



HM Government

Review of the Balance of Competences between the United Kingdom and the European Union Trade and Investment

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Trade and Investment

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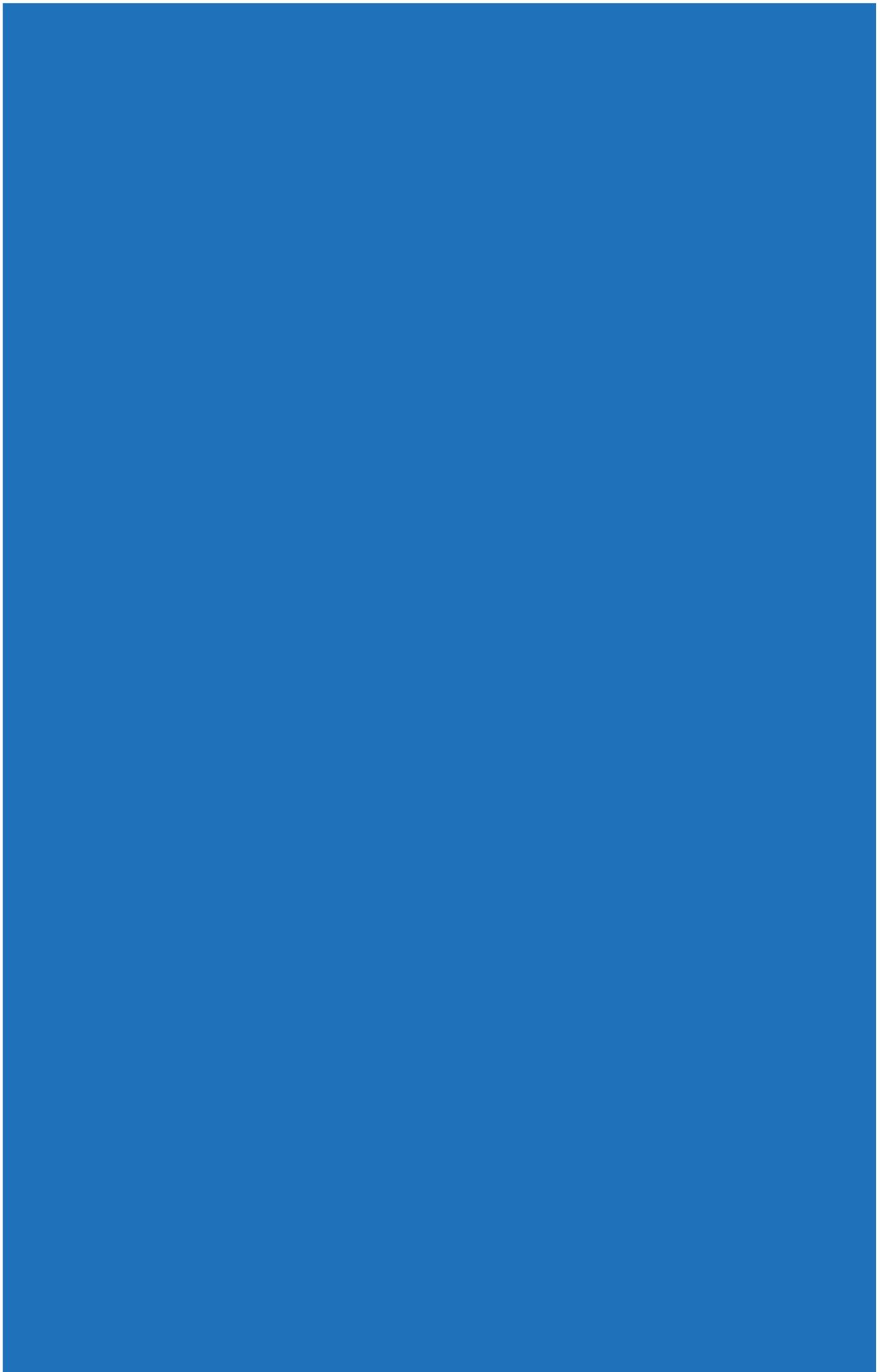
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Executive Summary

This report examines the balance of competences between the European Union and the United Kingdom in the area of Trade and Investment, and is led by the Department for Business, Innovation and Skills. It is a reflection and analysis of the evidence submitted by experts, non-governmental organisations, business people and other interested parties, either in writing or orally, as well as incorporating views and evidence presented in other relevant material. Where appropriate, the report sets out the current position agreed within the Coalition Government for handling this policy area in the EU. It does not predetermine or prejudge proposals that either Coalition party may make in the future for changes to the EU or about the appropriate balance of competences.

Chapter 1 sets out the historical development of international trade and investment and EU trade and investment policy. International trade and investment have increased and changed significantly over the past 60 years. The rules that govern trade and investment have also evolved. A multilateral world trading system, now embodied in the World Trade Organisation (WTO), has contributed to a world-wide reduction in the levels of tariffs applied to trade. Countries have also developed their own bilateral trade agreements and taken part in plurilateral agreements which address specific areas. No overarching multilateral system for investment has emerged. The EU's competence for international trade policy first emerged as a result of the formation of the Customs Union. This competence has expanded, through rulings of the European Court of Justice (ECJ) and revisions of the EU Treaties, to cover an increasing number of issues. Through its Common Commercial Policy (CCP), the EU has entered into a large number of international trade and investment agreements.

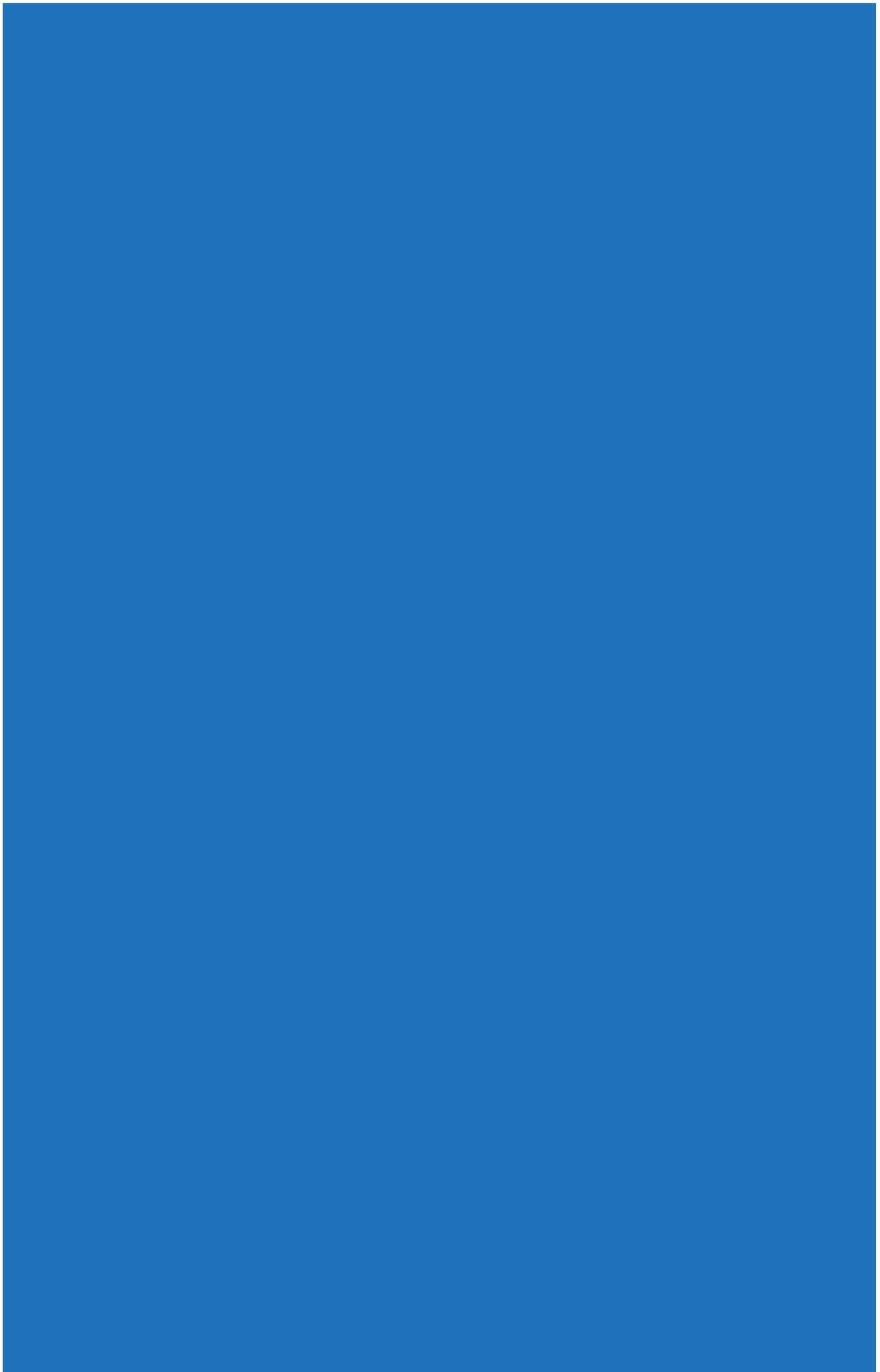
Chapter 2 explains the current state of competence, after the entry into force of the Treaty of Lisbon in 2009. The Lisbon Treaty made certain significant changes to EU trade and investment policy. It clarified and extended the scope of the CCP, codifying existing ECJ case law and explicitly including foreign direct investment. However, some disputes over competence remain. The Lisbon Treaty also introduced procedural and institutional changes, changing the voting requirements for decision-making in the CCP and strengthening the role of the European Parliament, both in the development of internal rules and in international negotiations. The EU is currently updating its internal rules to bring them into line with the requirements of the Lisbon Treaty and introducing new rules to deal with its new competences. At present, the CCP involves a range of activities, including: negotiating international trade and investment agreements, including ones with development objectives; negotiating at the WTO and playing an active role at the Organisation for Economic Co-operation and Development (OECD); implementing 'trade defence' measures to protect EU producers against the effects of unfair trade; and establishing rules on import and export controls and on 'export credit agencies'.

Chapter 3 explores the impact of the current balance of competences over trade and investment on the UK's national interest. The evidence received from stakeholders generally suggests that the balance of competences in this area allows the UK to achieve results that are in the national interest. However, a small number of respondents criticise the current balance and several highlight issues relating to the specific ways in which competence is exercised, for example, in trade defence, and when using trade to achieve development aims.

The central debate over the balance of competences in this area focuses on whether the **benefits of the increased influence** that arise from being part of a bloc outweigh the **costs of the compromises** that come with it. Many suggest that the EU's negotiating weight enables the UK to achieve better results in international negotiations than it would on its own. This increased influence is also thought to allow the EU to influence multilateral rules and to deter harmful policies from other actors. However, being part of the EU limits the UK's ability to prioritise its own interests. Assessments of the impacts of these constraints are mixed. Any costs of being part of the CCP also need to be weighed up against the benefits of being part of the Single Market, since the UK cannot be in the Single Market without also being part of the CCP. The literature suggests that being in the Single Market has had a net positive impact on UK trade.

Chapter 4 considers the future of the balance of competences over trade and investment. Certain challenges are likely to arise from growing interest in securing broader and deeper trade and investment agreements which go beyond tariff rates to address key 'behind the border' issues including differences in regulatory practices and approaches. Other pressures include internal developments within the EU and the single market, which will affect what the EU can offer in any negotiations, and from changing business practices. Some stakeholders were concerned that in responding to these challenges the EU would start focusing on areas that would make it harder for their interests to be met.

There are several possible options that the EU and the UK could pursue in order to address these challenges and to make their actions and processes more effective. Within the EU, competence debates could be resolved and operational effectiveness could be improved, through changes to resourcing, improvements in transparency, and changes in the roles of the institutions. Any more radical changes in the balance of competences would require a significant change in the UK's relationship with the EU, as the UK cannot regain competence for trade and investment without leaving the EU. There are several possible alternatives that the UK could pursue. Each would have different implications for the UK's trade both with the EU and non-EU countries. Also relevant to any consideration of alternatives are the UK's capacity and expertise, and the effect that the UK's departure from the EU would have on the policies of the EU. These are very difficult to determine.



Introduction

This report is one of 32 reports being produced as part of the Balance of Competences Review. The Foreign Secretary launched the Review in Parliament on 12 July 2012, taking forward the Coalition commitment to examine the balance of competences between the UK and the European Union. It will provide an analysis of what the UK's membership of the EU means for the UK national interest. It aims to deepen public and Parliamentary understanding of the nature of our EU membership and provide a constructive and serious contribution to the national and wider European debate about modernising, reforming and improving the EU in the face of collective challenges. It has not been tasked with producing specific recommendations or looking at alternative models for Britain's overall relationship with the EU.

The review is broken down into a series of reports on specific areas of EU competence, spread over four semesters between 2012 and 2014. More information can be found on the review, including a timetable of reports to be published over the next two years, at <https://www.gov.uk/review-of-the-balance-of-competences>.

The analysis in this report is based on evidence gathered following a call for evidence. It draws on written evidence submitted, notes of seminars or discussions held during the call for evidence period and existing material which has been brought to our attention by interested parties, such as past select committee reports or reports of the European Commission. A list of evidence submitted can be found in Annex A. Other relevant literature has also been drawn on. For a full list see Annex C.

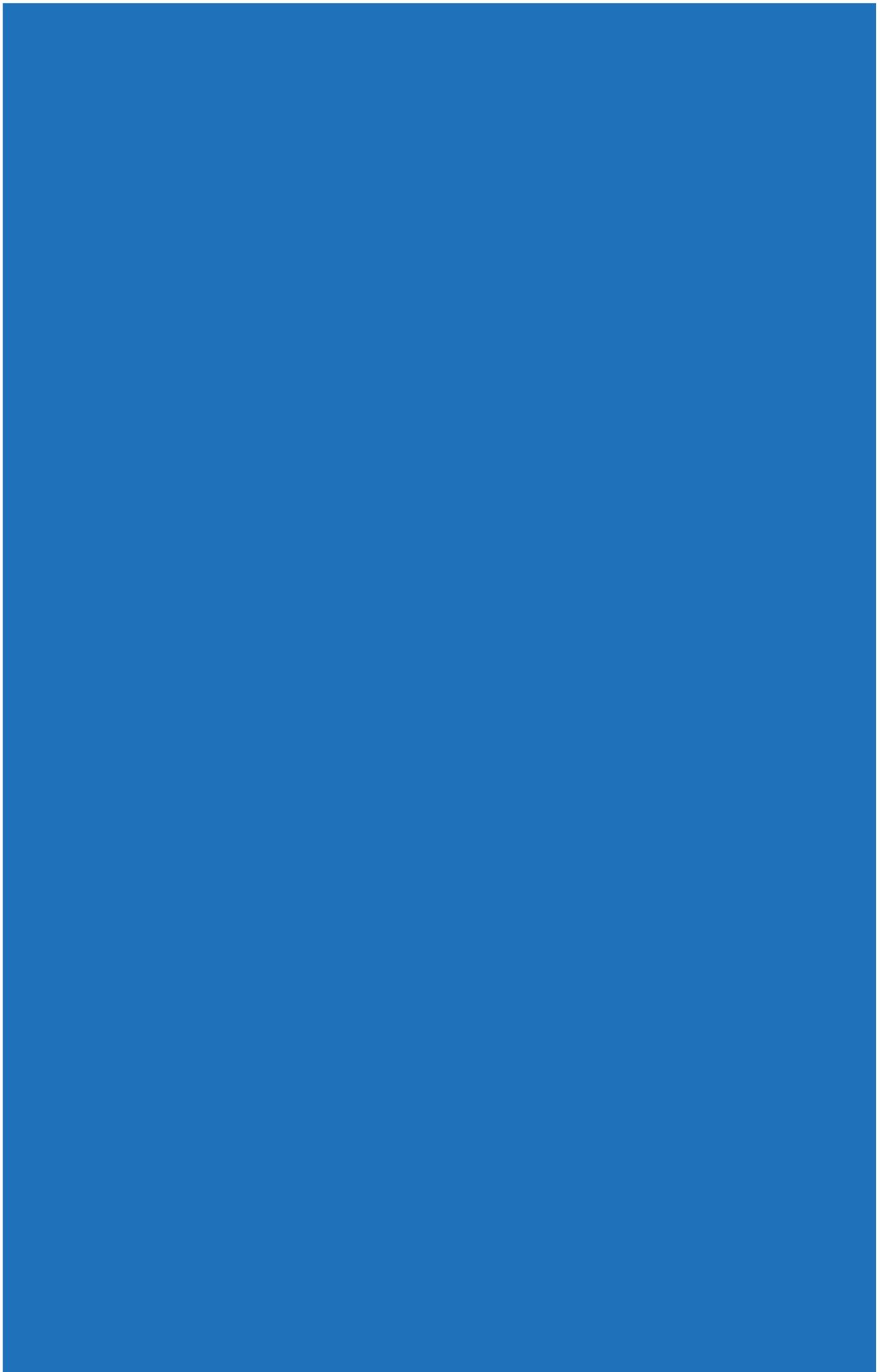
For the purposes of this review, we are using a broad definition of competence. Put simply, competence in this context is about everything deriving from EU law that affects what happens in the UK. That means examining all the areas where the Treaties give the EU competence to act, including the provisions in the Treaties giving the EU institutions the power to legislate, to adopt non-legislative acts, or to take any other sort of action. But it also means examining areas where the Treaties apply directly to the Member States without needing any further action by the EU institutions.

Definition of EU competence

The EU's competences are set out in the EU Treaties, which provide the basis for any actions the EU institutions take. The EU can only act within the limits of the competences conferred on it by the Treaties, and where the Treaties do not confer competences on the EU they remain with the Member States.

There are different types of competence: exclusive, shared and supporting. Only the EU can act in areas where it has exclusive competence, such as the customs union and common commercial policy. These are discussed in this report. In areas of shared competence, such as the Single Market, environment and energy, either the EU or the Member States may act, but the Member States may be prevented from acting once the EU has done so. In areas of supporting competence, such as aid policy, culture, tourism and education, both the EU and the Member States may act, but action by the EU does not prevent the Member States from taking action of their own.

The EU must act in accordance with fundamental rights as set out in the Charter of Fundamental Rights (such as freedom of expression and non-discrimination) and with the principles of subsidiarity and proportionality. Under the principle of subsidiarity, where the EU does not have exclusive competence, it can only act if it is better placed than the Member States to do so because of the scale or effects of the proposed action. Under the principle of proportionality, the content and form of EU action must not exceed what is necessary to achieve the objectives of the EU Treaties.



Chapter 1:

Developments in Trade and Investment and EU Competence

- 1.1 World trade and investment have grown rapidly in the last 60 years. They are also very different in 2014 from 60 years ago, for some of the following reasons:
- Businesses from more countries are involved in trading, and the variety of products and services that are traded has grown enormously. The increase in businesses trading from countries with an abundance of labour and natural resources, especially emerging economies like China, Brazil, India and Russia, has presented a challenge to countries like the UK.
 - The nature of trade has changed from being about trade in finished products. There has been a big increase in intra-industry trade, such that the UK both imports and exports the same products, for example cars.
 - Trade is no longer just about products: services are now a larger part of trade and more services are embedded in manufactured goods and traded with goods.¹ For example, Rolls-Royce's power systems, such as aero engines, produce decades of aftermarket services revenue and now account for over 50% of the company's revenue stream.
 - Businesses have become increasingly specialised in particular aspects of the production process, such as distribution or marketing. Fewer individual businesses are involved in the whole chain of production.
 - Production chains have become global, with the production of a good no longer occurring in one country alone. Exports from one country are often inputs into bigger production processes, while many imports are also inputs to production.
 - International investment flows have increased dramatically. Investors have looked to make investments abroad to take advantage of lower costs (for example when 'offshoring'), to exploit particular resources, and to gain access to new markets.
 - Emerging economies have become increasingly important as sources and destinations of investment.

¹ Swiss Body of Trade, *Everybody is in Services* (2012). This finds 'Services are necessary for any firm seeking to take advantage of global value chains and to move up these chains to capture more value'.

- 1.2 The UK has a long history as a trading nation, with the expansion of British trade in the 18th and 19th centuries going hand in hand with the expansion of the British Empire. Over the last 60 years, British trade and investment have grown and changed significantly, reflecting many of the global trends outlined above. Successive British governments have supported a liberal approach to trade and investment, both within the EU and internationally.²
- 1.3 The UK trades with many countries, but the EU is its largest trading partner for trade in goods, accounting for about half of UK exports. The sort of goods that the UK exports has evolved over time – the share of trade in chemicals and commodities has increased while trade in machinery and transport equipment has been gradually declining. Another important trend in UK trade has been the increasing importance of services exports. Although the total value of the UK's goods exports still exceeds the total value of the UK's services exports, the UK is a net exporter of services and a net importer of goods.
- 1.4 The UK is also a hugely important source and destination for investment. According to the latest available data, from 2012, it has the third largest stocks of inward foreign direct investment, behind the USA and Hong Kong, and the second largest stocks of foreign direct investment abroad, behind the USA.³
- 1.5 Further detail on developments in trade and investment is set out in Appendix A.

The Development of the World Trading System

- 1.6 The world trading system, the international rules which govern trade between countries, has developed considerably over the last 60 years. Rules on trade were developed after the Second World War. The most important set has been the General Agreement on Tariffs and Trade (GATT). The GATT was launched in 1947 as an agreement on tariffs. Its early decades focused mainly on negotiating reductions in tariff rates. Negotiations to reduce tariffs under the GATT took place in rounds and have involved an increasing number of countries – see Table 1.1. Although the WTO replaced GATT as the international organization responsible for international trade rules, the General Agreement remains the basis for the WTO's treaties for trade in goods.
- 1.7 As tariffs have been reduced, 'non-tariff measures', also known as 'non-tariff barriers', have become increasingly important barriers to global trade. Multilateral negotiations are therefore increasingly focused on these measures, which include quantitative restrictions on imports (such as limits on the amount of a certain agricultural product that one country can export to another), technical barriers to trade (such as sanitary standards imposed by one country, which might be very difficult for foreign exporters to meet), regulatory differences, and subsidies which give domestic firms an unfair advantage.

² See, for example, HMG, *Trade and Investment for Growth* (2011).

³ UNCTAD database, available at www.unctad.org/fdistatistics, accessed on 30 January 2014.

Table 1.1 Number of Countries Participating in Trade Negotiations

Year	Place/name/event	Subjects covered	No. of Countries involved
1947	Geneva round	Tariffs	23
1949	Annecy round	Tariffs	13
1951	Torquay round	Tariffs	38
1956	Geneva round	Tariffs	26
1960-61	Geneva Dillon round	Tariffs	26
1964-67	Geneva Kennedy round	Tariffs and anti-dumping measures	62
1973-79	Geneva Tokyo round	Tariffs, non-tariff measures, framework agreements	102
1986-1994	Geneva Uruguay round	Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO etc.	123
1995	WTO established		130 (no. of WTO members)
2001-present	Doha round	Wide agenda, including further opening of markets (including agricultural), services and intellectual property regulation, strengthening assistance to developing countries.	159 (current no. of WTO members). Increased to 160 following the accession of Yemen in 2013

WTO, 'The GATT years: from Havana to Marrakesh' (2013).

- 1.8 The world trading system today is embodied in the WTO, which was established in 1995, at the end of the Uruguay Round of negotiations. The WTO is currently the host to negotiations under the 'Doha Development Agenda' (DDA) launched in 2001. The WTO's 9th Ministerial Conference, held in Bali, Indonesia, in December 2013 reached agreement on a number of the DDA measures – see Box below. The work of the WTO and the evolution of the types of issues addressed in the world trading system are set out in Appendix B.

