this area and give him or her sufficient means to do so.

### **Ensure more robust monitoring and enforcement of trade policy**

The need for better monitoring and enforcement applies as much to the internal market as to international trade. For decades the Commission has tended to turn a blind eye to the inefficient public administrations of certain Member States; this has to end. The EU collaborative system of governance is seriously weakened by the lack of capacities and outdated organisation and practices in public administrations, in many new and some old Member States alike.

Whether EU, WTO or bilateral, the tools for enforcement have to be used effectively and when it is strategically desirable. In order to properly do so, the Commission needs to make sure to have the ability, the resources and the will to enforce strict market-based principles as authorized by the multilateral and bilateral treaties as well as in line with our own domestic rules. To do so, the Commission could consider a more easily identified entity to be in charge of trade rules enforcement. The Commission should provide an annual report on actions and measures taken. Non-compliance must have consequences.

### **Improve our understanding of our trading partners**

The challenges presented by China, US, Africa and others cannot be faced unless we truly understand the history, culture and socio-economic background of these countries or continents. This ranges from comprehending the unique Chinese political system (neither capitalist nor statist in our traditional conception) to taking account of the massive cultural and economic diversity across Africa.

The EU should as much as possible recruit from the growing pool of Chinese speakers and Africans residing in Europe to aid us in our understanding of other trading partners.

### **Develop a more effective communication policy on trade vis-à-vis the public**

As highlighted already, trade policy is receiving a bad press on the European and international stage. A new approach, based on simple language communicated directly to the citizen is required. It must be focussed on the concrete benefits, practical gains for consumers and the role that trade can play as a vehicle for sustainable development.

This must of course go hand in hand with addressing feelings of left-behindedness and reassuring ordinary people about how the collateral effects of trade can be mitigated.

The policy must go beyond social media and address broader information communication technology.

### **Adapt to the Fourth Industrial Revolution and the growing importance of services relative to goods**

The 'Fourth Industrial Revolution'<sup>10</sup> is fundamentally changing how we trade and the very nature of global value chains.

This shift has impacted not only industrial production but also trade specifically, in the increased cross-border flows of purely digital products that involve practically no transport or distribution costs, and in the rise of digital e-commerce platforms that enable smaller companies to participate in exporting

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<sup>10</sup> Klaus Schwab "What is the Fourth Industrial Revolution?" World Economic Forum, Dec 2015.

and importing. As a result, the barriers for business and individuals to create wealth have been significantly lowered, and more agile, innovative competitors now have the ability to oust well-established players. E-commerce in particular has the potential to deliver rapid economic growth, because it makes distance irrelevant. However, there is equally a risk that these developments favour only large platforms.

In addition to increase in international trade in stand-alone services and services traded alongside goods (e.g. machinery surveillance and maintenance services), services content in goods often represents a major part of the value of high-tech products, in particular. While goods are more and more frequently assembled with inputs of varying origin, the embedded services tend to have a high level of domestic value added. Therefore, in addition to services forming an ever bigger share of the value of a product, the domestic value creation of the product is increasingly dependent upon its services content.

This raises many questions. As services are due to be tariff free, are we de facto paying more tariffs in our export markets of the services content of a product than of the "hardware"? What if the components that are assembled into a final product cannot meet specific (bilateral) rules of origin even if the domestic value added of the final product is very high due domestic services content, such and R&D, software or similar?

As the competitiveness of the EU and its possibilities in the global technological race increasingly dependent on its ability to produce high-end, high value added products, with a considerable services component, it would be worthwhile to analyse whether rules of origin or rules that govern customs valuation should be revised to support the competitiveness of EU operators.

The EU Missions and strategy should be linked in order to form a coherent vision with a set of overarching objectives which can be understood by Europeans and the world. This would bring back system legitimacy and credibility, as well as feed ideas into the policy cycle so as to ensure everything is aligned upfront.

### **Adopt a new approach to measuring the impact of globalisation**

The first step to understanding the impact of globalisation is to have the right data and know how to measure it. Currently the data used for both policy planning and public debate on trade and globalization is often one-sided and misleading, creating black and white import-export debates that largely overlook the fact that EU competitiveness is based on its ability to tap into global value chains where the divisions between imports and exports, goods and services is increasingly blurred.

Impact assessment studies done by the Commission should lead to a transparent exchange with Member States how to manage potential future consequences. Trade analysis methods need to be revised. In order to understand how globalization is affecting the EU's economies, there needs to be a more fine-tuned set of data that analyses:

1. The value added of our trading partners in EU imports,

2. The level and final consumption of EU value added in exports,
3. The impact (including geographical) of trade on different types of companies, employment, gender equality and climate change,

The data required for this exercise exists in Europe; the challenge is to access it and collect it in the most effective way. Rules on access differ from Member State to Member State (as does technological capability), underlining the necessity of having consistent EU-wide rules.

With regular production of the above data/statistics, a common EU-wide understanding of the impact of globalization will be possible and therefore have a better-informed internal (and public) debate on holistic policy responses. There should be an increased role for the globalisation fund to deal with its consequences, but this may require to review funding and operation.

In practical terms, the work done by the OECD in the context of the Trade in Value Added (TiVA) database would also provide a basis for such analysis. As the policy responses for the EU mission and strategy in this respect would require multi-disciplinary approach that crosses competence lines, there needs to be regular (at least yearly) reporting on EU's position in global economy and on the management of economic and ecological interdependence. The role of the EU Statistical Office (EUROSTAT) should be upgraded to ensure this regular reporting, involving close collaboration with the OECD.

The current decision-making silos are not fit for this, so it is proposed to set up an advisory group of "Innovators" to guide the discussion without being inhibited by competence lines.

July 2019