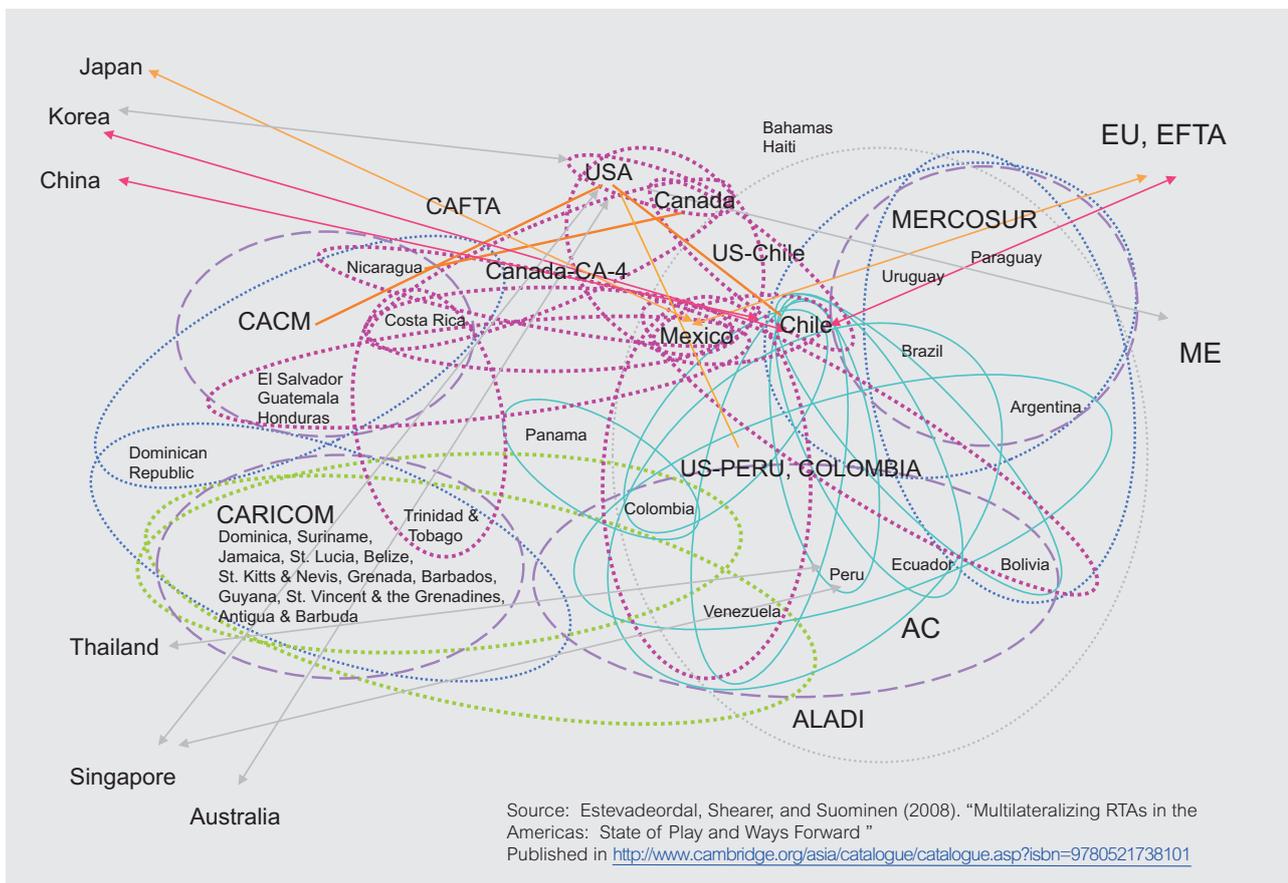
The agreement reached at the 9th WTO Ministerial Conference included:

- A trade facilitation agreement, worth around \$100 billion which will cut unnecessary bureaucracy at borders and streamline procedures to smooth the movement of goods across the world. Two-thirds of the benefits will accrue to developing countries and 10% to Sub-Saharan Africa. Landlocked countries in Africa will be the biggest gainers in proportion to their GDP. Because they suffer disproportionately from inefficient borders small traders in particular will benefit. The agreement includes provision to speed up the passage of food and other perishable items through borders.
- A set of three agriculture proposals, including an agreement on the interplay between food stock procurement and WTO rules which preserves the right of all countries to provide food security for their people, while reducing the risk of procurement at above-market prices distorting markets and damaging farmers in other countries. The other agriculture agreements involved a political agreement to reduce export subsidies and a plan to make the management of quotas more transparent.
- Development-specific agreements included a mechanism to monitor the implementation of WTO rules from a developing country perspective; and political agreements on rules of origin, on duty-free quota-free market access, on services trade from Least Developed Countries and on solving cotton market issues.
- The Conference also agreed the accession of Yemen to the WTO.

Details on the negotiations and the resulting 'Bali package' can be found at <https://mc9.wto.org/>

- 1.9 Alongside the development of the multilateral trade system, and partly because of previously slow progress in multilateral, WTO negotiations, many countries have also been negotiating and agreeing trade deals between themselves. There are now many bilateral trade deals, such that the international system of trade deals has become overlapping and complex, and is often referred to as a ‘spaghetti bowl’ of deals. Figure 1.1 illustrates the regional and bilateral trade deals that linked different countries and groups of countries in the Americas in 2008.
- 1.10 Some bilateral or regional trade deals have the potential to set global standards, by virtue of the volumes of trade that they govern. One example of this is the EU-US trade deal (the Transatlantic Trade and Investment Partnership, discussed in Chapter 4), which is currently under negotiation. Even in the absence of trade deals, big economies, particularly the EU and the US, can have an influence on the ‘rules’ of global trade by setting standards internally that become accepted globally. For example, the EU has set standards relating to mobile telecoms, product safety and the environment which have spread across many different parts of the world. The EU has often sought to extend the reach of its standards through ‘regulatory dialogues’ with other major economies, including China and the US.⁴

Figure 1.1 Overlapping Trade Deals between WTO members in the Americas



R. Baldwin and Thornton, *Multilateralising Regionalism: Spaghetti Bowls as Building Blocks on the Path to Global Free Trade*, (2008).

⁴ T. Buck, 'Standard Bearer', *Financial Times* (2007).

The Development of an International Investment System

- 1.11 Unlike the world trading system, there is no comprehensive multilateral agreement on rules for international investment or a governing body equivalent to the WTO. International work on investment has focused on two main issues: it has sought to reduce barriers for investors looking to invest in other countries, improving what is known as ‘market access’ for investments by, for example, changing rules prohibiting foreign ownership in certain sectors; and it has sought to improve the treatment of international investors once they have made an investment in a particular country (this is known as ‘investment protection’). Although the WTO does not deal with all investment issues, its agreements do address some issues relating to market access for investments in the services sector and prohibit certain measures that discriminate against foreign investors. The Organisation for Economic Co-operation and Development (OECD) has a Declaration on investment, which is a policy commitment by adhering governments to provide an open and transparent environment for international investment and legally binding Codes, which stipulate progressive, non-discriminatory liberalisation of rules governing the movement of capital.⁵ This is discussed further in Appendix B.
- 1.12 In the absence of a comprehensive multilateral investment agreement, countries have also addressed their concerns about investment through bilateral agreements. Some of these have formed parts of broader trade and investment agreements, while others have been negotiated as stand-alone investment agreements. These stand-alone agreements, typically known as Bilateral Investment Treaties (BITs), sometimes deal with both market access for investments and investment protection, but frequently only address post-establishment investment protection.⁶ The UK has BITs, dealing only with investment protection, with 94 countries – see Appendix C. These Treaties generally allow investors of each party to make compensation claims against the other party when they believe that they have been mistreated in certain ways. Investors can make these compensation claims using different forms of international arbitration, the most common of which are those established under the World Bank’s International Centre for the Settlement of Investment Disputes (ICSID) and the United Nations Commission on International Trade Law (UNCITRAL). After the Lisbon Treaty, the EU has at least some competence to negotiate BITs. This is discussed in Chapter 2.

⁵ For more information see OECD, Declaration on Investment, REV 2011. Available at: www.oecd.org/investment/, accessed on 30 January 2014.

⁶ At the time of writing there are over 2300 BITs in force.

The Development of European Trade and Investment Policy

1.13 European trade policy developed out of the creation of the common market in 1958 (see box below). It has evolved in response to the changing world trade and investment system and growth and changes in the nature and type of trade and investment. On becoming a member of the European Economic Community (EEC) in 1973, the UK joined the customs union of the EEC and since then UK trade policy has been governed by European trade policy.

A customs union is a stage of international integration. It is more advanced than a free trade agreement (FTA) and is an essential element of a fully functioning single market. It has two dimensions. Internally, Member States agree to remove any customs duties, charges having equivalent effect to customs duties, or quantitative restrictions on goods originating from other member states – this allows the free movement of goods within the customs union regardless of their origin.⁷ Externally, Member States agree to adopt a common external customs tariff, which governs the treatment of imports from countries outside the customs union.

The common customs tariff must be applied identically in all Member States. If it were not, goods would be able to enter the customs union and circulate at different prices depending on which country they entered through, distorting trade patterns and undermining the Single Market.⁸ With different external tariffs, steps would have to be taken internally to limit the free circulation of goods (through a ‘rules of origin’ system to determine which tariff should be applied to any good). This would constitute a trade barrier between Member States and the customs union would cease to operate.

In order to avoid this, any customs union must have a common external tariff. To have a common external tariff, members of a customs union must agree a common international trade policy, so that Member States cannot negotiate their own independent agreements on tariffs with non-Member countries.⁹

The impact of the development of the Single Market on trade policy is discussed in Chapter 4.

⁷ For more detail on the free movement of goods within the EU, see HMG, *The Balance of Competences Between the UK and the EU, Single Market: Free Movement of Goods Report*, published in parallel with this report.

⁸ With a full Single Market, similar principles apply to the movement of capital and services – if different Member States offer significantly different levels of market access to foreign investors and services providers, this would also distort competition within the Single Market. It is partly for this reason that the EU’s CCP has developed to include trade in services and market access for investment.

⁹ The difference between a Free Trade Area and a customs union is described briefly in Chapter 4. Table two of the CEPR research published in parallel with this report presents a summary of the different elements.

- 1.14 The founders of the EEC had the goal of setting up a common market in which goods, services and capital could be traded freely and labour/people could move. This also involved the creation of a customs union in the EEC in 1968. The development of the common market is described in Chapter 1 of the Balance of Competences report on the Single Market, published in July 2013.¹⁰
- 1.15 The customs union itself had to be integrated into the existing international economic rules, regulated by the 1948 GATT and subsequently the WTO. Their arrangements and rules have had to be transposed into European law. Article 110 of the EEC Treaty, now Article 206 TFEU, declares that in creating a customs union, the EEC intended to contribute, in accordance with the common interest, to the harmonious development of world trade, the gradual removal of restrictions to international trade and the lowering of customs barriers.

The Development of the Common Commercial Policy (CCP) before the Treaty of Lisbon¹¹

- 1.16 From its inception in 1957, the EEC, which later evolved into the European Community (EC) and the EU, has had competence over international trade in goods. It has exercised this competence through its international trade policy, the CCP. The CCP has changed dramatically over the years since 1957, generally expanding to cover more and more areas of international trade and investment.
- 1.17 The competence of the EEC in the field of the CCP, defined in Article 113 EEC, [later Article 133 of the Treaty establishing the European Community (TEC), and now Article 207 Treaty on the Functioning of the European Union (TFEU)], was initially limited to trade in goods. This competence, which, as set out in the box above, followed on from the creation of a customs union, included a common customs tariff and common import and export regimes for goods. As the nature and scope of international trade have changed and expanded, the CCP has changed and expanded in response. However, the development of a uniform external trade regime beyond the customs union and the common external tariff has not been straightforward. European Court of Justice (ECJ) rulings and, later, treaty changes have been important in determining the extent of the CCP, which has often been disputed.

Development of the CCP through ECJ Rulings

- 1.18 The first major ECJ ruling which acknowledged the shift of competence over trade policy from the Member States to the EC was Opinion 1/75.¹² In this case, the Court was asked whether the EC could conclude an international agreement relating to export credits (a way of aiding exports by providing trade finance). The Court ruled that the content of the agreement fell within the scope of the CCP and confirmed that the Community had exclusive competence to conclude international agreements in this area. This meant that Member States could not independently enter into international agreements within the scope of the CCP and opened up the possibility for the CCP to develop into the sort of policy that we see today.¹³

¹⁰ HMG, *The Balance of Competences Between the UK and the EU: Single Market: Synoptic Report* (2013).

¹¹ This section draws on legal analysis submitted by Dr. Michael Waibel, published in parallel with this report.

¹² *Understanding on a Local Cost Standard*, Opinion 1/75 [1975] E.C.R. 1355.

¹³ See Holdgaard and Holdgaard, *The External Powers of the European Community* (2001).

The CCPs should be Interpreted Dynamically

1.19 The ECJ further extended the scope of exclusive Community competences in Opinion 1/78.¹⁴ This Opinion was sought to settle the question of whether the EC, its Member States, or both should be allowed to be party to an international agreement dealing with trade in rubber. The question arose because it was not clear whether all the elements of the agreement fell within the scope of the CCP. The Court built on arguments in Opinion 1/75 to confirm that the CCP should be interpreted dynamically, so that it could keep pace with the changing character of international trade and remain relevant over the course of time. This principle was confirmed in several other rulings through the 1970s and 1980s. Opinion 1/78 also set out certain arguments relating to the idea of ‘mixed’ agreements; these are agreements to which both the EC and its Member States are parties. It made it clear that where the EC and Member States both had competence over parts of an agreement, both should participate in that agreement.¹⁵

Implications for the WTO

1.20 The idea that the CCP should be interpreted dynamically has allowed it to extend beyond tariffs on goods to other areas of international trade. This was significant in the next major expansion of the CCP, which coincided with the conclusion of negotiations on the development and expansion of the multilateral trade system in the mid-1990s. These negotiations resulted in the WTO Agreements, which, as set out above, established a framework for trade relations among its Member countries that extended beyond trade in goods and into new areas of international trade. Given the scope of the WTO’s activities, it was unclear whether the EC’s competence to join the WTO and to sign its agreements was exclusive.

1.21 The Court analysed this question in Opinion 1/94.¹⁶ The ruling first confirmed that all the WTO agreements on trade in goods came within the CCP, and therefore under the EC’s exclusive competence. It then considered the question of competences in the field of services and intellectual property rights, which were now being addressed in WTO negotiations, through the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). The Court did not see any reason in principle to exclude trade in services from the CCP’s scope. However, examining different modes of supply of services, it found that only cross-border supply was sufficiently similar to trade in goods to be considered part of the CCP.¹⁷ It therefore concluded that the three other modes of supply did not fall within the scope of the CCP. On the question of intellectual property rights, the Court held that the EC’s competence only covered the provisions on the release into free circulation of counterfeit goods, while the rest of the TRIPS was outside the CCP’s scope. Based on these conclusions, and contrary to the European Commission’s view, the Court found that the

¹⁴ *International Agreement on Natural Rubber*, Opinion 1/78 [1979] E.C.R. 2871.

¹⁵ Holdgaard and Holdgaard, *The External Powers*.

¹⁶ *WTO Agreement*, Opinion 1/94 [1994] E.C.R. 5267.

¹⁷ Article 1(2) GATS defines trade in services as comprising four modes of supply: 1) cross-frontier supplies not involving any movement of persons; 2) consumption abroad, which entails the movement of the consumers into the territory of the country in which the supplier is established; 3) commercial presence, i.e. the presence of a subsidiary or a branch in the territory of the country in which the service is to be rendered; 4) the presence of natural persons from a country, enabling a supplier from one member country to supply services within the territory of any other country.

Community and Member States shared competence to conclude both the GATS and the TRIPS. They were therefore concluded as ‘mixed’ agreements, signed and ratified by both the EC and its Member States.¹⁸

Development of the CCP through Treaty Revisions

- 1.22 In reaction to Opinion 1/94, which showed the importance of the CCP keeping pace with developments in world trade, the Treaty of Amsterdam (1997) enabled the Council acting autonomously to extend the CCP to cover international negotiations and agreements on services and intellectual property, without the need for treaty changes. However, this option was never needed. Even if it had been, it is unlikely that Member States would have been unanimously in favour of using it at that time. The Treaty of Nice (2001) went one step further in codifying developments in the CCP through ECJ jurisprudence, bringing issues relating to the provision of services, the establishment of service providers and the protection of intellectual property under the auspices of the CCP. At the same time, it also included several exceptions to the scope of EC competence, such as cultural and audio visual services. These amendments broadened the scope of the CCP but were criticised for their lack of clarity.¹⁹
- 1.23 The Lisbon Treaty was the next major step in the development of the CCP. Seeking to improve democratic legitimacy, improve effectiveness and allow for a more comprehensive policy, it introduced several significant changes, including an increased role for the European Parliament, further clarification and expansion of powers for the EU, and modified voting procedures in the EU’s Council of Ministers. The impact of the Lisbon Treaty is explored in Chapter 2.

The EU’s Trade Agreements

- 1.24 Using the powers given to it through the CCP, the EU has been steadily negotiating trade agreements. As well as multilateral negotiations within the framework of the WTO Agreements, the EU has also engaged in an increasing number of negotiations with key trading partners of the EU and the UK, particularly as multilateral progress has slowed down. Some of these negotiations have been with individual countries, while others have been between the EU and other regional blocs. The length and content of these negotiations have varied considerably. In general, they have become increasingly deep and comprehensive, dealing with an ever-wider range of sectors and tackling an ever-increasing number of barriers to trade and investment. The most comprehensive EU trade agreement yet to have entered into force is the FTA with the Republic of Korea – see detail in Appendix B. A map illustrating the current extent of the EU’s international trade negotiations is shown at Figure 1.2.

¹⁸ Further information on mixed agreements can be found in HMG, *The Balance of Competences Between the UK and the EU: Foreign Policy Report* (2013).

¹⁹ M. Cremona, ‘A Policy of Bits and Pieces? The Common Commercial Policy after Nice’, CYEL (2001) and C. Herrmann, ‘Common Commercial Policy after Nice: Sisyphus World would have done a Better Job,’ 39 CML Rev 7 (2002).

Figure 1.2 EU Trade Agreements²⁰

1.25 The economic impacts of these agreements vary in relation to their content and the nature of the EU's trading relationship with the partner in question. The estimated long-term annual impact on the UK's economy of the recently agreed Comprehensive Economic and Trade Agreement between the EU and Canada is a £1.3 billion increase in GDP.²¹ The equivalent estimate for the Transatlantic Trade and Investment Partnership with the USA is an increase of GDP of between £4 billion and £10 billion.^{22 23} Because of these sorts of impacts on the economy, the UK has traditionally been one of the EU's strongest advocates of trade and investment liberalisation through international agreements.

²⁰ European Commission Memo, *The EU's Bilateral Trade and Investment Agreements – Where Are We*, November 2013. Available at: http://europa.eu/rapid/press-release_MEMO-13-1080_en.htm, accessed on 19th November 2013.

²¹ J. Francois and M. Manchin, *The Implications of an EU-Canada FTA for the United Kingdom*, study produced for the Department for Business, Innovation and Skills (unpublished).

²² These estimates are based on different assumptions, therefore they are not directly comparable.

²³ Centre for Economic Policy Research, 'Estimating the Economic Impact on the UK of a Transatlantic Trade and Investment Partnership (TTIP) Agreement between the European Union and the United States' (2013).

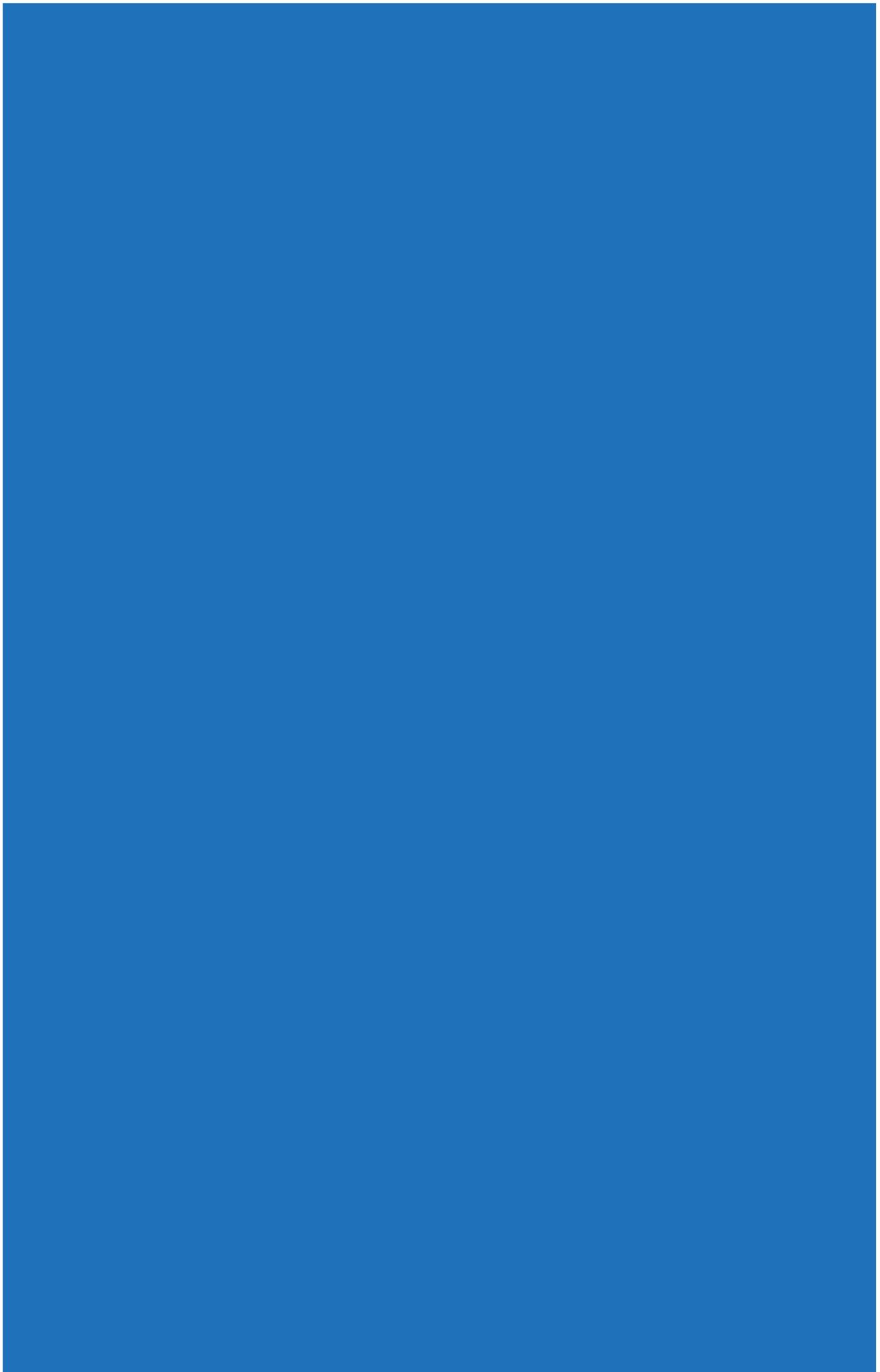
Crown Dependencies

The interplay between the EU CCP and the UK's obligations towards its Crown Dependencies (the Isle of Man and the Bailiwicks of Guernsey and Jersey) is important and complex. Some aspects of EU law apply to the Crown Dependencies: the Isle of Man and the Bailiwicks of Guernsey and Jersey, as set out in Protocol 3 to the UK's Treaty of Accession to the European Communities. By virtue of Protocol 3, EU rules ensuring a Single Market for goods apply to the Crown Dependencies, and they are part of the EU Customs Union. However, the Crown Dependencies are 'third countries' (i.e. non-EU countries) for other purposes, including the CCP. Only those provisions within EU trade and investment agreements that give improved market access to the EU for goods from a non-EU country will therefore apply directly in the Crown Dependencies.

For international agreements related to other aspects of trade and investment, the Crown Dependencies continue to rely on the UK to represent them internationally and enter into agreements on their behalf. Two notable examples are participation in the WTO, where the UK's membership has been extended to the Isle of Man, and the interplay between the EU's new competence in the field of investment protection and the UK's ability to maintain or agree BITs for the Crown Dependencies.

Summary

- 1.26 The world trading environment has evolved significantly since the first multilateral negotiations for the GATT in 1947. The main issues of contention have moved from tariffs to non-tariff barriers. The way business operates has also changed: many multinational enterprises work across different continents and businesses are specialising in stages of production rather than the whole production of a specific good, so that supply chains can involve many businesses from many different countries. Moreover, the importance of services, both those embedded in goods and those traded independently of goods, has grown. Investment flows have also increased and changed significantly: emerging economies have become more important as sources and destinations of investment and investors are investing more and more internationally to gain access to resources and markets.
- 1.27 Consequently, trade and investment negotiations have become more complex and span a growing number of issues. EU competence over trade and investment, having first arisen out of the Customs Union, has also expanded over time. This expansion, which has not always been smooth, has helped it to negotiate these increasingly complex international agreements. The next chapter sets out the current extent of the CCP, and how it works in practice.



Chapter 2:

Current State of Competence

The Common Commercial Policy (CCP) after the Treaty of Lisbon

- 2.1 The Treaty of Lisbon constitutes an important step in the CCP's evolution and sets out the current state of EU competence in the area of trade and investment. It has expanded the scope of competence in some areas of trade and investment, and clarified it in others. However, certain disputes over the extent of the CCP still remain.

The Nature and Scope of the CCP

- 2.2 As well as changes to the scope of the CCP and to the institutional processes through which it is implemented, the Treaty of Lisbon also codified the principles developed by the ECJ regarding the nature of EU competence, discussed in Chapter 1, explicitly stating that the CCP falls within the exclusive competence of the EU and that only the EU may legislate and adopt legally binding acts in the areas covered by the CCP.¹ In practice, these rules already applied, but the Lisbon Treaty made them explicit.
- 2.3 The scope of this exclusive competence, set out in Article 207 TFEU, is not limited to trade in goods, but also includes trade in services, trade-related aspects of intellectual property (IP) and foreign direct investment (FDI). Most of these additions codify pre-Lisbon ECJ case law. Article 207 TFEU is shown below.

Services and IP

- 2.4 By establishing that the EU is exclusively competent for all services (barring transport services – see below) and trade-related aspects of IP, the Treaty of Lisbon brought an end to longstanding debates over the extent of EU competence in these areas. Although the Treaty does not define 'services' and 'IP', the context of the various Treaty amendments and ECJ opinions suggests that these terms refer to trade in services as defined in GATS, covering all four modes of supply of services, and to trade-related aspects of IP rights as regulated in TRIPS.
- 2.5 These changes mean that the EU is now exclusively competent to negotiate trade agreements with provisions on services. The Treaty has abandoned the previous shared competence over trade in cultural and audiovisual services, educational services, and social and human health services. However, where services in these sectors might be affected in certain ways by international agreements, the Treaty still requires unanimity in the Council for the negotiation and conclusion of these agreements. The sole exception to the EU's exclusive competence over trade in services is in the field of transport, which is

¹ See Articles 2(1) and 3(1) of the TEU.

an area of shared competence. The balance of competences in relation to transport is the subject of a report published in parallel to this report.

- 2.6 IP, an increasingly important element of trade negotiations, is dealt with in more detail in the *Single Market: Free Movement of Goods Report*, published in parallel with this report.²

Article 207

1. The common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of IP, foreign direct investment, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies. The common commercial policy shall be conducted in the context of the principles and objectives of the Union's external action.
2. The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall adopt the measures defining the framework for implementing the common commercial policy.
3. Where agreements with one or more third countries or international organisations need to be negotiated and concluded, Article 218 shall apply, subject to the special provisions of this Article.

The Commission shall make recommendations to the Council, which shall authorise it to open the necessary negotiations. The Council and the Commission shall be responsible for ensuring that the agreements negotiated are compatible with internal Union policies and rules.

The Commission shall conduct these negotiations in consultation with a special committee appointed by the Council to assist the Commission in this task and within the framework of such directives as the Council may issue to it. The Commission shall report regularly to the special committee and to the European Parliament on the progress of negotiations.

4. For the negotiation and conclusion of the agreements referred to in paragraph 3, the Council shall act by a qualified majority.

For the negotiation and conclusion of agreements in the fields of trade in services and the commercial aspects of IP, as well as foreign direct investment, the Council shall act unanimously where such agreements include provisions for which unanimity is required for the adoption of internal rules.

The Council shall also act unanimously for the negotiation and conclusion of agreements:

- (a) In the field of trade in cultural and audiovisual services, where these agreements risk prejudicing the Union's cultural and linguistic diversity;
- (b) In the field of trade in social, education and health services, where these agreements risk seriously disturbing the national organisation of such services and prejudicing the responsibility of Member States to deliver them.

² See particularly the legal annex to HMG, *The Balance of Competences Between the UK and the EU Single Market: Free Movement of Goods Report*, published in parallel, which discusses recent ECJ cases relating to competence over IP.

5. The negotiation and conclusion of international agreements in the field of transport shall be subject to Title VI of Part Three and to Article 218.
6. The exercise of the competences conferred by this Article in the field of the common commercial policy shall not affect the delimitation of competences between the Union and the Member States, and shall not lead to harmonisation of legislative or regulatory provisions of the Member States in so far as the Treaties exclude such harmonisation.

Foreign Direct Investment

- 2.7 The most significant extension of the CCP through the Lisbon Treaty came through the inclusion of FDI in Article 207 TFEU.³ Although market access for investments – the ability to acquire a business or set up a new business or subsidiary in a foreign country – generally came under the CCP before the entry into force of the Treaty of Lisbon, post-establishment treatment of investment – that is, the protections provided after an investment has taken place – was not part of the CCP. This division allowed the EU to sign international agreements addressing market access for investment and Member States to sign their own international agreements on ‘investment protection’.
- 2.8 The expansion of the CCP to cover FDI has changed this division, and, although the extent of EU competence over investment remains disputed (see paragraphs 2.43 to 2.46 below), it is now accepted that the EU has at least some competence to conclude agreements addressing the post-establishment treatment of investment. This change is intended to address the potentially distorting effect of the web of different Member State investment protection agreements on investment in the Single Market. EU-wide investment protection agreements, offering harmonised standards of protection for foreign investors in the EU, will remove differences in levels of protection arising from different investment protection agreements. This should, in theory, allow for fairer competition between Member States wishing to attract foreign investment, allowing the Single Market to function more efficiently.

The Limits of the CCP

- 2.9 As well as setting out the areas which fall within the CCP, Article 207 TFEU establishes its limits. Article 207(6) TFEU aims to prevent the exercise of the EU’s external competence under the CCP from affecting the balance of internal competences between the EU and its Member States.⁴ It also states that the exercise of that competence should not lead to harmonisation of legislative or regulatory provisions of the Member States where the Treaty expressly prohibits this, such as in the fields of immigration, health, and education and vocational training.⁵ EU measures under the CCP cannot, therefore, have the effect of harmonising Member States’ laws and regulations in these areas. The EU cannot, for example, commit Member States to harmonising their health legislation through an international trade agreement.

³ FDI is an investment in a country by an individual or company from another country, either by buying a company in the target country or by expanding an investment in an existing company in that country, and involves a lasting management interest, normally considered to be at least ten per cent of the ownership of the company.

⁴ W. Shan and S. Zhang, ‘The Treaty of Lisbon: Half Way toward a Common Investment Policy,’ *European Journal of International Law* (2010) 21 (4): p1049-1073.

⁵ These are dealt with in Articles 19(2), 168(5), 165(4) and 166(4) TFEU respectively.

The Principles and Consistency of EU External Action

2.10 The Treaty of Lisbon introduced general principles and objectives for all EU external action, including action under the CCP. Under the terms of the Treaty, the CCP should, therefore, be guided by principles including: support for democracy, the rule of law, human rights, sustainable development, and the progressive abolition of restrictions on international trade (see box below).

Article 21

1. The Union's action on the international scene shall be guided by the principles which have inspired its own creation, development and enlargement, and which it seeks to advance in the wider world: democracy, the rule of law, the universality and indivisibility of human rights and fundamental freedoms, respect for human dignity, the principles of equality and solidarity, and respect for the principles of the UN Charter and international law.

The Union shall seek to develop relations and build partnerships with third countries, and international, regional or global organisations which share the principles referred to in the first subparagraph. It shall promote multilateral solutions to common problems, in particular in the framework of the United Nations.

2. The Union shall define and pursue common policies and actions, and shall work for a high degree of cooperation in all fields of international relations, in order to:
- (a) Safeguard its values, fundamental interests, security, independence and integrity;
 - (b) Consolidate and support democracy, the rule of law, human rights and the principles of international law;
 - (c) Preserve peace, prevent conflicts and strengthen international security, in accordance with the purposes and principles of the United Nations Charter, with the principles of the Helsinki Final Act and with the aims of the Charter of Paris, including those relating to external borders;
 - (d) Foster the sustainable economic, social and environmental development of developing countries, with the primary aim of eradicating poverty;
 - (e) Encourage the integration of all countries into the world economy, including through the progressive abolition of restrictions on international trade;
 - (f) Help develop international measures to preserve and improve the quality of the environment and the sustainable management of global natural resources, in order to ensure sustainable development;
 - (g) Assist populations, countries and regions confronting natural or man-made disasters; and
 - (h) Promote an international system based on stronger multilateral cooperation and good global governance.

3. The Union shall respect the principles and pursue the objectives set out in paragraphs 1 and 2 in the development and implementation of the different areas of the Union's external action covered by this Title and by Part Five of the Treaty on the Functioning of the European Union, and of the external aspects of its other policies.

The Union shall ensure consistency between the different areas of its external action and between these and its other policies. The Council and the Commission, assisted by the High Representative of the Union for Foreign Affairs and Security Policy, shall ensure that consistency and shall cooperate to that effect.

- 2.11 The Treaty also sets out where responsibility lies for ensuring that the CCP is consistent with other EU action. Together with the Council, the Commission is responsible for ensuring the compatibility of CCP agreements with internal EU policies and rules. The Commission and the Council, assisted by the High Representative of the Union for Foreign Affairs and Security Policy, are responsible for ensuring consistency between the CCP and other aspects of EU external action.

What Does the EU's Competence Allow it to Do?

- 2.12 There are two types of policy instruments through which the EU exercises the CCP:

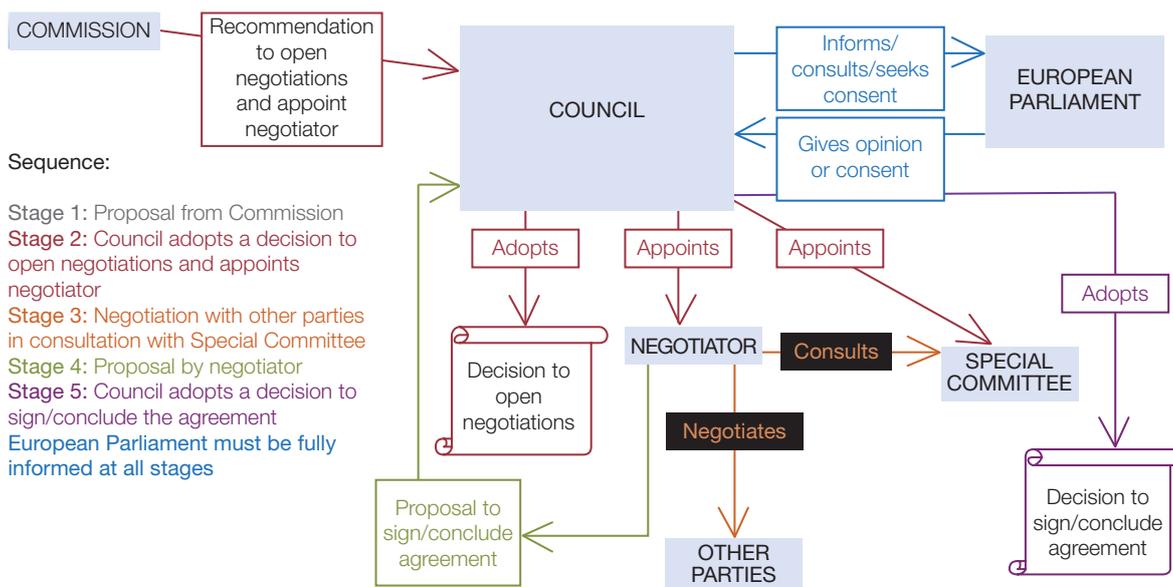
- Bilateral, plurilateral and multilateral agreements between the EU and third countries; and
- Internal legislation which sets the terms for autonomous measures, such as trade defence instruments and export and import controls.

Negotiating International Agreements

- 2.13 The process for the negotiation and conclusion of agreements in the field of the CCP, such as FTAs, is set out in Figure 2.1. It is described in Article 218 TFEU, read in conjunction with Article 207 TFEU. Article 218 TFEU sets out the procedural framework to be followed for conducting negotiations on agreements on behalf of the EU. The framework governs all cases where an agreement with a third country or international organisation will apply to the EU, irrespective of whether it is entered into by the EU alone or is a 'mixed agreement', entered into by both the EU and its Member States, although for mixed agreements there are some additional steps. Where an agreement has substantive content which includes both EU exclusive competence and shared competence, in principle it would be open to the Member States to authorise the EU to enter into all parts of the agreement, so that it would be an EU-only agreement. The Commission has expressed its preference for such agreements to be EU-only. The UK's policy is that Member States should also be party to such agreements when they cover areas of shared competence that the EU has not previously exercised, so that they constitute mixed agreements, with both the EU and the Member States being parties. For example, the 2010 FTA with the Republic of Korea is a mixed agreement because it covers areas falling within Member State competence, including certain commitments in the Protocol on Cultural Cooperation.
- 2.14 In practice, EU agreements covering matters within the CCP have generally also dealt with matters falling within Member State competence and have been concluded as mixed agreements. However, the question of whether each agreement will be mixed or EU-only has been, and will continue to be, subject to negotiation and to the development of EU case law.

2.15 Regardless of whether the agreement in question is mixed or not, the Commission must, as set out in Figure 2.1, work closely with the Council throughout the negotiation process. First, in order to negotiate an international trade and investment agreement, the Commission must obtain a mandate to do so from the Council. It does this by making a proposal which is then, typically, amended by the Council before being adopted, though it can also be rejected. This mandate contains ‘negotiating directives’ which guide the Commission’s engagement with the relevant negotiating partner(s); the mandate also specifies who will be conducting the negotiations, typically the Commission, and the Council committee which must be consulted by the Commission during negotiations. In trade and investment policy, the relevant committee is the Trade Policy Committee.⁶ Throughout negotiations, the Commission reports back to this Committee and, on technical issues, to its various working groups. Normal practice involves the Commission consulting the relevant working groups before each negotiating round and debriefing them afterwards. Strategic and political issues are generally discussed at the full Trade Policy Committee or by Ministers, at the meeting of the Council that deals with trade issues – the Foreign Affairs Council (Trade). At the end of any negotiations, the Council must also adopt a decision to sign and conclude an agreement. When an agreement is mixed, it must also be ratified in Member States, typically by their national parliaments.

Figure 2.1 Procedures for Negotiating International Trade Agreements:



Addressing Disagreements on Competence – the Double Decision Mechanism

2.16 When giving the Commission mandates to negotiate agreements covering areas of Member State competence, that is agreements which will be concluded as mixed agreements, any negotiations by the Commission on behalf of the Member States must be separately authorised by the Member States. To address this issue, the Council and EU Member States have, since the EU-Japan FTA mandate in 2012, started using a ‘double decision’ mechanism. Under this mechanism, the Council authorises the Commission to negotiate on areas falling under EU competence, and the Member States, acting independently of the EU, authorise the Commission to negotiate on areas falling under Member State competence. This approach is intended to allow the Commission to negotiate on areas falling under Member State competence and to do so without shifting the balance of competences towards the EU. The precise scope of each decision is left

⁶ The Trade Policy Committee is attended by senior Member State officials responsible for trade and investment policy. It also has several working groups, attended by less senior officials, which focus on particular technical issues.

ambiguous, allowing for differences of interpretation of the balance of competences to persist without getting in the way of the launch of negotiations. In practice, this provides a pragmatic solution to allow negotiating mandates to be agreed and negotiations to take place by avoiding prolonged arguments about competence. On the other hand, it does not resolve arguments over competence but rather puts them off for another day. Ambiguity regarding the extent of EU competence over the content of any agreement may have to be addressed when negotiations are concluded and the agreement in question enters into force, particularly if parts of the agreement are applied provisionally by the EU, pending ratification. The Commission does not support the double decision mechanism but does not seek to stand in the way of it being used.

An Increased Role for the European Parliament

2.17 One of the most significant institutional changes introduced by the Treaty of Lisbon in the field of the CCP was a strengthening of the role of the European Parliament. The Parliament has no formal role in the agreement of the EU's negotiating mandate but Article 207(3) requires the Commission to report to the European Parliament on progress in the negotiation of CCP agreements. Most importantly, the Parliament now has a formal role in the conclusion and ratification of CCP agreements. Whereas previously the Parliament was excluded from this process, its consent is now required before the Council can adopt a decision concluding any agreement. This strengthens the Parliament's influence over negotiations. As will be discussed in Chapters 3 and 4, this increased influence has led to greater emphasis in negotiations on certain aspects of agreements, such as human rights clauses, beyond the 'core' trade and investment content. In its first use of its new powers under the Lisbon Treaty, the European Parliament rejected the adoption of the Anti-Counterfeiting Trade Agreement (ACTA) by the EU in July 2012 due to concerns over the balancing of the protection of intellectual property rights with the rights of EU citizens.⁷

Negotiation and Representation at the WTO

2.18 The EU, in exercising its competence on trade and investment, generally represents Member States at the WTO. This means that the Commission acts on our behalf in negotiations at the WTO, representing UK interests in, for example, the negotiation on trade facilitation and other measures at the recent Bali Ministerial Conference, the Council for Trade in Goods, and the Technical Barriers to Trade and Sanitary and Phyto-Sanitary Committees. It also represents the UK and the EU in trade defence and other WTO disputes, whether as applicant or respondent, and coordinates Member States' views on WTO accessions and trade policy reviews. The UK and other Member States, as WTO members in their own right, engage directly in areas where there are elements of Member State competence. In the area of development aid for trade, although there is both Member State and EU competence (see paragraph 2.36 below), Member States agree for the Commission to represent their interests.

At the OECD

2.19 Trade and investment issues are also discussed at the OECD. Trade work is mainly analytical and in recent years has been actively supporting the work of the G20 by, for example, working with the United Nations Conference on Trade and Development (UNCTAD) and the WTO, to analyse and report on protectionist behaviour and new barriers to trade and investment. The OECD has long been at the forefront of efforts to develop international rules relating to capital movements, international investment and trade in services.⁸

⁷ See Appendix B for more detail.

⁸ See Appendix B for more detail.

2.20 The UK and most other EU Member States are members of the OECD. The EU is not a formal member but does have the right to sit and speak in Committees. This means that UK representatives speak alongside Commission representatives. Some non-European members complain that this gives European members a greater voice. In preparing for most Committee meetings, the Commission seeks to coordinate with Member States.

Internal Legislation

2.21 In order to implement the CCP and Treaties negotiated under it, the EU needs internal rules (legislation) to govern its decision-making. This legislation is developed principally on the basis of powers given to the EU through Article 207 TFEU. It is now agreed through the 'ordinary legislative procedure', which involves the European Parliament, as well as the Council and the Commission. Among other things, the rules of the CCP cover decision-making for the EU's adoption of trade defence measures and EU export and import controls, and arrangements for Member State export credit agencies. Changes to these internal rules may also affect the balance of powers between the EU institutions by changing the role or responsibilities of the European Commission, Council or Parliament. Some recent technical changes to EU legislation have been necessary to bring these processes into line with the requirements of the Lisbon Treaty.

2.22 When the EU is adopting internal legislation in the field of the CCP, it now follows the 'ordinary legislative procedure'. This means that the Council and the European Parliament, on the basis of proposals made by the Commission, develop legislation in this area together. The following section includes some examples of the sorts of internal legislation that the EU has introduced since the Lisbon Treaty, or that it is currently negotiating.

Trade Omnibus Regulations

2.23 The changes necessary to bring internal trade policy decision-making into line with the requirements of the Lisbon Treaty, including, for example, voting rules for decision-making procedures, will be implemented in early 2014 by two 'Trade Omnibus' regulations:⁹

- Trade Omnibus I addresses a significant number of trade policy decisions, which were previously the responsibility of the Council. These now become the responsibility of the Commission in consultation with Member States (as distinct from the Council). The most important legislation covered by Omnibus I is the basic EU anti-dumping and anti-subsidy regulations (see box on trade defence below). One of the effects of the changes is that it will become harder for Member States to block Commission proposals for anti-dumping and anti-subsidy measures – a 'qualified majority' will be needed to block Commission proposals rather than the current simple majority threshold.
- Trade Omnibus II converts powers granted to the Commission by various trade policy regulations into 'delegated powers'. Delegated powers are granted to the Commission by the Council and the European Parliament to allow it to set out technical requirements and to adjust existing legislation (without affecting its core substance). For example, updating an annex to an international agreement to bring it into line with changes in the way that tariffs are classified. The delegation of powers may be revoked by the Council or the Parliament, which can also object to the exercise of the delegated power in specific circumstances.

⁹ The Trade Omnibus regulations have been examined closely by the European Scrutiny Committee of the House of Commons. The Committee debated the regulations in March 2013.

Enforcement Regulation

2.24 A new 'Enforcement Regulation' is currently being considered in the Council and European Parliament. If agreed, it will establish a legal framework under which the Commission would have powers, subject to a determining Member State vote, to take action to protect the EU's rights under multilateral, e.g. WTO, and bilateral trade agreements, usually to protect EU exporters suffering from a third country's failure to implement a WTO Dispute Panel ruling.

Trade Defence

Trade defence involves taking actions against low-priced or unexpectedly high volumes of imported products which cause damage to domestic industries. Trade defence action takes three forms:

- Anti-dumping duties when an exporter is 'dumping' its products on a market by selling exports at lower prices than those in their home market or their costs;
- Anti-subsidy measures when an exporter is benefiting from certain trade distorting subsidies; and
- Safeguard action in response to unforeseen surges in imports that cause, or threaten to cause, injury to domestic producers.

Trade defence actions usually take the form of increased duties on products imported to the EU from a specific country or countries. They are usually in place for a minimum of five years, but sometimes much longer.

Although trade defence measures typically affect a small part of trade, they often involve significant tariffs and therefore can have profound effects on individual markets. They typically benefit some European producers, who are suffering because they cannot compete with the low-priced imports that the trade defence measures seek to address, but impose significant costs on those within the EU, both industrial users and consumers, who use these imports.¹⁰

The EU's average 'most favoured nation' (MFN) tariff on industrial goods is 4.2%, but the average anti-dumping duty is around 30%, and in some cases even higher.¹¹ For example, bicycles from China are subject to an anti dumping duty of 48%, Chinese ceramic tiles attract an anti-dumping duty of up to 70% and some types of wood screws from China are subject to duties of 85%.¹²

¹⁰ Department for Business, Innovation and Skills, *Anti-dumping: Selected Economic Issues: Trade and Investment Analytical Papers Topic 18* (2012).

¹¹ Members of the WTO agree to give each other 'Most Favoured Nation' status. No member of the WTO can treat a country with MFN status less advantageously than any other country with MFN status. Exceptions apply only to preferential treatment for developing countries, regional free trade areas and customs unions. The 'MFN tariff' is, therefore, the tariff that one WTO member applies to imports from other WTO members with which they do not have a preferential trade deal.

¹² These duty rates are taken from individual Council Regulations imposing definitive anti-dumping measures. Details of past and current EU trade defence cases, including duty rates, can be found at the DG Trade website: <http://trade.ec.europa.eu/tci/completed.cfm>, accessed on 30 January 2014. The average MFN tariff can be found at: <http://stat.wto.org/TariffProfile/WSDBTariffPFRReporter.aspx?Language=E>, accessed on 30 January 2014.

Trade Defence Modernisation

2.25 A further regulatory proposal under consideration is a proposal from the Commission to modernise the EU's trade defence instruments. The purpose of the modernisation is to improve current trade defence instruments by, for example, increasing the transparency and predictability of decision-making and greater use of the Commission's existing power to initiate trade defence investigations on its own (*ex officio*) responsibility, rather than on the basis of complaints from businesses.

Regulations Dealing with Investment

2.26 As described in paragraph 2.7 above, the Lisbon Treaty now states explicitly that the CCP covers foreign direct investment. It is clear from this that the EU can now negotiate international treaties that deal with at least some aspects of investment protection. Member States have over 1200 of their own bilateral investment treaties (BITs), covering post-establishment protection and, generally, giving investors access to international arbitration when their rights are infringed by governments. These BITs will remain in force until they are gradually replaced by EU investment protection agreements, under arrangements set out in an EU regulation, which entered into force in January 2013.¹³ This regulation, known as the 'Grandfathering Regulation', also allows Member States to continue negotiating their own BITs, if authorised to do so by the Commission.

2.27 The EU is now negotiating its own investment protection agreements, generally as chapters of its FTAs.¹⁴ Under these agreements, foreign investors will be able to make compensation claims against the EU and/or its Member States where their rights under the agreement have been infringed either by the EU or by a Member State government. In June 2012, the Commission proposed a regulation establishing a framework for deciding who (individual Member States or the Commission) should be responsible for conducting defences of these claims and who (individual Member States or the EU) should pay for any eventual compensation arising from them. The proposal follows the principle that whoever (the EU or a Member State) is responsible for the action leading to an investor's claim should pay for and, by and large, defend it.

2.28 The European Commission has experience negotiating trade agreements and in conducting WTO proceedings. But it is less experienced in exercising the EU's competence in the field of investment protection and, to date, has not been required to defend an international investment arbitration.

Strategic Trade Controls, Arms Export Controls, Sanctions and Embargoes

Dual Use

2.29 Except controls relating to military goods (see below), export controls on goods, including dual-use items, fall within the CCP. They therefore fall under exclusive EU competence and are implemented through directly applicable EU Regulations. Dual use items are civilian goods, software and technology that may have military uses, particularly in nuclear, chemical and biological weapons programmes and missile programmes. The main EU

¹³ Regulation No 1219/2012/EU of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements between Member States and third countries (2012).

¹⁴ The Commission's first negotiations on investment protection have been as part of the FTA negotiations with Canada, India, Singapore, USA, Japan and Morocco. Negotiating mandates have also been agreed for negotiations with Tunisia, Jordan and Egypt. The most advanced negotiations are with Canada and Singapore. The Commission has also begun negotiations on the EU's first stand-alone investment agreement, with China.

legislation on such exports is known as the Dual-Use Regulation.¹⁵ Under this regulation, controlled items may not leave the EU customs territory without an export authorisation. The Regulation includes the list of items subject to control and the rules which Member States must apply to trade in those items.

- 2.30 In addition, legislation known as the Torture Regulation concerns trade in equipment and products that could be used for capital punishment, torture or other cruel, inhuman or degrading treatment or punishment.¹⁶
- 2.31 Even though the EU has exclusive competence in this area, the implementation of the controls is carried out by Member States in accordance with the directly applicable EU regulations. Member States may add additional safeguards if they so wish.

Military Goods

- 2.32 In contrast, Member States retain competence over export controls for arms and military equipment. The UK's decisions on the export of arms and ammunition are taken in accordance with its Consolidated Criteria, which take into account factors including international law (such as UN arms embargoes), human rights, regional stability and national security. Despite the fact that Member States have competence to act independently in this area, they have agreed to work together to achieve consistent arms control policies. They adhere to common criteria for deciding whether or not to allow the export of arms and military equipment and have agreed mechanisms of information exchange and consultation. These are set out in an EU 'Common Position', which defines the common rules applying to all Member States governing control of exports of military technology and equipment.¹⁷ The UK's Consolidated Criteria are fully consistent with the EU Common Position.
- 2.33 Member States also work together within the EU framework to impose arms embargoes and sanctions against individual countries. EU sanctions and embargoes are set out in EU Council Decisions and Regulations, and are considered more effective than unilateral responses to international security issues. However, Member States also retain the right to impose arms embargoes and sanctions unilaterally.

Export Credits

- 2.34 An export credit allows a foreign buyer of exported goods or services to defer payment over a period of time. The EU has exclusive competence over the financial terms and conditions of export credits. However, official export credits are provided by Member States' Export Credit Agencies (ECAs). There is no EU-wide ECA. Member States' ECAs are regulated by national rules, but the EU has played an active role in the harmonization of ECAs and the co-ordination of policy statements and negotiation positions, particularly at the OECD, where arrangements for export credits are negotiated. It has also ensured the application of the OECD's arrangements through an EU regulation.¹⁸

¹⁵ Council Regulation No 428/2009/EC of 5 May 2009 Setting up a Community Regime for the Control of Exports, Transfer, Brokering, and Transit of Dual-Use Goods (recast) (2009).

¹⁶ Council Regulation No 1236/2005/EC as amended by Commission Implementing Regulation No 1352/2011/EU of 21 December 2011 concerning trade in certain goods which could be used for capital punishment, torture, or other cruel, inhuman or degrading treatment or punishment (2011).

¹⁷ Council Common Position 2008/944/CFSP of 8 December 2008 defining common rules governing control of exports of military technology and equipment (2008).

¹⁸ Regulation No 1233/2011/EU of the European Parliament and of the Council of 16 November 2011 on the application of certain guidelines in the field of officially supported export credits and repealing Council decisions 2001/76/EC and 2001/77/EC (2011).

2.35 When the OECD's discussions extend beyond the financial, trade-related aspects of export credits into areas relating to corporate social responsibility, the EU Member States which are members of the OECD represent themselves.

Trade and Development

- 2.36 The EU's competence in development cooperation and humanitarian aid is a specific form of shared competence commonly referred to as a parallel competence. This means that the EU has competence to carry out activities and conduct a common policy, but the exercise of that competence does not prevent Member States from exercising theirs.¹⁹ This competence allows the EU to take action in trade-related areas of development policy, such as Aid for Trade, overseas development assistance aimed at helping developing countries to strengthen their capacity to trade. However, the EU also uses the CCP, often in conjunction with its development competence, to achieve development objectives.
- 2.37 One way in which it does this is through trade preferences for developing countries, particularly African, Caribbean and Pacific (ACP) countries. The EU has offered these preferences since 1971. The EU's present system of trade preferences, the Generalised System of Preferences (GSP), grants developing countries reduced tariffs for their goods when entering the EU market, making it easier for them to export their products and contributing to economic growth, with no expectation or requirement that this access be reciprocated by the countries concerned. The GSP+ sub-scheme grants enhanced preferences to countries which ratify and implement international conventions relating to human and labour rights, environment and good governance. Furthermore, the GSP's 'Everything But Arms' scheme grants full duty-free access to imports of all products, except arms, from 49 of the least developed countries (LDCs). In total over 170 countries outside the EU currently benefit from the GSP, and in 2011 imports from countries that received GSP preferences were worth €87 billion. In October 2012, the EU adopted a reformed GSP law which took effect on 1 January 2014. Revisions brought in by this reform will concentrate GSP preferences on the 90 developing countries most in need.²⁰
- 2.38 As well as these autonomous preferences, the EU also negotiates international agreements with development objectives. The 'Economic Partnership Agreements' (EPAs), a new set of agreements based on the trade chapter of the Cotonou Agreement, are being negotiated with African, Caribbean and Pacific countries with a view to providing reciprocal open market access between the EU and ACP signatory states.²¹ At present, the EPA signed with Cariforum, a grouping of 16 Caribbean states, in 2008 is the only comprehensive regional EPA that has been signed.²² More generally, the EU has made efforts over the past few years to ensure that its policies, including its trade and investment policy, are coherent with its development objectives.²³

¹⁹ For more detail see HMG, *The Balance of Competences Between the UK and the EU: Development Cooperation and Humanitarian Aid* (2013).

²⁰ Regulation No 978/2012/EU of the European Parliament and of the Council of 25 October 2012 applying Generalised System of Preferences and repealing Regulation (EC) No 732/2008.

²¹ The Cotonou Agreement is the most comprehensive partnership agreement between developing countries and the EU. Since 2000, it has been the framework for the EU's relations with 79 countries from ACP.

²² The trade aspects of development policy and the associated balance of competence are discussed in HMG, *The Balance of Competences between the UK and the EU: Development Cooperation and Humanitarian Aid* (2013).

²³ The EU has done this through its 'Policy Coherence for Development' approach. See for example, European Commission, 'EU 2013 Report on Policy Coherence for Development,' (2013), found at http://ec.europa.eu/europeaid/what/development-policies/policy-coherence/index_en.htm, accessed on 30 January 2014.

Trade and Investment Promotion and Market Access

- 2.39 Trade and investment promotion activities remain a Member State competence, although the EU plays a role in some areas, including agriculture.²⁴ UK Trade & Investment (UKTI) is the government body responsible for supporting businesses' international trade and investment activity.²⁵ However, in recent years, the Commission has begun to take an interest in promoting EU business in overseas markets and has suggested EU trade missions. Led by DG Enterprise and Commissioner Tajani, the Commission has introduced 'Missions for Growth' to help EU companies and in particular SMEs to develop their activities within the EU and abroad.²⁶ The missions involve political and business meetings but do not deal with specific trade policy issues. In the initial period between December 2011 and June 2013, nine separate Missions for Growth involving 12 different countries took place.²⁷ More than 300 companies, including some business federations from 17 EU Member States participated. The European External Action Service is also planning some activities, including a business forum event during the EU-Africa summit in April 2014, to bring together EU and African businesses.
- 2.40 Trade and investment promotion support for businesses helps them conduct business in other markets, such as by helping businesses identify the relevant domestic regulations with which they need to comply. However, such activity can also help identify other barriers to trade and investment. These can often be regulatory in nature. Identifying such barriers, and hearing businesses experience of them, can inform on-going FTA negotiations. In extreme cases it might involve the EU taking a complaint against the third country to the WTO.

Areas of Contention over Competence

- 2.41 There are a number of areas in trade and investment where disputes about competence persist. They include the following:
- Maritime transport;
 - Investment; and
 - The Justice and Home Affairs (JHA) opt-in.

Maritime Transport

- 2.42 The EU and Member States can both act in areas of shared competence. But Member States may only exercise their competence to the extent that the EU has not exercised its competence (Article 2(2) TFEU). Transport is an area of shared competence under TFEU and maritime transport is an area in which there remains shared competence

²⁴ There are some EU regulated promotion activities within the agricultural sector. Council Regulation (EC) No 3/2008 provides for EU funding to trade organisations for promotional measures that are aimed at increasing the information on, and sales of, certain agricultural products in EU countries and third country markets, such as fruit, vegetables, milk, olive oil, wine, meat, and including organic products, plants and products of ornamental horticulture and products with a regional protected status, such as Protected Designation of Origin (PDO) and Protected Geographical Indication (PGI). Information about promotion of EU farm products can be found at <http://ec.europa.eu/agriculture/promotion/>, accessed on 30 January 2014.

²⁵ UKTI works with UK-based businesses to ensure their success in international markets, and encourage the best overseas companies to look to the UK as their global partner of choice. See <http://www.ukti.gov.uk/home.html>, accessed on 30 January 2014.

²⁶ See http://ec.europa.eu/enterprise/initiatives/mission-growth/missions-for-growth/index_en.htm, accessed on 30 January 2014.

²⁷ United States of America; Brazil; Argentina; Mexico; Chile; Peru; Uruguay; Colombia; Morocco; Tunisia; Egypt; Russia; and China.

that the EU has not yet exercised ('unexercised shared competence'). Contention has arisen, for example, in relation to the recent Ukraine Association Agreement, where the Commission has proposed provisionally applying parts of an agreement dealing with maritime transport. The UK's policy is generally to avoid allowing the EU to exercise previously unexercised areas of shared competence. It is the UK's view that in provisionally applying parts of a trade agreement with a third country that fall under unexercised shared competence, such as aspects of maritime transport, the EU exercises its competence in relation to that third country only. The balance of competences over maritime transport is explored in more detail in HMG report on *The Balance of Competences between the UK and the EU: Transport*, published in parallel to this report.

Investment

- 2.43 The dispute over competence in this area is complex. One element of the dispute relates to the types of investment that the EU's competence covers. Investment can take a number of forms with the main distinction being between direct and indirect (also known as portfolio) investment. The difference comes down to the investor's involvement in the management of their investment. With direct investment, there is a strong and lasting link between investor and investment, whereas these links are weaker with indirect investment. The UK, along with other Member States, argues that the EU only has exclusive competence over foreign direct investment (FDI), as stated in Article 207 TFEU, and that at least some competence over portfolio investment can be exercised by Member States since it is either unexercised shared competence or exclusive Member State competence.
- 2.44 However, the European Commission believes that the EU has exclusive competence over all types of investment. It believes that this competence derives partly from Article 207 TFEU (for FDI) and partly from Article 63 TFEU (for portfolio investment). Article 63 TFEU sets out internal rules on capital flows. The Commission argues that as external agreements with third countries could affect these rules, under Article 216 TFEU the EU has external competence over portfolio investment.²⁸ However, the extent of EU competence in this area has not yet been brought before the ECJ and the dispute over it will probably not be settled until it is.
- 2.45 There is also disagreement about what the EU's competence over investment enables the EU to do in practice. It is generally accepted that Article 207 TFEU gives the EU competence over investment liberalisation – lowering barriers to investment into and out of the EU – and that this means that provisions addressing market access for foreign direct investments can be included in EU trade agreements. However, there is less agreement over what the Lisbon Treaty means for the EU's competence over the post-establishment treatment of investment, and the extent to which it is competent to sign investment protection agreements.
- 2.46 This disagreement is important because it impacts on the nature of EU agreements dealing with investment protection. If some elements of investment protection agreements come under exclusive Member State competence, as some Member States argue, then these agreements must be concluded as mixed agreements, signed and ratified by the EU and all Member States. If some elements come under unexercised shared competence but none are under exclusive Member State competence, then the UK's policy is that these agreements should be concluded as mixed agreements. If all elements fall within exclusive EU competence, these agreements can be signed and ratified only by the EU, giving Member States less influence over their content.

²⁸ Regulation of the Council and of the European parliament establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is party COM (2012) 0335 final.

JHA Opt-In

2.47 While trade in services falls within the EU's exclusive competence post-Lisbon, the Government's position is that the Mode 4 provisions on the temporary movement of skilled personnel (which concern the admission of third country nationals onto the territory of the United Kingdom; see footnote 18 in chapter 1 for more detail) in trade agreements also fall within the scope of the United Kingdom's Title V opt-in. For further discussion of the UK's JHA opt-in and its relevance to migration policy, see HMG report on *The Balance of Competences between the UK and the EU: Asylum and Immigration*, published in parallel to this report.²⁹

Conflicts Arising from the European Commission's Dual Roles

2.48 The current decision-making arrangements can potentially cause difficulties if the European Commission is required to play multiple roles simultaneously. One possible situation might be if the European Commission takes action against a Member State, where it believes that a Member State law contravenes the rules of the Single Market. However, laws introduced by Member States for domestic reasons might be relevant to their international trade commitments. It is possible that a non-EU country could complain to the WTO about the trade distorting effects of the domestic law introduced by a Member State. In most circumstances, it is the European Commission that will defend the Member State at the WTO. As such, it is theoretically possible for a situation to arise in which the European Commission is simultaneously bringing an infraction case against a Member State for infringement of Single Market rules and defending the same Member State against a claim from a third country at the WTO.

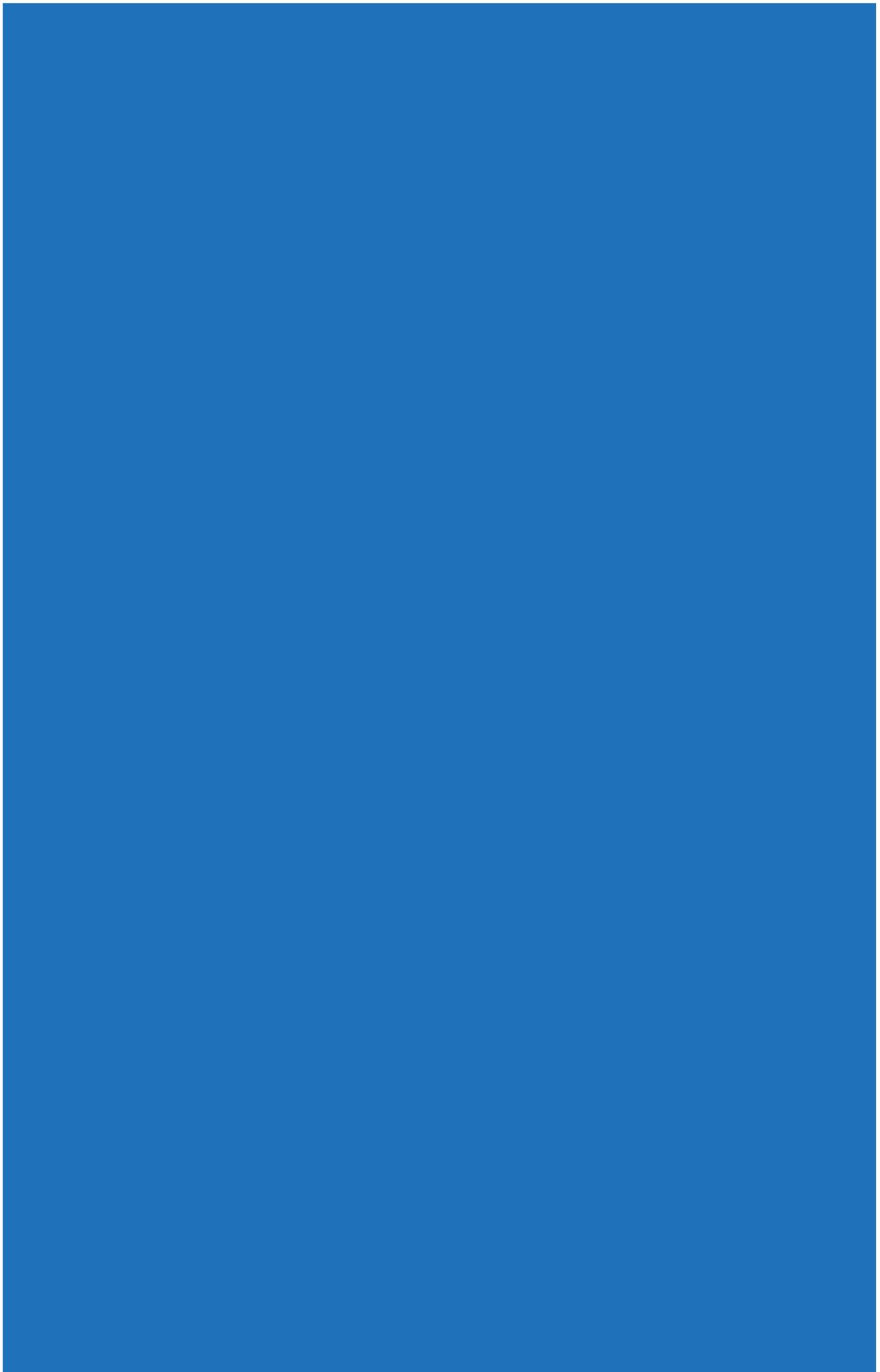
2.49 In practice, such simultaneous action is unlikely to take place and it is possible that third countries may wait for the outcome of the Commission's internal actions before launching a trade case. If it ever did occur, a Member State could find itself having to simultaneously defend itself against the Commission while at the same time providing the Commission with evidence so that it can defend its interests in a trade dispute.

2.50 In addition, the breadth of the Commission portfolio means that there may be inconsistencies and sometimes conflicts between the approaches of various directorates-general to the same issue. For example, this occurred in the case of an the imposition by DG Trade of anti-dumping measures against energy saving light bulbs imported from China, which increased their cost to consumers, at a time when DG Environment was attempting to phase out traditional incandescent light bulbs to promote energy saving.

Summary

2.51 The Lisbon Treaty represented a significant development in the balance of competences over trade and investment and in how the EU exercises its competence in this area. The process to update the internal rules governing EU decision-making is still ongoing, and the balance of powers could still be affected by the way in which these rules are developed, not least since there are still some contested areas. The negotiation of trade and investment agreements may also have an effect on the balance of competences, especially given the increasing number of areas being covered, though Member States have developed ways to try to avoid this happening where they do not want it to.

²⁹ Discussion of relevant national security issues will be addressed in HMG, *The Balance of Competences between the UK and the EU: Police and Criminal Justice*, published later in the Review.



Chapter 3:

International Trade and Investment and the UK's National Interest

- 3.1 This chapter explores the UK's trade and investment interests and whether they are met by the current balance of competences and the way these competences are exercised. It summarises various arguments presented in responses to the Government's Call for Evidence for this report, at stakeholder events held to gather evidence and in wider literature, as appropriate. The chapter begins with arguments in support of the current balance of competences before examining the disadvantages.
- 3.2 Determining what is in the UK's interests is not straightforward. It will inevitably reflect a balance of competing interests, which may not always align. For example competing producers may have different views on whether competitors should be allowed to enter the EU and UK market; consumers may desire a different outcome in terms of access to imports than domestic producers; and tax payer interest may be different again.

General Comments on the Current Balance of Competences

- 3.3 A wide variety of respondents made submissions in response to the Call for Evidence. They included numerous businesses, business organisations and groups who summarised the views of their members. There was a general view among stakeholders that the division of powers in the field of trade and investment is broadly in the UK's national interest, particularly as it increases the UK's international influence in this area.¹ Some selected comments are shown below. However, many also had comments on, and criticisms of, the way competence is exercised in practice. Those comments are discussed in this chapter.

'We believe this balance of competences to be broadly appropriate.'

The British Chambers of Commerce.

'SMMT believes that the balance of competences between the EU and UK on trade and investment is right.'

The Society of Motor Manufacturers and Traders.

'[We] see no advantages in altering the current balance of competences in this area'.

The Scotch Whisky Association.

¹ A summary of the discussions at stakeholder events is published in parallel with this report.

‘We have no doubt that there are significant advantages in the EU negotiating on Trade and Investment matters with other countries on behalf of the EU as a whole. Britain’s interests are best served in this case by being part of a 500 million plus bloc of consumers rather than negotiating such agreements on its own.’

The Council of British Chambers of Commerce in Europe.

‘Operating as part of a trading bloc strengthens both the UK and Europe’s bargaining power and ability to lower trade barriers and support investment.’
‘[...] so competence at the EU level remains in the interests of the UK.’
‘Repatriation of trade policy competences would threaten the integrity of the Internal Market.’

EEF and UK Steel.

‘British interests are much better served if the UK remains an influential and fully committed member of an efficiently organised EU.’

Wolf Rüdiger Bengs.

‘EU States combined offer a far more attractive package to international partners that the UK does alone.’

TUC.

‘A large majority of respondents endorsed ... belonging to a larger sphere of influence, such as the EU.’

Scottish Council for Development and Industry.

‘Competence over international trade and investment negotiations should remain with the EU.’

Lloyd’s.

‘the UK’s trade and investment potential is strengthened by its membership of the EU and that the EU is likewise made stronger by the membership of the UK.’

The British Irish Chamber of Commerce.

‘We would not wish to see our ability to tailor our approach to supporting investment and trade weakened through any changes to the balance of competences in this area.’

Welsh Government.

‘The EU’s Common Commercial Policy has been a success story for the UK:

- Trade partners want access to the entire EU Single Market: negotiating as a bloc gives the EU added power;
- The UK has successfully influenced EU trade policy’s open market objectives.’

TheCityUK.

‘With regard to trade and investment the EU should be regarded as a resource which should be supported to the full.’

The British Ceramic Confederation.

‘It is hard to find any persuasive arguments that the EU’s competence over trade and investment has been a disadvantage for UK manufacturers and exporters.’

Catherine Bearder MEP.

But other views on the current balance of competences include:

‘The UK is unable to make FTAs that might suit it with economies that are growing.’

The Freedom Association.

‘The EU is too large, divided and unwieldy to close deals with the most important markets.’

Civitas.

‘There are difficulties that the UK experiences as a result of the Commission negotiating on behalf of all 27 EU Member States.’

Fresh Start.

Advantages for the UK of the Current Balance of Competences

- 3.4 The most common argument in favour of the current balance of competences relates to the impact that being part of a larger bloc of producers and consumers has on trade negotiations and similar activities, in particular the defence of trade interests.

Negotiating Weight in International Negotiations

- 3.5 The academic Sophie Meunier summarises the arguments in favour of the EU negotiating as a bloc as follows: ‘In spite of its complexities, the pooling of external representation in the EU is generally expected to strengthen the European entity in international trade negotiations. The common expectation is indeed that a united Europe is greater than the sum of its parts. Whether one believes that the distributional outcomes of negotiations are determined by power, preferences, or other ad hoc variables, the common assumption is that the more integrated the EU is, the stronger bargaining leverage it can exert’.²
- 3.6 This view was presented in many submissions. The Senior European Experts Group (SEEG) noted, ‘the negotiating heft of the EU is [...] considerable; even the larger Member States, like the UK, would struggle to obtain as good terms in trade talks on their own as the EU can achieve’.³ Similarly, the British Chambers of Commerce (BCC) noted that the UK has a better chance of achieving success if it negotiates as part of the EU than if it negotiates alone. They highlighted that the trend in negotiations is for new and deeper issues to be addressed. An important source of the advantage to the EU’s weight is that the EU has more to trade off during negotiations than the UK would be able to alone.⁴

² S. Meunier, *Trading Voices: the EU in International Commercial Relationships* (2005).

³ SEEG, *submission of evidence*.

⁴ British Chambers of Commerce (BCC), *submission of evidence*.

- 3.7 An integral part of the argument about the weight of the EU being advantageous for the UK is that its bargaining leverage is relevant not just for obtaining a good outcome from negotiations but also in putting issues, of importance to the UK but also other Member States, on the negotiating table in the first place. The CBI argues that the weight of the EU enables it to set very ambitious objectives in bilateral negotiations, going beyond standard trade barriers to include trade in services, access to public procurement markets, and TRIPS+ rules on intellectual property rights, because ‘the draw of greater access to the Internal Market provides an incentive for other trade partners to negotiate with the EU on these topics’.⁵ Similarly, Professor Rob Ackrill in *British Influence* argued that ‘we are seeing currently the clear benefits of negotiating trade agreements at the EU level. At its most basic, the EU in total has more on the table than any individual country and thus has greater leverage and bargaining power’.⁶
- 3.8 Moreover, the size of the Single Market and number of EU consumers make many third countries want to negotiate with it, despite the potential threat to themselves of allowing the EU greater access to their own markets.⁷ ‘EU policy with regard to trade negotiations is extremely liberal [...] the issue therefore is not so much that the EU has too many defensive interests but that it has a very large export potential, which can engender protectionism in the potential trade partner [...] The UK on its own might be seen as less of a threat – but also its market is less tempting as it is so much smaller than that of the EU as a whole’.⁸ Lloyd’s also notes that ‘many major third countries would probably have limited appetite to engage in bilateral negotiations [...] with the UK on its own, a significantly smaller country’.⁹

Representation at the WTO in Negotiations

- 3.9 The weight of the EU also benefits the UK through its representation at the WTO. It can be very hard to determine whether the Commission achieves a better deal for the UK than we would have been able to achieve for ourselves. However, respondents to the Call for Evidence have tended to find the Commission’s actions in the WTO to have been beneficial for the UK. The SEEG notes that the EU has taken a high profile in the WTO. They quote another commentator: ‘the EU is one of the WTO’s two heavyweight boxers; the other is the United States’ and cite the influence of the EU in gaining Russian and Chinese entry to the WTO and hence bringing them into the global rules-based trading system, which is good for the UK.¹⁰ TheCityUK notes that ‘there have been instances where the EU’s capacity to deliver trade policy in services can be truly classed as visionary, as in the Community’s tenacity in sustaining the GATS negotiations on financial services through to their final conclusion as the Fifth Protocol to the GATS (1998)’.¹¹ In addition, the Government of Australia notes: ‘through its membership of the EU, the UK can leverage its influence even further... [which is] particularly important in advancing multilateral trade liberalisation in the World Trade Organization.’¹²

⁵ CBI, *submission of evidence*.

⁶ *British Influence, submission of evidence*,

⁷ According to the World Bank in 2012 the EU 509 million people and had a GDP (current price) of 16,600 billion US dollars.

⁸ David Roberts, *British Influence, submission of evidence*.

⁹ Lloyd’s, *submission of evidence*.

¹⁰ SEEG, *submission of evidence*.

¹¹ TheCityUK, *submission of evidence*.

¹² Government of Australia, *submission of evidence*.

The EU's Weight Can Influence Multilateral Rules

3.10 The Law Society noted that 'harmonisation within the EU often forms a working example and blueprint for international agreements'.¹³ The attractiveness to third countries of engagement with the EU also means that 'the EU can be more demanding, for example by requiring trading partners to share commitments on labour and environmental standards'.¹⁴ The breadth of the EU's deals means it is more likely to be successful in influencing global regulatory frameworks. The BCC identifies the requirement of the EU that its partners adhere to EU competition policy principles as part of its deals. In the case of Columbia and Peru they note the EU managed to bind sub-national authorities to these principles.¹⁵

Defending The EU's Trade Interests

The Weight of the EU May Deter Harmful Actions by Third Countries

3.11 The greater weight of the EU may actually help deter trade partners from harming the commercial interests of the EU, including the UK, because, in the event of retaliatory trade action by the EU, the potential volume of trade that EU measures could disrupt would be larger than any single Member State could on its own. The EU's trade partners know this. However, for the threat of EU retaliations to be fully effective, all Member States must support them. There may be occasions where a Member State would, if it could choose independently, not undertake retaliatory action because it would not be in its interests to do so. Where this happens, that Member State has to compromise on its own interests for the greater good of the EU.

To Defend the Single Market and Act as a Bulwark Against Protectionism

3.12 It is in the UK's interests for the Single Market to function effectively. Trade defence is an important way of stopping the Single Market and the competitiveness of EU businesses from being undermined by unfair actions of third countries, such as dumping goods. The European Commission seems, because of its relative isolation from influence by vested interests, to be in a good position to act in the defence of the Union without engaging in beggar-thy-neighbour policies. The EU's system for trade defence means that the Council and European Parliament are largely confined to setting the parameters of trade defence policy. In negotiations on these, those Member States in favour of a liberal trading approach want robust rules concerning the introduction of duties to address dumping and subsidies to prevent their use as a tool of protectionism. On the other hand, those Member States that have a more protectionist stance are likely to want rules to ensure such action should be taken.

But There are Concerns About the EU's Use of Trade Defence Instruments

3.13 Despite this, respondents to the Call for Evidence raised issues with the European Commission's behaviour in trade defence cases. The British Retail Consortium expresses concerns about the Commission's increased power over the use of trade defence instruments, resulting from the Lisbon Treaty. The Consortium argues that this further erodes the interest and influence of Member States in decision-making on anti-dumping and identifies two concerns: that the Commission will have more scope to put in place anti-dumping measures which are unlikely to be in the UK's interests; and that the Commission might operate a highly aggressive and confrontational trade policy based on

¹³ Law Society, *submission of evidence*.

¹⁴ The Commonwealth Environmental Investment Platform (CEIP), *submission of evidence*.

¹⁵ British Chambers of Commerce, *submission of evidence*.

the selective use of trade defence instruments. There is, according to the Consortium, a danger that ‘the Commission will be tempted to use TDIs [trade defence instruments] as its primary instrument of trade policy, effectively circumventing the Council’.¹⁶ Some elements of the Commission’s proposal to modernise the trade defence system (see paragraph 2.25) may allow the Commission greater discretion to do this.

Impact on Consumers from Free Trade

Consumers within the EU benefit from trade and trade liberalisation through lower prices and more choice.

From 1996 to 2006, EU import prices for textiles and clothing fell by 27.5% and 38.4% respectively in real terms, as a result of liberalisation measures. In the same period, the import price of consumer electronics fell by around 50%.¹⁷

Consumers also benefit from trade through access to a wider variety of goods and services. Based on an earlier US study, the European Commission estimates that greater variety from trade benefits the average European consumer by around €600 per year.¹⁸

Historically, protection of certain sectors, notably textiles and clothing and agriculture protection has hurt EU consumers.

In 1997 it was estimated that agricultural protection cost the average EU family of four \$1,500 per year in higher food prices.¹⁹

Despite reforms of the Common Agricultural Policy (CAP), which are likely to have reduced costs for consumers to some extent, EU agricultural markets are still protected by relatively high tariffs. For example, EU average MFN tariffs on dairy products are 54%, on sugar 31% and on cereals 22%.²⁰

3.14 The British Retail Consortium thinks that ‘UK commercial interests are served badly through the EU’s use of trade defence instruments’ and that British consumers consequently pay more for imports while the protection offered often delays much needed EU industrial restructuring. They are critical of the decision-making system because ‘even where a majority of Member States vote against proposals the Commission has ignored their ‘opinion’ and pressed ahead with measures anyway.’ They note that this happened at the provisional stage of the investigations into imports of ceramic tableware and solar panels, both imports from China.²¹

Use of Dispute Settlement at the WTO

3.15 An important element of the Commission’s representation role is to take up cases on behalf of EU Member States at the WTO. This includes defending the EU and its Member States in the event of a complaint against the EU by a third country and representing Member States and EU offensive interests when a third country introduces new barriers contrary to its WTO commitments.

¹⁶ British Retail Consortium, *submission of evidence*.

¹⁷ European Commission, Staff Working Paper: *Trade as a Driver of Prosperity*, Accompanying Commission Communication, Trade, Growth and World Affairs (2010).

¹⁸ C Broda and D.E. Weinstein, ‘Globalization and the Gains from Variety’, *The Quarterly Journal of Economics*, 541-585 (2006).

¹⁹ WTO, ‘10 benefits of the WTO trading system’ (2008).

²⁰ WTO, *Statistics Database: Tariff Profiles*, EU (27/01/2014).

²¹ British Retail Consortium, *submission of evidence*.

3.16 Since the inception of the WTO, the EU has been one of the biggest users of the WTO Dispute Settlement System and has been involved in 160 dispute settlement cases, see Table 3.1. The British Retail Consortium believes that the Commission has consistently demonstrated that it is willing and able to use international dispute settlement mechanisms to pursue the commercial interests of its operators. They note that 'this is often long-haul work requiring detailed and tenacious attention from the Commission, which it consistently delivers'.²²

Table 3.1 Main Users of WTO Dispute Settlement Mechanism²³

Member	Complainant	Respondent	Third Party
United States	106	120	107
European Union	89	74	137
Canada	33	17	89
Brazil	26	14	77
Mexico	23	14	67
India	21	22	91
Argentina	19	22	47
Korea	16	14	79

3.17 A number of submissions identified examples in which the EU has supported British business interests in trade disputes:

- Business for New Europe gives two examples of where the weight of the EU has been positively used to defend UK trade interests:
 - i In 2012 Argentina called on its companies to stop accepting exports from the UK in protest over the Falkland Islands. The EU supported the UK and has filed a case with the WTO over a number of EU/Argentina trade issues.
 - ii In 2003 the USA was forced to lift tariffs on UK steel producers by the WTO, which authorized the EU to impose counter-tariffs on US goods if the USA ignored the WTO's ruling.²⁴
- Diageo said that 'the Commission has successfully brought four dispute settlement cases challenging tax practices that discriminated against Scotch whisky protecting significant value for business'.²⁵

3.18 The Scottish Council for Development and Industry argues that the EU has been as successful as the US over the past five years in defending its interests before the WTO, with a slightly lower number of cases initiated but with a higher rate of success.²⁶ Research supports this claim, showing that when the EU has pursued complaints all the way through the legal process, it has had a better than average success rate – see Table 3.2. Many of the EU's complaints, as with those of other complainants, do not proceed all the way through complete hearings before the WTO but are settled in one form or another.

²² Idem.

²³ WTO (2014), available at: http://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm, accessed on 30 January 2014.

²⁴ Business for New Europe, *submission of evidence*.

²⁵ Diageo, *submission of evidence*.

²⁶ The Scottish Council for Development and Industry, *submission of evidence*.

Table 3.2 EU Performance in WTO Panels.

Complainant	Share of complaints going to panel (excludes complaints since 01/07/2003)	Percentage of completed panels won
EU	45%	96%
ALL	45%	89%
10 most frequent complainants	46%	87%
US	38%	79%

Source: Young, A. (2004).

Disadvantages for the UK of the Current Balance of Competences

3.19 It does not necessarily follow that the weight of the EU will lead to good trade and investment outcomes for the UK. Different factors determine success in negotiations, including the ability to use the weight and size of the market to secure concessions or deny market access with trade partners²⁷ The various arguments presented against the current balance of competences, or the way in which the EU's competences are currently used, are discussed below.

We Should Pick Our Own Terms

3.20 The Freedom Association argued that, 'if set free from the regulatory burden [imposed by the EU's rules] that is currently being imposed, [the UK] could in fact operate in different terms'. It argues that being able to operate on our own terms should not be a problem because 'the world in which there were external tariffs is increasingly over and...the Customs Union is becoming archaic'.²⁸ While tariffs are now considerably lower, this argument does not consider the importance of 'non-tariff barriers' to trade and investment, as set out in Chapter 1, which means that regulatory issues, such as the implementation or recognition of standards, are now increasingly important to free trade. The Freedom Association argues that having an independent trade and investment policy would not be detrimental to the UK's trading interests because the UK could negotiate its own FTAs with third countries to achieve preferential access to other countries' markets.²⁹ The Association quotes Global Britain's conclusion that EU membership 'may have been economically beneficial when EU tariffs were relatively high. But tariffs are now low and moreover only pertain to the import of goods, whereas much of Britain's trade relates to services'.³⁰ Regarding any potential loss of EU 'muscle', the submission quotes Prof. Patrick Minford's argument that 'as our intention would be to admit goods and services from all countries freely without tariffs or other protection, at world prices, there is really no likelihood that any of these countries would find it in their interest to raise tariffs on our goods and services'.³¹ The submission does not assess the effect of having an independent trade and investment policy if the UK did not want to make the commitment to admit goods and services freely as Prof. Minford sets out.

3.21 How far the UK could choose its own terms in a trade deal would be limited by other international commitments, including WTO rules. The tariffs faced by EU and UK exports, depending on whether they are with countries with which the EU has an FTA or not, is shown in Table 3.3. It suggests EU FTAs have been successful in lowering tariffs. If the UK

²⁷ S. Woolcock, 'EU Policy Towards Free Trade Agreements,' ECIPE Working Paper No. 03/2007 (2007).

²⁸ The Freedom Association, *submission of evidence*.

²⁹ *Idem*.

³⁰ Global Britain, *UK Customs Duties: very low on average and reducing*, *Global Briefing note*, 81 (2012).

³¹ P Minford, 'Setting Business Free: Into the Global Economy' (2013).

were free to agree its own trade agreements, UK exports would only benefit from the lower tariffs if the UK could negotiate FTAs that had an equivalent effect to the EU agreements. The scale of integration of global trade and the desire to minimise costs to access multiple (large) markets means that in effect most businesses would, in any case, have to accept the standards and regulations determined by other trade blocs, including the EU, but without the opportunity to influence them as effectively. Moreover, the NFU suggests that if the UK were to leave the EU 'it would also be highly likely that the UK would have to apply the EU's Common Customs Tariff on goods from third countries. This would be necessary to avoid a 'carousel' on trade. In addition, the UK would lose all the preferential access [to third country markets] that the EU has negotiated so far'.³² This would only be necessary if the UK wished to remain in the Customs Union; alternative models for the UK's relationship with the EU are set out in Chapter 4.

Table 3.3 Tariffs Faced by EU Exports (2009, in %)³³

FTA status	Share of EU exports, %	Tariffs faced by EU exports (trade weighted tariff) %
1. FTA in force as of 2009	27.7	1.2
2. FTA concluded but not yet applied, or negotiations on-going or planned in 2009	25.6	5.4
3. No FTA	46.7	3.3
All	100	3.0

3.22 A further criticism of the collective EU approach is that it takes a long time to negotiate trade deals, not helped by Member States taking time to agree between themselves on the negotiating mandate. The UK, being able to pick our own terms could allow us to increase the speed at which FTAs are agreed. This is an argument made by Civitas.³⁴ For example, the UK may have negotiated an FTA with Canada more quickly than the EU, which has to address a wider range of interests, including, in this instance, significant agricultural market access concerns. The same could be true of other EU negotiations. Because the issues that hold up negotiations can often be in areas, such as agriculture, in which the UK has weaker offensive or defensive interests than some other Member States, delays can be interpreted as EU membership making it more difficult for the UK to achieve the liberalisation we want. It should be noted, though, that the UK has its own offensive and defensive concerns, such as financial services and migration, which can also be difficult in negotiations. The Freedom Association quotes Senator Philip Gramm, former Chairman of the United States Senate Banking Committee, who argues that the EU could have had an FTA with the USA in the late 1990s or early 2000s if the initiative had not been blocked by French concerns.³⁵ However, this does not necessarily mean that the US would have liked to negotiate an FTA with the UK independently: the British Retail Consortium states that 'it is unlikely that the US would have engaged in such a complex exercise [negotiations between the EU and US] with the UK alone'.³⁶

³² NFU, *submission of evidence*. 'Carousel trade' is the phenomenon described in the box on p11, whereby goods could take advantage of different external tariffs in a customs union to enter a customs union via a country with a lower tariff.

³³ European Commission, *Trade as a Driver of Prosperity, Commission Staff Working Document Accompanying European Commission, 'Trade, Growth and World Affairs' (2010)*.

³⁴ Civitas, *submission of evidence*.

³⁵ The Freedom Association, *submission of evidence*.

³⁶ The British Retail Consortium, *submission of evidence*.

- 3.23 It is difficult to assess the net impact of the EU having to cater for such a wide range of interests in its trade agreements. However, the breadth and complexity of EU interests may lead to long negotiations, making states wait longer to realise the benefits of agreements, and to negotiations that do not focus purely on UK interests, but rather balance them with other, competing interests. There is also a risk that when defensive interests dominate, the outcome might be a ‘lowest common denominator’ approach, which does not reflect the UK’s liberal stance on trade and investment. Finally, if the EU is too constrained in negotiations by the interests of its Member States, and the competing interest groups within them, this might lead to the collapse of negotiations. It is not easy to ascertain whether or how often this might have happened to the EU, but the British Retail Consortium argues, ‘Where international negotiations have failed (DDA, EU/GCC) this has almost always been because of the intransigence and protectionism of our negotiating partners’.³⁷
- 3.24 However, the inflexibility that arises from this breadth and complexity of interests may help the EU to secure a good deal, as negotiating partners know that the EU position is tightly constrained and that it is extremely difficult for the Commission to make concessions without losing support from Member States. The greater flexibility that the UK would derive from negotiating alone might make it more difficult to achieve results that so closely reflect its negotiating position.³⁸
- 3.25 Setting aside questions of whether being part of a bloc leads to better or worse results for the UK, it is worth also considering how the UK’s negotiating position at the start of negotiations on trade and investment agreements would be affected by being able to negotiate independently. Acting independently, the UK Government would, subject to constraints arising from its international commitments, have greater freedom to focus on UK interests when defining its priorities. However, these priorities would, like the EU’s negotiating mandates, be a compromise between different interest groups. While some groups would be better catered for by a UK negotiating position, others might find that the EU’s approach to negotiations aligns better with their interests than that of the UK Government.
- 3.26 For example, the NFU cites the EU-Mercosur negotiations and analysis which showed that the UK would be the second worst affected Member State in terms of agricultural revenue. The NFU credits the EU with recognising this potential impact and consequently negotiating for a balanced agreement, in contrast to the UK Government, which, it says, had a strong commitment to concluding an agreement with Mercosur despite negative impacts on the agricultural sector.³⁹ Meanwhile, others might find that neither the UK nor the EU adequately looked after their interests: the International Meat Trade Association complains that ‘at both a UK and EU level policy decisions are skewed to the interests of farmers’.⁴⁰

And Pick Our Own FTA Partners

- 3.27 One of the justifications given to support a different relationship with the EU is that UK businesses are making insufficient headway in to the rapidly growing markets in the emerging economies, especially Brazil, Russia, India and China because the UK’s membership of the Single Market distorts the UK’s trade pattern. Booth and Howarth note

³⁷ *Idem.*

³⁸ The theory that tight constraints can help negotiators to achieve good outcomes is set out by R Putnam, *Diplomacy and Domestic Politics: The Logic of Two-Level Games* (1988).

³⁹ NFU, *submission of evidence.*

⁴⁰ The International Meat Trade Association, *submission of evidence.*

that 'the destination of the UK's exports does not correlate well with forecast GDP growth in various world markets'.⁴¹ The Freedom Association quotes Lea and Binley's argument that 'these opportunity costs [of the EU Customs Union] are likely to be increasingly significant, given the relative decline of the EU as an economic bloc and the rise of the Commonwealth' and argues that by being in the Customs Union, the UK is unable to agree FTAs that might suit it with economies that are growing.⁴²

Switzerland and China signed a comprehensive bilateral FTA in 2013. Some 93% of industrial trade volume stands to benefit from lower tariffs. The FTA also includes provisions that aim to improve trade in services, reduce technical and sanitary barriers, and protect intellectual property. The agreement allows for long transition periods (of five or ten years for some categories of goods and in certain cases twelve or even fifteen years). Some commentators believe that China's willingness to use the FTA as a test run for negotiations with the EU contributed to its completion. A Swiss-Chinese joint study into the likely impacts of the agreement finds that the GDP of China and the Swiss Confederation will increase by 0.01% and 0.23% respectively as a result of the FTA.⁴³

Recent examples suggest that the EU concludes deeper FTAs than the Swiss-China FTA. For instance, the EU-Korea FTA, which entered into force in 2011, eliminates 98.7% of duties in trade value in both industrial and agricultural products within five years. It also incorporates fundamental WTO rules on non-tariff barriers, and sets up mechanisms to allow for tackling further non-tariff barriers, as they arise. More recent negotiations, such as those with Canada, have been still more ambitious and comprehensive.

- 3.28 In assessing this argument it is important to distinguish between the choices of individual businesses about who they wish to trade with (both import and export) or their choice of location for investment with the legal frameworks established by WTO rules and EU FTAs. Business for New Europe cites Jo Johnson MP, who argues 'Trading in the EU and outside is a false choice. The proportion of Germany's goods exports going to the BRIC countries is more than twice ours.' This is in spite of the fact that German exporters face the same barriers as UK exporters.⁴⁴ Moreover, the SEEG states 'there is no bar to the UK trading successfully with any country in the Commonwealth or the emerging economies outside it [...] The success of Germany in exporting to new and emerging markets belies the suggestion that the UK cannot do this while in the EU'.⁴⁵
- 3.29 Analysis by Decreux shows projections for EU countries in 2025 under different scenarios for the further completion of the Single Market. He finds that while impacts vary between Member States, 'the overarching conclusion is that countries for whom exports are more oriented towards the EU experience higher increases in exports in comparison to those that have a more diversified trading relationship'.⁴⁶ This is because the main channel through which the EU economy is affected by further effort on economic integration is through further liberalisation and the reduction of trade costs for intra-EU trade.

⁴¹ Booth and Howarth, Open Europe, *Trading Places: Is EU Membership Still the Best Option for UK Trade?* (2012).

⁴² The Freedom Association, *submission of evidence*.

⁴³ People's Republic of China and Swiss Confederation, *Joint Feasibility Study on China-Switzerland Free Trade Agreement* (2010).

⁴⁴ Business for New Europe, *submission of evidence*.

⁴⁵ SEEG, *submission of evidence*.

⁴⁶ Y Decreux, *Completing the Single Market II Twenty Years On – the UK and the Future of the Single Market* (2012).

Trade-off Between Trade Policy and Reform of the Single Market

- 3.30 Reciprocal trade negotiations operate by offering concessions or promises of reform. One argument is that the reforms of the Single Market, such as successive reforms of the CAP, ultimately weaken the negotiating clout of the EU in trade negotiations. As barriers to trading within the EU are lowered unilaterally through such reforms, benefits flow to trading partners without them having to give anything in return. On the other hand, the more effectively the Single Market works, as a result of reforms, the more attractive it is as a place to do business for businesses in third countries, as well as bringing increased benefits for businesses and consumers within the Single Market.
- 3.31 For the UK's interests, this implies that internal reforms that enhance the effectiveness of the Single Market may come at a price of diminished negotiating clout in external trade negotiations. Arguably, this may be offset if the set of policies on which the EU can negotiate with third parties is expanded. However, the same point applies to any country, irrespective of whether it is in the EU. That is, were the UK to leave the EU, unilateral domestic reforms could undermine the UK's negotiating clout in any reciprocity-based trade negotiations.

The Impact of the Single Market on the UK's Trade with Other Countries: Trade Creating or Trade Diverting

- 3.32 Assessing the merits of the arguments for and against being in the CCP and the impact of the balance of competence on UK trade with third countries is not easy. One common type of economic analysis is to look at trade deals and asks whether they are trade creating or trade diverting. By eliminating tariffs and other barriers to trade between their members, customs unions affect the flow of trade between member countries and those outside. A question, therefore, is what the impact of the UK's membership of the EU and its participation in the EU's FTAs has been on the UK's trade with non-EU countries.

Evidence of Trade Creation and Diversion in the EU

It is normally assumed that a customs union will provide a considerable incentive to increase trade between members and, possibly, to reduce trade between members and non-members. Trade creation arises from increased trade between members of a customs union resulting from the elimination of tariffs and reduction of other trade barriers to trade between members. Trade diversion occurs when trade is diverted from a more efficient producer (outside the customs union) to a less efficient one (within the customs union) as a result of the elimination of tariffs within the customs union. While in some respects this has not been researched as rigorously as one might expect, the prevailing view is that the common market has been net trade creating. Evidence is summarised below.

Trade Creation and Diversion in the European Common Market⁴⁷

This study assesses the first six years of the Common Market and concludes that it has been largely trade creating. Although trade diversion was apparent in a number of commodities, trade partners were compensated by 'external trade creation' (higher imports as a result of higher income growth in the EU as a result of the Common Market) especially in fuels and machinery. The report concludes that the UK suffered quite significant loss of market share as a result of being outside the Common Market at that time. The trade diversion losses suffered by the UK largely wiped out the gains it has derived from external trade creation.

⁴⁷ Bela Balassa, 'Trade Creation and Trade Diversion in the European Common Market,' *The Economic Journal*, 77 (1967) p1-21.

Trade Creation and Trade Diversion in the European Common Market: An Appraisal of the Evidence⁴⁸

This study concludes that the impact of the Common Market (before the UK's accession) has been on balance trade creating, though the welfare gains are relatively small. It estimates that the welfare gain from trade creation had been around 0.15% of national income, while trade diversion, mainly in agriculture, is about half the size of the trade creation gains.

The Trade Diverting Bias of Preferential Trading Arrangements⁴⁹

This criticises the prevailing view at the time that the EC had been, on balance, trade creating. It argues that there is a tendency to overstate the gains from trade creation, particularly given the likelihood that, absent the EC, individual Member States would have liberalised manufacturing tariffs on a 'most favoured nation' basis anyway. The costs of trade diversion in agriculture are, however, more certain and, because of high agricultural tariffs, significant. He further argued that the EC has had a bias towards trade diverting policies, and that early FTAs negotiated by the EC had little scope for trade creation. Where there has been a potential for trade creation, for example, sugar from the ACPs after the UK's accession, the Community responded by offering huge subsidies to compensate EU (beet) producers.

Britain in Europe: A survey of Quantitative Trade Studies⁵⁰

This study examines four assessments of the impacts of the UK's accession to the Common Market. It concludes that there has been no convincing or comprehensive estimate of the welfare effects of British accession. However, the study's cautious appraisal is that while accession worsened the UK's trade balance in manufactures, the greater availability of foreign manufactures contributed to economic welfare. The impact of trade diversion on UK imports has been very limited, with only Sweden and Canada suffering diversion.

The Single Market Review⁵¹

Using econometric analysis, this study concludes that the Single Market has been trade creating, both for EU and non-EU producers. It finds little evidence of any substantial trade diversion of non-EU trade.

HM Treasury Analysis⁵²

HM Treasury econometric analysis showed positive and significant effects of EU membership on trade flows, with any trade diversion caused by the Union outweighed by trade creation. It estimated that trade between Member States was boosted by 38% by membership of the Union, with only 5% of trade diverted from non-member countries. In addition to the 'EU effect' on trade, the model observes a positive 'Single Market effect' of 9%. The study estimates that that UK trade with EU members increased by 7%, with only 4% of trade with non-EU countries suffering diversion.

The EU trade effect for the UK is significant, but smaller than the average effect for EU Member States, possibly reflecting that the UK was more open to trade than some Member States before accession, and therefore the relative impact may have been less.

⁴⁸ Bela Balassa, 'Trade Creation and Trade Diversion in the Common European Market: An Appraisal of the Evidence,' *The Manchester School*, 42 (1967) p93-135.

⁴⁹ R. Pomfret, 'The Trade Diverting Bias of Preferential Trading Arrangements,' *Journal of Common Market Studies* (1986).

⁵⁰ A.L. Winters, 'Britain in Europe: a Survey of Quantitative Trade Studies,' *Journal of Common Market Studies*, 25 (4) (1987) p 315-335.

⁵¹ Allen et al. 'European Single Market: How The Programme has Fostered Competition' (1998).

⁵² HM Treasury, *EU Membership and Trade* (2005).

- 3.33 A number of studies have predicted the likely impacts of EU external trade agreements. Although they have not, in general, addressed the specific question of whether they are trade creating or trade diverting, they have tended to find that they generate a net benefit for the UK economy. This suggests that the impact of trade diversion is smaller than the impact of trade creation. This is supported by an assessment of the actual impacts of recent EU agreements by Copenhagen Economics which shows that a number of EU agreements have generated significant increases in exports and, in some cases, imports.⁵³ Where an agreement has failed to generate significant increases in trade, this can often be explained by the back-loading of tariff reductions or the fact that tariffs were already low as a result of existing preferential arrangements, such as the Generalised System of Preferences.
- 3.34 One of the few studies to examine whether an FTA would be trade creating or trade diverting was a study on the EU-Japan FTA. This suggests that the agreement could bring welfare gains for both the EU and Japan but losses for third countries as a result of trade diversion.⁵⁴ However, overall, the effects of trade creation on the EU outweigh any negative effects from trade diversion. See Table 3.4 for more detail.

Table 3.4 Impacts of Alternative Baselines on The Long-Run Welfare Effects

	Standard baseline, no Doha or Korea	Korea agreement in baseline	Doha in baseline	Korea and Doha in baseline
National Income Effects, percentage change from 2018 baseline				
Japan	+0.48%	+0.48%	+0.47%	+0.47%
European Union	+0.20%	+0.20%	+0.20%	+0.20%
OECD members	-0.01%	-0.01%	-0.01%	-0.01%
Non-OECD members	-0.02%	-0.02%	-0.02%	-0.02%

Source: CGE simulations.

The Introduction of Other Issues Into Trade and Investment Agreements

- 3.35 Trade-offs with other policy issues are growing as trade policy objectives are becoming more frequently bundled together with other objectives. All EU trade agreements contain a clause stipulating that human rights are an essential element in relations between the parties. As noted in paragraph 2.17 and explored further in paragraphs 4.10 to 4.15, the increased involvement of the European Parliament in trade policy has contributed to a stronger focus on broader issues, such as human rights and sustainable development. This is supported by the TUC, which is 'calling for the EU's negotiating position to be more strongly guided by the principles of 'social cohesion' and human rights'.⁵⁵ However, certain other respondents criticise it. This includes the BCC, which warns that this focus risks becoming 'an excuse for protectionism'.⁵⁶ Human rights clauses have sometimes caused problems in negotiations, with partners reluctant to accept them. This is another example of where different stakeholders have different views as to whether the EU's trade and investment policy is in the UK's interests. Moreover, with such a broad range of issues covered, complex trade-offs are possible, and it is often difficult to determine whether these trade-offs have worked, on balance, in the UK's favour or against it.

⁵³ Copenhagen Economics, *Ex-post Assessment of Six EU Free Trade Agreements* (2010).

⁵⁴ Copenhagen Economics, *Assessment of Barriers to Trade and Investment Between the EU and Japan* (2009).

⁵⁵ TUC, *submission of evidence*.

⁵⁶ BCC, *submission of evidence*.

Trade and Investment Promotion

Support for Trade and Investment Promotion to Remain a National Competence

- 3.36 All respondents to the Call for Evidence that commented on trade and investment promotion, including those who participated in the stakeholder events, were broadly supportive of the current balance of competence for export and investment promotion. For example, the CBI considered the division of competences in which the EU sets the parameters for market access through the CCP and the UK competes with other Member States on trade and investment promotion to win business 'to be an optimal approach'.⁵⁷ Diageo noted that having trade and investment promotion at the national level 'is in no way incompatible with competence for trade policy sitting at an EU level'.⁵⁸ The BBC questioned 'how investment promotion outcomes could be improved by the UK relinquishing its competency', not least because the UK's interests often differ from other Member States, on whom we cannot rely to make our case.⁵⁹
- 3.37 National competence for trade and investment promotion also allows for local and regional characteristics and interests to be better taken into account: promotion activity 'can be adapted to regional circumstances and tailored to certain products, sectors or features of the economy'.⁶⁰ By using local knowledge 'the UK can focus its efforts on products and services in which UK businesses enjoy a competitive advantage'.⁶¹ UK Trade & Investment's 'Great' campaign was cited as a successful example of drawing on 'local identities to promote British trade. The Scottish Council for Development and Industry notes that not just local knowledge but local representation is important for success and that some of its members 'may benefit from more proactive support from Scottish representation'.⁶² The British Retail Consortium highlights the positive associations of quality, heritage, tradition and innovation that many markets have with 'British'. The Consortium notes, in contrast, that 'there is little brand value to be extracted from "Made in the EU"'.⁶³
- 3.38 Benefits at a sector level were identified too. 'The UK's aerospace, defence and security industries benefit from the UK having control over its own promotion of external trade.' This also 'ensures that unique national capabilities are highlighted to potential investors'.⁶⁴
- 3.39 The role of other UK institutions in supporting UK trade, such as the British Council's activity to promote trade in the arts and education, was also identified.⁶⁵ Benefits from the Prime Minister and Ministers including businesses and trade promotion issues in their official visits overseas and using international meetings on other issues to progress trade interests were also noted.

But The EU Could Play a Useful Role

- 3.40 A cautious argument was also presented that the EU could play a role in trade and investment promotion, supplementing the activities of national bodies. The British Exporters Association suggests that while 'the EU plays a valuable role in trade promotion

⁵⁷ CBI, *submission of evidence*.

⁵⁸ Diageo, *submission of evidence*.

⁵⁹ BBC, *submission of evidence*.

⁶⁰ The Federation of Small Businesses (FSB), *submission of evidence*.

⁶¹ British Influence, *submission of evidence*.

⁶² The Scottish Council for Development and Industry, *submission of evidence*.

⁶³ The British Retail Consortium, *submission of evidence*.

⁶⁴ ADS Group, *submission of evidence*.

⁶⁵ The Scottish Council for Development and Industry, *submission of evidence*.

in terms of negotiating preference agreements and providing the Market Access Database.’ It can also play a useful role ‘in ensuring that any barriers inhibiting pan-European corporate endeavour are kept to a minimum’.⁶⁶

- 3.41 British Influence suggests that the European Commission could provide practical support since, for example, ‘sharing sites at trade fairs enables Member States to save money’. They also argue that there may be benefits from EU action in this area, as ‘promoting a message of ‘trade and invest UK – as part of the EU’ can help increase effectiveness through advertising Britain as part of the world’s largest single market’.⁶⁷ Similarly, the FSB suggests: ‘The EU could play a role in disseminating best practice on what works in terms of engaging new exporters and mentoring existing exporters.’⁶⁸ Catherine Bearder MEP notes that EU trade promotion missions could be beneficial, particularly by saving Member State resources.⁶⁹

So Long As It Is Complementary

- 3.42 However, respondents were generally sceptical about the ability of the EU to conduct trade and investment promotion which fully reflects UK businesses’ interests ‘there is surely a danger that the Commission’s trade missions will trip up over those of Member States.’⁷⁰ Any EU trade and investment promotion activity should complement rather than be a replacement for UK promotion work. The Scottish Council for Development and Industry is supportive of EU activity, ‘providing that [...] would not negatively impact or duplicate national initiatives’.⁷¹
- 3.43 But there are concerns about fairness, and avoiding one Member State’s businesses receiving support over another’s. The Council of British Chambers of Commerce in Europe is concerned that ‘the EU will be in a hopelessly conflicted position where it has to adjudicate between representing the interests of different regions across the EU.’⁷² Of course, such concerns apply too at a national and sub-national level, for example when the UK has to decide how to allocate resources to support exporting businesses, which may be in competition with each other.

Strategic Trade Controls, Arms Export Controls, Sanctions and Embargoes

- 3.44 The general consensus from submissions to the Call for Evidence and views expressed during workshop discussions was that the current balance of competence on strategic trade controls is broadly in line with the UK’s national interest, particularly as it allows for a level playing field in some areas while allowing for flexibility in others. The Committees on Arms Export Controls believe ‘the present balance of competences is satisfactory for the UK’.⁷³ BAE Systems ‘consider it most important that export control policy remains an exclusive competence of Member States, working under the Council Common Position on arms exports’.⁷⁴ Tata notes: ‘Most export control restrictions are derived from international export control regimes. Therefore ... a change in the balance of competence would

⁶⁶ British Exporters Association, *submission of evidence*.

⁶⁷ The British Influence, *submission of evidence*.

⁶⁸ The FSB, *submission of evidence*.

⁶⁹ Catherine Bearder MEP, *submission of evidence*.

⁷⁰ The British Exporters Association, *submission of evidence*.

⁷¹ The Scottish Council for Development and Industry, *submission of evidence*.

⁷² The Council of British Chambers of Commerce in Europe (COBCOE), *submission of evidence*.

⁷³ The Committees on Arms Export Controls, *submission of evidence*.

⁷⁴ BAE Systems plc., *submission of evidence*.

have no effect on this issue'.⁷⁵ Lloyd's, meanwhile, 'supports the EU's role in introducing, negotiating and setting new international sanctions as it facilitates a level playing field amongst companies throughout the EU'.⁷⁶

- 3.45 A number of submissions commented on the extent to which the EU rules constrain the UK's flexibility to act independently of the EU. The Committees on Arms Export Controls comment that the present balance of competence does not prevent the UK Government from adopting tighter arms controls where it considers it is right and responsible to do so.⁷⁷ Civil society groups felt it was right that the UK should act unilaterally where necessary and generally took the view that whether or not the balance of competences on arms controls is right, the system should be judged upon how effectively it promotes international security and human rights. However, the Committees on Arms Export Controls suggest that coordination is beneficial, since acting unilaterally and introducing more stringent export controls 'without such EU-wide controls and policies, UK arms exporters would be placed at a competitive disadvantage to arms exporters from other Member States who had laxer national controls and policies'.⁷⁸ Some defence industry representatives similarly question the benefit to the UK of acting independently, imposing arms embargoes or sanctions unilaterally, and its effectiveness, arguing, 'if we don't sell it, someone else will'. This is supported by Lloyd's, which states that EU Member States should be consistent in their interpretations of UN/EU sanctions.⁷⁹
- 3.46 Discussing the issue of flexibility, Malcolm Russell notes that it is important to differentiate between issues covered by the strategic trade control regime and those outside it because there is a risk that they can become confused. He argues that 'being part of the EU strategic trade control process may...arguably, contribute to the UK being able to influence greater flexibility of approach in terms of embargoes.' He states that, while adopting less stringent controls might allow a short term increase in export sales, over the long term it is likely to be detrimental to the UK's wider international policies on, for example, humanitarian issues, jeopardise its defence capability and reduce its credibility in relation to its trading partners. He therefore argues that the optimum situation is for the UK to encourage as many states as possible to adopt the same standards of controls, over the same range of materials because 'Arms export controls are, therefore, most effective when the same high standards are implemented on the same materials across as wide a range of states as possible.' He concludes that 'the optimum situation, therefore, is to be a leading member of a wider process of strategic trade controls so as to influence the standards and breadth of controls that all Member States apply in consideration of strategic trade controls'.⁸⁰
- 3.47 One comment in favour of independent UK action in this area was made by the Committees on Arms Export Controls, which argue that having the competence to negotiate on the multilateral Arms Trade Treaty was helpful to the UK because 'it is unlikely that the UK could have played such a significant role if...the negotiation of the treaty had been an EU responsibility'.⁸¹ This would suggest that increased EU competence in this area might have decreased the UK's influence over the negotiations.

⁷⁵ Tata Steel UK Ltd., *submission of evidence*.

⁷⁶ Lloyd's, *submission of evidence*.

⁷⁷ The Committees on Arms Export Controls, *submission of evidence*.

⁷⁸ *Idem*.

⁷⁹ Lloyd's, *submission of evidence*.

⁸⁰ Malcolm Russell, *submission of evidence*.

⁸¹ The Committees on Arms Export Controls, *submission of evidence*.

Trade and Development

Some Elements of EU Trade Policy Support the UK's Objectives for Developing Countries:

- 3.48 The stated aim of the EU's trade and development policy is to put trade at the service of development and poverty reduction.⁸² In relation to the links between trade and development policy, the SEEG notes that 'The UK has a particular interest in this area because of the Commonwealth and the preferential access given to the Single Market for goods produced by many countries within it.' The Group comments that 'the radical 'Everything but Arms' policy, which the UK strongly supported ... is a major bonus for those [least developed] countries which the UK could not have introduced alone.'⁸³
- 3.49 Fiona Hall MEP notes that 'the EU has prioritised the UK's trade interests in its negotiations with partners' by introducing a regulation in 2012 for Emergency Autonomous Trade Preferences for Pakistan following severe floods in Pakistan in 2010, which was a key priority for the UK Government. This deal provided unilateral preferences for Pakistan's exports to the EU. It will be reinforced by amendments to the GSP to allow Pakistan to apply for GSP+ status under the new regime due to be launched in 2014.⁸⁴ However, Booth and Howarth argue this example shows how the UK's interests have been held back because 'an interest group in other EU states has held up trade negotiations that are seen to be a UK priority ... slowing down and watering down negotiation'.⁸⁵

But Some Might Cause Problems For Developing Countries

- 3.50 The SEEG argues that 'the EU's agricultural policies in particular have not always been in the interests of the developing world and one of the many adverse consequences of the failure (so far) of the Doha Development round of world trade talks is the lost opportunity to open up to a far greater degree EU markets ... to food producers in the developing world'.⁸⁶
- 3.51 The Freedom Association is critical of the Economic Partnership Agreements (EPAs) being negotiated between the EU and developing countries.⁸⁷ While EPAs are intended to promote trade between the two, they say that 'the EU has adopted a negotiating style more reliant upon the stick than the carrot, which has left a bitter taste in the mouths of many premiers across the developing world.' 'Whilst EPAs have been broadly beneficial, the EU has been accused of 'bullying' developing countries into signing up to these agreements by threatening to reduce their preferential access to EU markets and to sharply raise tariffs unless they commit.'
- 3.52 The Freedom Association refers to 'the damaging impact they [EPAs] have had upon some of the least developed countries of the world. EPAs require developing countries to eliminate around 80% of their tariffs on goods imported from the EU.' One aim of EPAs is

⁸² Commission Communication to the Council and the European Parliament, *Trade, Growth and Development, Tailoring Trade and Investment Policy for Those Countries Most in Need*, COM (2012) 22 final, January 2012.

⁸³ SEEG, *submission of evidence*.

⁸⁴ Fiona Hall MEP, *submission of evidence*.

⁸⁵ Booth and Howarth, *Open Europe, Trading Places: Is EU Membership Still the Best Option for UK Trade?* (2012)

⁸⁶ SEEG, *submission of evidence*.

⁸⁷ EPA negotiations started in 2002 after the EU's former system of trade preferences for ACP countries was deemed WTO incompatible. Following a European Commission proposal in 2011, the EU agreed a 1 October 2014 deadline for the removal of the temporary trade preferences that were granted to some developing countries as an interim measure during the EPA negotiations. The deadline was deemed necessary to counter the risk that these temporary preferences would be challenged in the WTO if not put on a sound legal footing. EPA negotiations can still continue beyond this date if necessary.

to protect ACP countries' 100% duty-free quota-free access to EU markets. In turn, ACP countries are required to gradually liberalise 80% of their markets over 15-25 years. The EU considers this asymmetric opening as the minimum required by WTO legal obligations.⁸⁸

- 3.53 The TUC is also concerned that 'EPAs require premature and inflexible liberalisation for developing nations which may restrict their industrial development, have adverse impact on food security and reduce tariff revenue'.⁸⁹ The EU, on the other hand, argues that EPAs allow developing countries to protect their interests through a wide range of safeguards, anti-dumping duties and infant industry protection. The Freedom Association believes that 'were the UK to form a looser trading relationship with the EU, it would be able to form more of its own trade deals with developing countries, on far more equitable terms'.⁹⁰
- 3.54 The TUC has concerns about the effectiveness of the GSP, through which, as set out in Chapter 2, developing countries are unilaterally granted reduced tariffs for their exports to the EU. Referring to the GSP+, it describes its 'reservations about the operation of the GSP system to practically tackle labour rights abuses.' It also suggests that the scheme is not presently sufficiently transparent, noting that it 'hopes that the revised version of the GSP system due to be launched in 2014 will be made open to public input and be more transparent to allow better reporting and response to incidents of abuses'.⁹¹ The revisions to the GSP+ scheme will provide for more frequent monitoring, with countries now having to cooperate fully with international monitoring bodies. The EU will also now be able to use other sources of information to track the implementation of relevant conventions.
- 3.55 The Freedom Association makes one final, general criticism of the impact of the EU's development-related action on the UK, arguing that 'as a result of EU membership, the UK's relationship with developing nations is being harmed.' They quote the Tongan High Commissioner saying 'most of my work is based in Brussels now...everything must now be with the EU' and as a result predict that 'Tonga's High Commission will no doubt be leaving soon as the UK has given it little incentive to remain'.⁹²

Investment Protection and Investment Market Access

3.56 As discussed in Chapter 2, the EU has not yet had time to fully exercise its new competence over foreign direct investment, so evidence regarding its effectiveness as an operator in the field of investment protection is limited. However, the Law Society quotes a practitioner who argues that 'the transfer of competence to the EU, in relation to investment protection, has created a very complex situation.' They identify advantages of the EU having competence for investment:

- Simplification in the number of treaties and reduction in the number of instruments covering investment
- A more uniform approach to investment. They suggest this could also result of a higher level of protection for investors.
- Spreading costs between Member States, where the issues are considered to be at the EU level.

⁸⁸ The Freedom Association, *submission of evidence*.

⁸⁹ The TUC, *submission of evidence*.

⁹⁰ The Freedom Association, *submission of evidence*.

⁹¹ The TUC, *submission of evidence*.

⁹² The Freedom Association, *submission of evidence*.

3.57 And they identify the disadvantages as:

- An increase in the level of complexity and uncertainty, resulting from Commission involvement in the negotiation of BITs and the EU being able to involve itself directly in the resolution of disputes.
- The inability to use ICSID arbitration to resolve investor-state disputes as the EU currently cannot be a signatory to the ICSID convention.
- A lack of competition and loss of diversity from Member States in vying to attract investment.⁹³

3.58 The CBI highlights the importance of maintaining the high levels of protection present in existing UK BITs in new EU BITs or investment provisions in FTAs.⁹⁴ This is supported by the TheCityUK, which argues that ‘overseas investments by UK business should continue to enjoy the best protection available’.⁹⁵

3.59 TheCityUK also argues that the EU’s new investment policy will need to be ‘rounded’, covering not only pre-establishment issues of market access and post-establishment questions of levels of protection for EU businesses in third country markets, but also equivalent questions of market access and protections that the EU will be ready to offer to third country FDI in to the EU market. They note that they and their ‘members have consistently argued for an open EU market for FDI, not least as the basis for seeking equal openness and non-discrimination from trading partners’.⁹⁶

3.60 The Scottish Council for Development and Industry notes, however, that a rise in EU commercial diplomacy and competition between Member States for foreign investment, risks undermining the presentation of a united front at the EU level, which could affect investments in to the EU. They question whether the EU has been successful in conveying the need for such a united front.⁹⁷ In addition, the British Chambers of Commerce ‘feels the divergence of opinion between the Commission, the Council and the European Parliament sends out mixed messages’ to foreign investors. They note that this is bad for UK businesses who ultimately will suffer a loss in confidence in the Commission safeguarding their interests at the EU level.⁹⁸

The Impact of the UK on the EU’s Trade Stance

3.61 As well as considering the impact of EU trade and investment policy on the UK, it is important to assess the impact of the UK on EU policy. It is difficult to come to a definitive assessment of this impact, but getting an idea of it helps us to understand both how much the EU is addressing UK interests in its trade and investment policy and how much the EU’s policy in this area might change without UK involvement.

⁹³ The Law Society, *submission of evidence*.

⁹⁴ The CBI, *submission of evidence*.

⁹⁵ TheCityUK, *submission of evidence*.

⁹⁶ *Idem*.

⁹⁷ The Scottish Council for Development and Industry, *submission of evidence*.

⁹⁸ The British Chambers of Commerce, *submission of evidence*.

- 3.62 The UK has historically been one of the strongest advocates of a liberal approach to trade and investment in the EU. Several respondents note that the UK's approach has had a strong impact on the EU's policies 'It is clear that for forty years the fundamentally liberal UK approach to trade and investment policy has had an important and beneficial effect on EU policy as a whole, and results have been achieved which are overwhelmingly to the advantage of the UK, whose voice has been stronger internationally as a consequence'.⁹⁹ This is supported by a source quoted by British Influence: 'Working with like-minded countries, such as Germany, Netherlands and Sweden, the UK makes EU trade policy more liberal than it would be if we were not a member. ...Historically the UK has influenced EU trade and investment policy as much as any other Member State and more than most. It is vital that this influence is not diminished'.¹⁰⁰ The logical extension of this argument is that the EU's trade and investment policy would be less liberal without the UK's involvement.
- 3.63 It is also argued that, thanks to an alignment of interests, the UK has, through the EU, also been able to amplify its liberalising impact internationally and to pursue its goals more effectively 'The UK shares the interests of the EU ... This applies equally to the proposed TTIP with the USA, to continuing efforts despite years of stagnation, to get more advance within the WTO Doha Agenda, and to developing economic relations with the BRIC countries... They are EU objectives too, and we have better chances of achieving them from within the EU rather than from outside'.¹⁰¹ This argument is supported by the SEEG: 'The EU has, overwhelmingly, been a force for trade liberalisation in Europe and around the world' emphasising a rules-based approach and commitment to the international system. They further argue that 'the 'fortress Europe' notion of the EU as a protectionist bastion has been exaggerated'.¹⁰² This view is shared by some commentators, who argue that, despite the recently strengthened role of the more protectionist European Parliament, EU trade and investment policy has remained liberal, partly because of the liberal outlook of the relevant parts of the European Commission.¹⁰³ Despite these arguments, it is extremely difficult to assess the net impact of the UK on the EU's policies, and the balance between amplification of the UK's liberal approach and the costs from having make compromises to take account of the more protectionist approaches of some Member States, such as those touched on in paragraphs 3.22 and 3.23 above.

Summary

- 3.64 In determining what is in the UK's interests regarding trade and investment policy, 'the UK must balance the potential benefits of increased 'clout' in negotiating as part of the EU against the cost of having deals that are not specifically tailored to UK interests'.¹⁰⁴ Much of the argument focuses on whether the weight of the EU, and being part of a larger bloc, can achieve a better outcome for the UK than the UK acting alone. Any consideration of the arguments is complex because ultimately trade policy focuses on negotiations which involve multiple trade-offs, the impacts of which are very difficult to evaluate.

⁹⁹ Michael D.C. Johnson reported by British Influence, *submission of evidence*.

¹⁰⁰ Christopher Roberts reported by British Influence, *submission of evidence*.

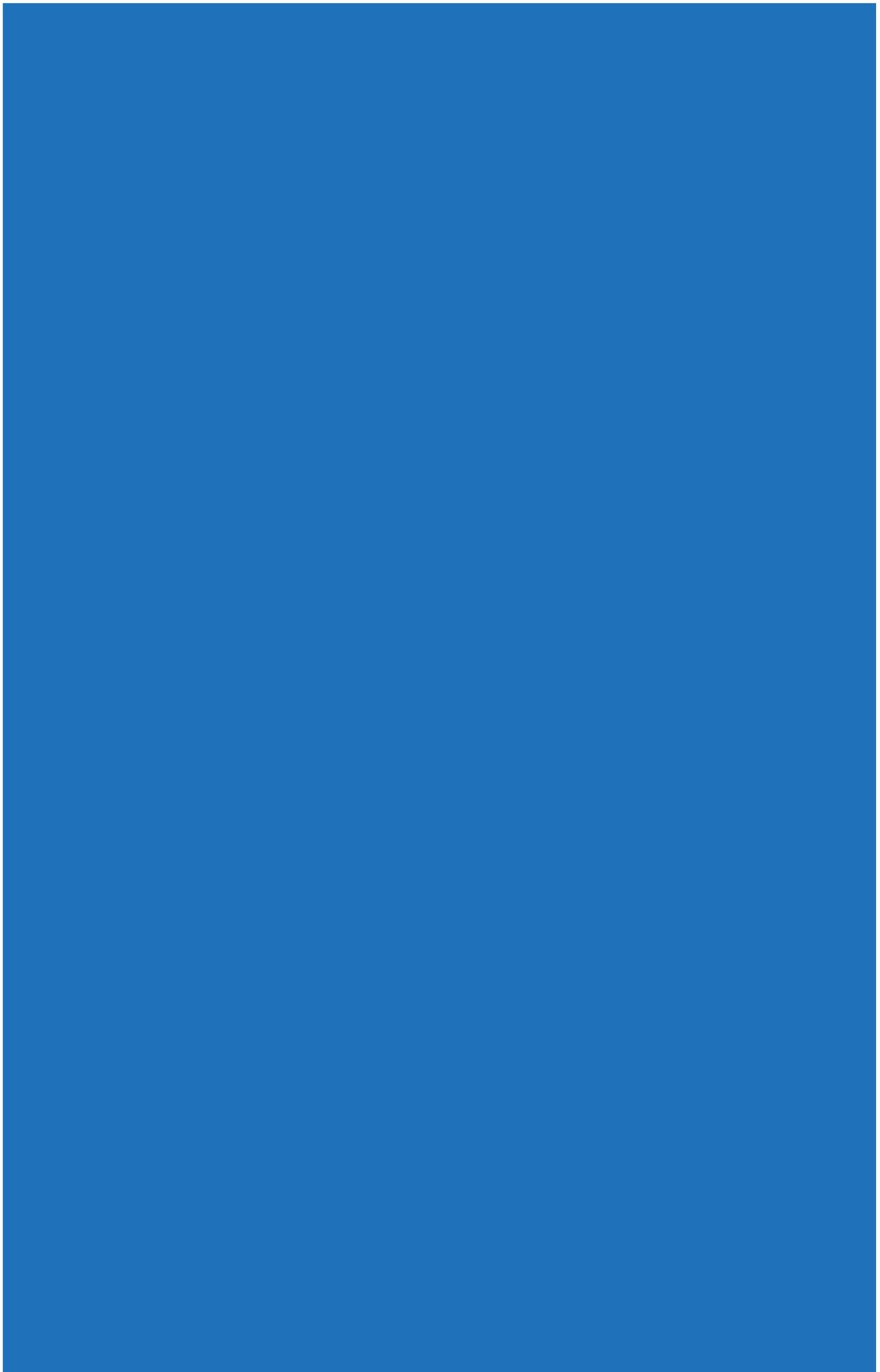
¹⁰¹ Michael D. C. Johnson reported by British Influence, *submission of evidence*.

¹⁰² SEEG, *submission of evidence*.

¹⁰³ See, for example, G. Siles-Brugge, 'The Power of Economic Ideas: A Constructivist Political Economy of EU Trade Policy', *Journal of Contemporary European Research*, 9 (2013).

¹⁰⁴ Fresh Start Project, *submission of evidence*.

3.65 When considering the extent to which EU trade and investment policy addresses UK interests, it is important, in addition to evaluating the CCP itself, to assess how any impacts of being part of the CCP compare to the impacts of being in the Single Market. This is because it is not possible to isolate the CCP from the Single Market – if the UK wants to be in the Single Market, the UK needs to be within the common external tariff, and hence within the CCP. Any costs of being in the CCP rather than having an independent trade and investment policy therefore need to be weighed up against any benefits from membership of the Single Market. Overall, analysis which examines whether being a member of the Customs Union has been trade creating or trade diverting finds that membership has been net beneficial to the UK. But that is not to say that all UK interests are met, not least because all UK interests are not homogenous. Challenges facing the future of the CCP and possible options for the UK are explored in Chapter 4.



Chapter 4:

Future Challenges and Options

Challenges Facing Trade Policy Makers

- 4.1 There are, and will continue to be, many pressures, challenges and opportunities facing the UK and businesses within it. This chapter explores a number of these and the implications for EU action in this area. Because any major shift in the balance of competences over trade and investment towards the UK would require the UK to leave the EU, this chapter sets out briefly the alternative trading relationships the UK might have with the EU, as identified by commentators.

Ongoing and New Negotiations

- 4.2 The Doha round of WTO trade negotiations has been running for 12 years. The 9th Ministerial meeting in Bali, Indonesia, in December 2013 agreed a deal on a number of areas (see box in Chapter 1). However, there is a need to identify how to best build on this momentum in order to get more liberalisation at the multilateral level. In addition to taking forward the DDA the WTO membership might also wish to consider what new issues they might want to negotiate in the WTO.
- 4.3 Alongside the multilateral trade negotiations, and partly because of their hitherto slow progress, a growing number of bilateral and regional trade and investment deals are being negotiated. Figure 1.2 shows the negotiations that the EU has concluded and has underway. Others are also negotiating trade deals, such as the Trans Pacific Partnership between twelve countries on the Pacific rim;¹ or the Regional Comprehensive Economic Partnership (RCEP) between the ten ASEAN Member States and its FTA Partners.²

Which Go Beyond Traditional Tariff Rates

- 4.4 As discussed in Chapter 1, complex non-tariff barriers are increasingly important in trade negotiations, and the latest agreements commonly go beyond the tariffs and quotas that have been the subject of previous trade deals. The Transatlantic Trade and Investment Partnership (TTIP) between the EU and the US is the largest of these negotiations by far and is pushing the boundary by addressing non-tariff barriers in such a way that both the EU and the US may potentially be required to examine their regulatory approaches. Moreover, the potential size of the TTIP deal has the potential to influence or set new

¹ These are: Brunei; Malaysia; Singapore; Vietnam; Japan; Australia; New Zealand; USA; Canada; Mexico; Chile and Peru.

² These are: Australia; China; India; Japan; Korea; and New Zealand are the non-ASEAN parties to the RCEP.

global standards because the scale of TTIP might also mean it is economically sound for third countries to adopt such standards in their home markets too. This would strengthen the existing role of the US and the EU in setting global standards, as discussed in Chapter 1.

EU-US Transatlantic Trade and Investment Partnership (TTIP)

Economic Benefits

The Government believes that the launch of negotiations for the EU-US Transatlantic Trade and Investment Partnership (TTIP) is a once in a generation opportunity – it has the potential to be the largest bilateral trade agreement in the world, and bring significant economic benefits in terms of growth and jobs to both sides of the Atlantic. It could add as much as £10bn annually to the UK economy in the long-term (£100bn for the EU and £80bn for the US).

The negotiations will cover three major themes, namely (i) market access, (ii) regulatory issues and (iii) rules and standards. The negotiations will be tough but the UK Government hopes that they can be completed within 18-24 months.

To achieve their potential, the negotiations need to be truly comprehensive – eliminating the vast majority of tariffs, addressing behind-the-border barriers across sectors, and looking to achieve regulatory coherence between Europe and the US will be the aims.

The UK already enjoys a very strong trading relationship with the US, so eliminating the generally low tariffs alone could add billions to both of our economies. A truly ambitious agreement that addresses non-tariff barriers, including regulations, standards and intellectual property practices, could add further still.

Beyond the initial negotiations, the objective is to further increase transatlantic cooperation through a ‘living agreement’. This means that businesses will continue to feel the benefits of increased regulatory coherence and a more coordinated approach to future legislation.

Strategic Rationale

The UK Government believes there are compelling strategic reasons for an agreement. Successful conclusion could allow the EU and US to agree common standards and rules fit for the 21st century, particularly in new and emerging areas, which others would need to follow. And by signalling both sides’ commitment to opening up trade and investment, an agreement would complement the Government’s broader liberalisation agenda including the World Trade Organisation’s push for a multilateral agreement on trade facilitation.

- 4.5 Chapter 3 discussed the argument that the UK could achieve a deal such as TTIP, more quickly on our own, outside of the EU. Respondents generally believed that the benefits of negotiating as a bloc outweighed the costs of its complications, but some disagreed.

Internal Competence Could Drive the Development of Trade Agreements (and Vice Versa)

- 4.6 From a competence perspective, such broad ranging negotiations present new challenges, including who will conduct the negotiations and represent the EU and Member States. Even in areas that do not explicitly fall within the CCP, where a proposed treaty is likely to affect the EU’s common internal rules the EU has the EU can, in some circumstances, gain exclusive competence to negotiate externally in areas in which it

has legislated internally, under the principle of implied competence.³ So, for example, where the EU has passed internal Single Market legislation, this may allow it to negotiate on the same matters in these areas with international partners, and stop Member States from negotiating independently. Broadening internal competence may therefore allow for broader EU trade negotiations. However, even where there is no EU competence in a particular area, Member States can authorise the Commission to negotiate on their behalf. They now do this through the double decision mechanism described in paragraph 2.16 above, which is designed to allow for broad negotiations without affecting the balance of competences.

- 4.7 One example of the potential impact of internal EU action on the scope of international trade negotiations is in the area of defence. This is highlighted by ADS. The EU has begun to increase the amount of harmonisation of the defence trade within the EU, for example by the 2009 Defence package (Directive 2009/81 covering defence procurement and Directive 2009/43 covering intra-community transfers). ADS note that the Commission have signalled intent to align external European defence trade with the changes to internal competence.
- 4.8 ADS argue that ‘whereas the directives were established to create safeguards on security of information and strengthen the technology industrial base across Europe, any development by the EU to increase its competence over external defence trade would be misguided, and would negatively affect the UK’s defence industry.’ They are concerned that allowing those Member States with limited or no defence industrial capability to influence other Member States’ trade in defence would adversely affect international defence sales.⁴ It is worth noting that even if the EU does have competence to negotiate externally on a particular issue, it still requires authorisation from the Council to do so, so Member States can still decide not to allow for EU negotiations on a particular issue, if they want.

Internal Reforms Might Weaken Trade Negotiations

- 4.9 The Government, along with other Member States, is in favour of reform of the Single Market, and, in particular, completing the single market in services. However, as discussed in Chapter 3, pursuing Single Market reforms might actually weaken the negotiating clout of the EU in bilateral negotiations and in multilateral fora because, as Single Market barriers are lowered through reforms, the benefits flow to trading partners, in addition to Member States, without having to give anything in return. In reciprocity-based negotiations, this impact could be offset if the range of issues on which the European Commission can negotiate could be expanded. The Commission negotiating mandate can already be expanded to include areas outside the EU’s competence, subject to the double decision mechanism. If certain areas start to fall increasingly within the normal scope of EU trade and investment agreements, there may be pressure to expand the EU’s exclusive competence over these matters, through an extension of the CCP. Of course, the same tension would exist between domestic reforms and reciprocity-based trade negotiations for the UK.

³ The doctrine of implied competence has been developed by the European Court of Justice through its case-law on EU external competence. Under this doctrine the competence of the EU in the external field arises not only from express conferment under the Treaties but may flow by implication from other provisions of the Treaties and the practice of the EU. Implied powers arise in broadly three situations. The commonest is where measures have been adopted by the institutions on the basis of an internal power. External powers may also arise even where internal measures have not been adopted, either because external and internal competence must be exercised simultaneously, or because an external power is implicit in the scheme of the internal power.

⁴ ADS Group, *submission of evidence*.

The Introduction of Non-Trade Issues into Trade Negotiations

- 4.10 There is also the potential for the content of trade and investment deals to expand as more policy issues become linked to trade and investment negotiations. Most countries are able to manage the additional and increasingly complex trade-offs within their own administrations. Within the EU, the delineation by policy area and different levels of competence beg the question how broad, deep and ambitious FTAs negotiated by the EU can genuinely become without producing a reaction from interest groups saying ‘this isn’t trade policy any more, this is domestic politics’.
- 4.11 For example, policy-makers tackling climate change are focusing attention on trade in goods made in polluting industries and trade in ‘green goods’. Asia-Pacific Economic Cooperation, a forum for 21 Pacific Rim member economies that seeks to promote free trade and economic cooperation, is developing an initiative on trade in ‘green goods’ which may be open on an MFN basis to others.⁵ The arguments set out in Chapter 3 about negotiating weight in trade negotiations, and the greater influence that the UK can have through the EU, can be extended to negotiations on trade issues that relate to climate change: the EEF notes that the UK needs to be in the centre of discussions on climate change.⁶
- 4.12 Similarly, the desire to encourage and support good corporate and social responsibility practices is gaining ground in trade discussions, in particular in demands to prevent the imports of goods or services from countries that do not apply good standards or practices. For example the US introduced a requirement for US companies trading with Burma to report on a range of issues related to corporate social responsibility.
- 4.13 In addition, TheCityUK notes that the introduction of non-trade issues into trade negotiations has implications for the role of the European Parliament. ‘More generally, the role of the Parliament can be expected to become even more important for trade policy, the more so as trade policy becomes more integrated with other economic policies (environmental, regulatory etc.) in which MEPs have wide-ranging interests.’⁷
- 4.14 The wider implication of an expansion of issues covered by trade agreements is that the Commission negotiators of trade deals would need to be able to address the wider issues, which may, in turn, lead to a demand for an extension of competence to cover the related issues. Alternatively, it could simply require Member States and/or the Council to agree a negotiating mandate for the Commission which allows such issues to be discussed, using the ‘double decision’ mechanism described above.

⁵ Members of the WTO agree to give each other ‘Most Favoured Nation’ status. No member of the WTO can treat a country with MFN status less advantageously than any other country with MFN status. Exceptions apply only to preferential treatment for developing countries, regional free trade areas and customs unions. The ‘MFN tariff’ is, therefore, the tariff that one WTO member applies to imports from other WTO members with which they do not have a preferential trade deal.

⁶ EEF, *submission of evidence*.

⁷ TheCityUK, *submission of evidence*.

In parallel to FTAs, the EU negotiates political association agreements which sit above the trade agreements. To date, the two have been formally linked. This allows for the EU to suspend trade preferences with the third country with which the Agreement is signed if there is a substantial violation of the political clauses, notably through human rights abuses.

The EU's FTA with Colombia and Peru was atypical in that it was an FTA which included political and human rights clauses, as there was not an umbrella agreement negotiated in parallel. This is not in line with normal practice: an association agreement is being negotiated separately on a parallel track with Canada, Japan, Ukraine, for example.

The Commission plays a minimal role in negotiations on association agreements, which are led by the EEAS and are not generally debated by Member States' trade representatives.⁸

- 4.15 An alternative approach that has been suggested would be to negotiate simpler trade deals which omit 'political' and 'human rights' clauses. TheCityUK notes that it has, in the past, opposed the inclusion of such clauses, on the grounds that 'these issues, while important in their own right, fall outside the core *raison d'être* of trade policy. ... The inclusion of these issues in trade negotiations produces an over-burdened agenda that may dissuade trading partners from agreeing to deliver further commercial advantages.' They refer to emerging markets' suspicions of attempts by developed countries to insert social clauses into trade agreements in the Doha Round of multilateral trade negotiations, the EU-Gulf Cooperation Council negotiations and EU-India FTA negotiations.⁹ However, views on these clauses vary – as outlined in paragraph 3.35, the TUC is in favour of using trade policy to pursue such objectives.

Can the EU Deliver?

- 4.16 As TTIP negotiations are expected to broach new ground for a trade deal, negotiators from DG Trade may have to draw on expertise from other areas of the Commission and from Member States. TTIP will be a learning curve. The Commission is also embarking on negotiating a new EU-China Investment Agreement. This will be the first stand-alone EU Investment Agreement and will test the new expertise the Commission has had to develop since the transfer of competence over FDI in 2009. Over time it is reasonable to expect the EU to develop its expertise on such matters.
- 4.17 On the other hand, even when EU trade negotiators are able to secure a deal, there is no guarantee the agreement will be implemented in the EU. For example, as part of the EU-Mexico FTA negotiations (concluded in 2001) an agreement for mutual recognition of each party's architectural qualifications was agreed between the ACE (Architects Council of Europe) and its Mexican equivalent. The EU (DG Trade) had a mandate to negotiate mutual recognition agreements for architectural qualifications along with various other services. However, despite this, the mutual recognition agreement on architectural qualifications with Mexico has not been ratified by the EU – it proved easier to reach agreement between the EU and Mexican professions than (so far) to reach agreement within the EU on how to amend the internal market regulations necessary to implement the agreement.

⁸ For further information on association agreements, see HMG, *The Balance of Competences between the UK and the EU: Foreign Policy Report* (2013).

⁹ TheCityUK, *submission of evidence*.

In a World of Greater Regional Integration

4.18 The EEF note that ‘it must be taken into consideration that other nations have plans and are coming together to form blocs and economic communities and are becoming more integrated, e.g. the UK would not want to find itself isolated’.¹⁰ At the WTO, some countries, such as the US and China, are big enough to act on their own to protect their interests but smaller countries form groups together where they have common interests in order to promote and protect themselves, even where they have not given over any competence. Sitting outside of those groups, it is questionable how much influence the UK would have acting alone, although if the UK were not a member of the EU, it is possible that we would still seek to coordinate with the EU at the WTO, in order to have a greater influence on negotiations.

4.19 Examples of groups which work together in the WTO include:

- The CAIRNS group is a coalition of 19 agricultural exporting countries. It states that ‘by acting collectively it has had more influence and impact on the agriculture negotiations than any individual members could have had independently’.¹¹
- ACP: African, Caribbean and Pacific countries, which enjoy particular preferences from the EU (see paragraph 2.37), also coordinate in the WTO.
- The G33 is a group of developing countries which has been pressing, in the Doha round of negotiations, for flexibility for developing countries to undertake limited market opening in agriculture.

4.20 According to the European Commission’s External Trade ‘Global Europe’ paper, FTAs, if approached with care, can build on WTO and other international rules by going further and faster in promoting openness and integration, and by preparing the ground for the next level of multilateral liberalisation.¹² Ethier claims that an individual regional arrangement may by itself do more harm than good.¹³ But widespread regionalism of the sort we are experiencing produces an outcome superior to that obtainable by multilateralism alone.

And Changing Business Practices

4.21 Chapter 1 noted that world trade and the practices of businesses have changed over time. The increased length of global value chains, which involve goods and services crossing multiple borders before a final sale, means that more and more countries’ interests are aligned. Actions which seek to protect a particular industry or worker will increasingly also damage the same country’s export interests where the protected industry is an input in a global value chain and the country’s exports. The length of the Doha round negotiations might also beg the question whether world trade and business practices have changed so much that the negotiations are now trying to fix an old problem. The same might be argued for some FTA negotiations.

Coping with Changing Dynamics Within the EU

4.22 Some argue that challenges arising from increased coordination or sharing of powers by the Eurozone countries will have an impact on the functioning of the CCP. The COBCOE suggests that the ‘elephant in the room’ is the question of the extent to which ‘EU institutions can be utilised to support Eurozone legislation or rules’. That is, could

¹⁰ EEF, *submission of evidence*.

¹¹ CAIRNS group, *submission of evidence*.

¹² European Commission, *Global Europe: Competing in the World*, COM (2006) 567 final, 2006.

¹³ W.J. Ethier, ‘The New Regionalism’, *The Economic Journal*, 108 (1998) p1149-1161.

the EU institutions effectively coordinate and manage trade and investment negotiations for a 'two-speed' Europe without prejudicing one group over another? This would have implications for the UK's trade and investment outlook because, as The Council of British Chambers of Commerce in Europe explains, 'one of the greatest challenges is reconciling what can become a two-speed Europe (countries within the Eurozone and countries outside) with a free and open market within the EU as a whole.' They are concerned that cash transfers within the Eurozone may provide unfair support for some EU economies over others and consequently 'distort ... the view that foreign investors have of the various states within the EU.' They note that a popular response to such challenges may be to seek to create 'more Europe' but argue that 'there should be more emphasis on looking more radically at areas where the principle of subsidiarity would be beneficial'.¹⁴

Coordination of Strategic Trade Controls, Arms Export Controls, Sanctions and Embargoes

- 4.23 Following from the general consensus that the balance of competence is broadly right, outlined in Chapter 3, the challenges identified predominantly focus on the need for consistency in the application of EU rules. Some specific issues are also identified, including fluctuating implementation standards across a broadening EU membership and creeping competence within the EU itself.
- 4.24 Lloyd's notes that 'some EU member states have adopted different interpretations of certain key terms in current EU sanctions regulations', for example, the storage and transport of Iranian crude oil, and encourages the EU 'to place greater stress on ensuring consistency in application of sanctions regulations.' Moreover, in specific areas, Lloyd's considers that the 'system is not fully harmonised across member states and the UK appears to adopt a more rigorous approach in implementing related (re) insurance restrictions ... [which] put UK insurers at a competitive disadvantage to the European counterparts'.¹⁵
- 4.25 Rather than questioning the balance of competences or highlighting differences between Member States, the UK Chamber of Shipping focuses on problems relating to effectiveness in the UK 'It does not really matter whether export controls are set at an EU or a national level: what does matter is that the control regime should work efficiently and predictably.' They also comment on related problems in the system coming from the 'interference' of UK border control or other control agencies in the physical departure of a shipment after it has received customs export clearance. But it is not clear to them whether the problems they experience are attributable to the division of competence between the UK and the EU, as opposed to insufficient coordination between UK agencies.¹⁶
- 4.26 BAE Systems identify a risk of competence creep stemming from the Commission seeking to use its competence over import and export control and of Directive 2009/43/EC on intra-community transfers to become a party to the UN Arms Trade Treaty (ATT), which concerns military goods only. They highlight the Commission's insistence that national ratifications of the ATT should proceed through Union processes as evidence of competence creep. They also doubt 'that the Union itself has the capability to manage and assess the complex scientific and technical matters that arise in export control decisions, not the politically delicate issues which often surround them'.¹⁷

¹⁴ COBCOE, *submission of evidence*.

¹⁵ Lloyd's, *submission of evidence*.

¹⁶ UK Chamber of Shipping, *submission of evidence*.

¹⁷ BAE Systems plc., *submission of evidence*.

How to Address the Challenges?

4.27 The section above identifies a number of challenges and opportunities facing the future of trade and investment negotiations. These are the challenges identified today. The world economy is evolving and different and new challenges and opportunities might appear in the future, for example with the growth of goods and services traded over the internet. There are a number of options that can be considered as means to address the challenges identified above. They are explored in the section below.

A Stronger Role for the EU?

Tidy Up Article 207 TFEU

4.28 One option might be to make EU decision-making more effective by removing the areas of contention between Member States, the Commission and the European Parliament. At one level this could involve resolving (possibly including through the ECJ) differences of views on competence as set out in the Treaties. This would avoid the expenditure of so much energy and time by both the Commission and Member States resolving differences of views for each negotiation and allow each negotiation to begin in the knowledge that the competence for various components is understood and agreed. A successful attempt to resolve these in one go could help speed up subsequent EU decision-making. However, such an exercise could itself be difficult to complete successfully and its future benefit would depend on the outcome being fit for purpose for all future circumstances.

4.29 A more radical alternative would be to amend Article 207 TFEU to remove the disputes over competence, possibly by handing all competence for trade and investment issues, where there is a disagreement, or shared (including unexercised) or Member State competence, to the Commission. This might make it easier to get liberalising trade deals; however, it would maintain the role of the European Parliament, who many fear is the most illiberal of the three institutions – Commission, Council and Parliament – involved in EU trade and investment policy. It might also make it harder to determine in advance how UK interests are being considered by the Commission, and harder to ensure that trade agreements address UK interests.

4.30 The benefit of either approach would be to allow the Commission to respond more effectively and quickly to proposals from negotiating partners to expand negotiating agendas.

May Drive Necessary Changes in the Single Market

4.31 One potential benefit of increasing the EU's competence is that EU trade deals form a positive force for change in the EU itself. TheCityUK states that 'a key question is the extent to which EU member-states will permit trade agreements to drive internal economic structural change within their own countries', arguing that 'if Member States cannot or will not make structural changes in such areas as services, labour markets and the role of the public sector, the EU will be inhibited from pursuing agreements with trade partners regarded as too competitive for EU domestic interests to accept as rivals'.¹⁸ Handing greater control to the Commission might therefore enable it to overcome the resistance from vested interests to achieve better trade deals with complementary reforms of the Single Market, but would involve giving up competence in some areas.

¹⁸ TheCityUK, *submission of evidence*.

A Better Resourced Commission

4.32 A number of responses note the large resources available to DG Trade, with around half of all DG Trade staff working on trade defence matters, and they do not think there is a shortage of resource in DG Trade. Rather, with TTIP beginning, potentially taking trade negotiations into new areas, negotiations beginning with China on the EU's first stand-alone investment agreement, DG Trade staff will need to acquire new skills and experience quickly. In addition they will have a number of other bilateral negotiations under way at the same time as well as negotiations at the WTO on the Doha Development Agenda deal and post-Bali agenda. Prioritising and using the right resource will be crucial for their success. One way to perhaps secure this might be for DG Trade to increase its intake of secondees from Member State governments. These would provide useful national perspective and bring expertise but they might also help provide more buy-in from their home states. In addition, British Influence suggested that 'as the European External Action Service acquires more expertise, the UK could benefit from this'.¹⁹ However, as outlined in Chapter 3 there is little support for the EEAS taking on trade and investment promotion activities alongside Member States.

A Different Relationship with Third Countries and, Hence, with the EU

4.33 A number of commentators argue for a more radical transfer of trade and investment competence to the UK. However, this could have significant implications for the UK's relationship with the EU. EEF argues that 'repatriation of trade policy competences would threaten the integrity of the Single Market. Put another way, it is doubtful the UK would be permitted to remain within the Single Market if it regained competence for the setting of rules and tariffs with regard to its extra-EU trade and then used that competence'.²⁰ As suggested in Chapter 1, a repatriation of competences over trade would not be possible without also withdrawing from the Customs Union.

Alternatives to Full EU Membership

4.34 Different types of change to the UK's relationship with the EU would affect the UK's relationship with third countries in different ways. There are a number of alternatives which are proposed by different commentators. Examining alternative forms of membership is outside the scope of the Balance of Competences Review although the possible changes in relationship proposed by different commentators are summarised in the Box for completeness. For a full discussion of the alternatives and the pros and cons of them, including the implications for UK trade see the CEPR economic analysis published alongside this report.²¹

¹⁹ British Influence, *submission of evidence*.

²⁰ EEF, *submission of evidence*.

²¹ There are many papers written on alternative forms of trade relationship the UK could have with the EU. See for example, Lee Rotherham, *Controversies from Brussels and Closer to Home* (2011). This discusses the EU rules and regulations that are members of EEA and EFTA are required to implement.

In considering an alternate trading relationship with third countries we need to consider the possible alternate relationship the UK would have with the EU because that shape of the UK-EU relationship would affect any relations with third countries. The following scenarios are described briefly and are based on the assumption that, in the absence of any other arrangement, the UK remains a member of the WTO; that upon the UK leaving the EU, the UK retains the same external tariffs as the EU; but the UK now applies those common customs tariff rates to imports from the EU, and vice versa.

1. **No trade agreement with the EU of any kind ‘going it alone’.** The UK could undertake trade negotiations with third countries and as a member of the WTO. The EU, because of its obligations at the WTO could not impose higher tariffs on imports from the UK or treat UK exports to the EU worse than its treatment of other non-EU WTO members.²² UK exporters would face the EU’s common external tariff instead of its current tariff-free access.
2. **To conclude an FTA with the EU confined to trade in goods.** The UK would have control over its tariff policy and be able to negotiate FTAs with third countries. However, if any UK FTA with the EU included ‘third party MFN provisions’, the EU would benefit from any preferences that the UK had given to other countries that went beyond those it had given to the EU. Likewise, the UK would benefit from any more extensive preferences that the EU had offered in its other FTAs. When exporting goods from the UK to the EU, costly Rules of Origin procedures would be required to prove goods originated in the UK, and therefore that the correct tariff was being applied; and exporters from the EU to the UK would have to designate origin for UK customs. It is difficult to estimate the precise costs of complying with Rules of Origin, but the Centre for Economic Policy Research (CEPR) literature review in support of this report concludes that the total trade costs of complying with Rules of Origin has been estimated to be between 4% and 15%.²³ These compliance costs include the costs of adapting production processes and identifying the sourcing of products which currently do not meet the origin rules because they include inputs from sources outside the EU, as well as administrative costs, such as record keeping and demonstrating compliance with the Rules of Origin requirements. Those exports which do not meet the origin rule would face both types of cost if they want to benefit from available preferences, i.e. low or zero EU tariffs. All UK exports to the EU claiming preferential treatment under an FTA would face the administrative costs. The latter have been estimated at between 1.9% and 6.8%. Being outside the Single Market would also, according to evidence analysed by CEPR, increase non-tariff barriers for the UK. If, for example, UK exporters wanted to sell goods to the EU, they would very likely have to comply with EU Single Market regulations.
3. **To conclude a modern FTA with the EU, similar to EU-Korea.** Many of the issues with a goods-only FTA, including those relating to MFN provisions, would also apply with a modern FTA. However, modern FTAs have far greater scope (see box above on TTIP and, in the appendix, on the EU’s FTA with Korea) and include foreign investment, services and movement of people. This arrangement would, therefore, reduce barriers, including non-tariff barriers, on a broader range of goods, services, and investments.

²² There are some exceptions to this, such as anti-dumping duties.

²³ Centre for Economic Policy Research, ‘*Estimating the Economic Impact on the UK of a Transatlantic Trade and Investment Partnership (TTIP) Agreement between the European Union and the United States*’, study produced for HMG, (2013).

4. **To conclude a customs union with the EU.** One advantage over an FTA with the EU is that it avoids the costly rules of origin requirements in order to retain zero tariff treatment. However, because the UK would be adopting the common external tariff, any changes the UK would want to make to tariffs on imports from third countries would require the agreement of the EU. The UK would therefore not have the freedom to conduct its own, independent tariff policy and possibly other aspects of trade policy.
5. **To accede to the European Economic Area (EEA).**²⁴ The EEA is an arrangement which combines an FTA with the EU, plus the ability to reap some of the benefits of the single market through a reciprocal agreement with EU members to apply the relevant EU Market laws to each other's trade. The EEA combines some of the benefits of independent action in trade negotiations with third parties and the potential to take independent action at the WTO with legal certainty in accessing the EU's market. Sectoral coverage is narrower than EU membership as it does not cover agriculture and fisheries. It includes commitment to the Four Freedoms of the EU²⁵ and EEA members implement EU regulations that apply to the commerce covered by the EEA accord. But non-EU members of the EEA do not take part in the collective decision-making process that determines the regulations which govern commerce in the EEA. EEA signatories are able to agree trade and investment deals on matters not covered by the EEA.
6. **To negotiate an FTA with the EU plus a suite of bilateral accords similar to those the Swiss Confederation has negotiated with the EU.** This arrangement combines an FTA with a slightly more flexible agreement than the EEA. In Switzerland's case, it does not implement or is subject to current and future EU laws but instead agrees to adopt equivalent laws to those of the EU, covering the Four Freedoms. The Swiss argue that this allows for tailor-made solutions yet retains the Swiss Confederation's independence in decision-making. Switzerland adopts equivalent legislation, rather than applying EU law directly and so can use different legislation to achieve the same objective. The suite of bilateral accords does not restrict the Swiss Confederation's rights of action in the WTO. The EU and the Swiss Federal Council have expressed dissatisfaction with the outcomes of the current accords.²⁶

Each alternative affords more leeway in managing commercial relations with third countries. The actual impact of any arrangement based on a UK-EU FTA would depend on whether third party MFN clauses are included and the policies covered by those clauses. There is a trade-off between, on the one hand, legally certain access to the EU market and, on the other hand, the ability to preserve independent action. However, which alternative the UK may be able to secure will depend on the terms on which the EU is willing to negotiate. See the CEPR research published alongside this report for more discussion of these alternatives and what they would mean for UK trade.

²⁴ The non-EU members of the EEA include Norway, Iceland and Liechtenstein, who along with Switzerland are members of the European Free Trade Association.

²⁵ The so-called four freedoms are freedom of movement of goods, persons, services and capital. These are discussed in HMG, *The Balance of Competences Between the UK and the EU: Single Market: Synoptic Report* (2013).

²⁶ See the CEPR research published alongside this report.

4.35 Responses to the Call for Evidence expressed views on several of these options. In particular, the Government of Japan noted that it ‘expects that the UK will maintain a strong voice and continue to play a major role in the EU’.²⁷ It should be noted, however, that assessing the impact of alternatives to EU membership on the UK’s trade and investment relationship with third countries is not straightforward or simple. Much depends on what others, including the EU would do and the type of relationship that the UK would be able to establish with the EU. The UK would only be able to achieve better trade and investment deals if:

- Third countries want to negotiate with the UK; and
- The UK can achieve good results in negotiations.

4.36 The UK would also have to make sure its trade deals addressed the interests of different groups within the UK. As noted in Chapter 3, some groups would certainly benefit from the UK being able to focus on their interests, while others, which get more attention from the EU, would lose out.

4.37 The European Commission has set out what it believes would be the implications of a Member State leaving the EU.

‘The Commission takes the view that if a Member State were to leave the European Union it would no longer benefit from preferential arrangements included in EU trade agreements. In such circumstances, a Member State would not be subject to the Union’s common commercial policy and could no longer benefit from agreements negotiated on that basis. Moreover, a third country offers concessions to the EU on a reciprocal basis, expecting market access to the Union as a whole. Third countries would be unlikely to offer as generous concessions to a Member State which has activated Article 50 that could only offer access to its own market’.²⁸

4.38 It is also important to note that many of the rules governing the UK’s trade and investment would continue to be set by external systems. For example, the UK would inevitably continue to be a member of the WTO, and to be governed by its rules, and the rules in areas such as export and import controls and export credits, which are governed by international arrangements, would in many cases remain the same.

Impact on Trade with the EU

4.39 If the UK were to leave the EU, there is a strong argument that, as the EU’s largest trading partner, it is likely that the EU would want some form of preferential trading relationship with the UK. It is not possible to determine which of the options the EU would prefer. However, there is no way to guarantee that the preferred relationship of the EU will correspond to the preference of the UK and enable the UK to achieve the best deals possible with third countries. It is very likely the EU would not want to enter into a trading relationship which allowed the UK full access to the Single Market without sharing the common external tariff because it would distort trade flows within the EU by allowing exporters to the EU to circumnavigate the EU’s tariffs and customs. This argument is

²⁷ The Government of Japan, *submission of evidence*.

²⁸ Commissioner De Gucht, Reply to European Parliament Written Question, European Parliament, 24 October 2012.

echoed by the NFU: 'It would...be highly likely that the UK would have to apply the EU's Common Customs Tariff on goods from 3rd countries.'²⁹

- 4.40 Moreover, EEF argues that 'trading within the EU would be vastly more complex and administratively burdensome if each member state is able to maintain its own tariffs on extra-EU imports, its own rules of origin, its own trade defence measures etc'.³⁰

Impact on Trade with Third Countries

- 4.41 It is difficult to know what trade and investment deals the UK would be able to negotiate with third countries and whether they would be willing and interested in negotiating a deal with the UK, especially those that are already beginning, intending to start or are in negotiations with the EU. As noted by the British Retail Consortium 'by virtue of its membership of the EU, the UK enjoys MFN+ access to many other markets. ... The long list of countries that the EU is engaged in bilateral negotiations with suggests that the UK can look forward to even more WTO+ access in the future' if the UK continues as a member of the EU.³¹ TheCityUK note that 'withdrawal from the EU would not only throw the UK's trade relations with the rest of the Single Market into doubt, but would also lead to the loss of trade and investment benefits in current EU trade arrangements with third markets'.³²
- 4.42 Proponents of change, such as Civitas, argue that plenty of other economies, such as Canada and Australia, are able to negotiate their own FTAs and are not without influence.³³ So why is it unfeasible for the UK to have a national trade policy? The relevant question is whether such economies manage to secure good deals in the FTAs they signed. The CEPR's economic research, published alongside this report, examines Canada and Australia's negotiations with the United States. All share a common language, similar legal systems and a defence partnership. The research finds that the Canadian experience was one of fraught and difficult negotiations, although the eventual deal was a good one. The Australian experience was that matters other than pure trade were caught up in the negotiations.
- 4.43 As discussed in Chapter 3, some argue that 'UK negotiating power would be weaker if it had to engage with third countries than by doing so together with a bloc of countries'.³⁴ However, the loss of negotiating power may be balanced by certain other considerations. One factor is that, in the long run, a key driver of gains from trade is the higher degree of competition that imports provide in domestic markets, which in turn drives increases in efficiency and productivity and hence UK competitiveness. So because imports matter, as well as exports, it may not necessarily matter in the long-term if the UK's FTAs are slightly more asymmetric than deals secured by the EU, as the UK would still reap long-term benefits from lower cost imports.

²⁹ NFU, *submission of evidence*.

³⁰ EEF, *submission of evidence*.

³¹ The British Retail Consortium, *submission of evidence*.

³² TheCityUK, *submission of evidence*.

³³ Civitas, *submission of evidence*.

³⁴ TheCityUK, *submission of evidence*.

4.44 An analysis of the Transatlantic Trade and Investment Partnership emphasises two other important points about the impact on the UK of a different trading relationship with the EU.³⁵ First, as the emphasis in FTAs has increasingly moved towards non-tariff barriers and regulatory standards in particular, as a result of the large reduction in or removal of tariffs between the EU and third countries, the risks of trade diversion, resulting from the existence of tariffs with the third country, diminish.³⁶ Indeed, with agreements on regulatory standards, there is the possibility of positive trade spillovers on third countries as regulatory standards are streamlined and there is some convergence on global standards. Second, to the extent that the UK suffered losses as a result of trade diversion in its initial accession to the Common Market, (resulting from trade being diverted from efficient third country producers to less efficient producers within the Common Market as a result of the elimination of tariffs on trade within the Common Market) the negotiation of EU FTAs with third countries (as well as multilateral liberalisation) is likely to reverse some of this (termed ‘trade reorientation’ in parts of the literature). However, the benefits of such reorientation on the import side are likely to be limited unless the EU makes significant concessions to allow third countries exports to access EU markets in agriculture. Also, and as emphasised by the CEPR, aside from any benefit on the import side, trade reorientation will also mean that the UK potentially loses market share to the third country FTA partner when competing in other EU markets.

Does the UK Have the Capacity to Take It On?

4.45 There would also be a question of capacity in the UK to undertake so many negotiations together and how quickly the UK could develop the necessary capacity and skills. According to the British Retail Consortium, ‘the Commission’s significant resource allows the EU to be far more active in bilateral negotiations than the UK would be on its own’. Of course, it also allows it to be more active in trade defence cases and in other areas than the UK might otherwise wish.³⁷

What Would Happen to the Position of the EU Without the UK?

4.46 In considering the alternatives to EU membership and what they mean for UK trade it is important too to consider what position the remaining EU would take and how this would affect the UK. It is likely, given the UK’s liberal trade stance, that the remaining EU would be less liberal, more protectionist, without the UK. This would affect the UK in a number of ways:

- The EU would be likely to be more protectionist in its approach to the UK (subject to whatever new relationship is established) and be more willing to raise trade defence or trade disputes against UK exporters;
- A more protectionist EU may have similar influence on negotiations in other fora, notably the WTO, and sufficiently influence those negotiations against the interests of the UK;
- By adopting a more protectionist, stance, the EU could suffer slower economic growth, which would reduce the growth of the UK’s main export market.

³⁵ Centre for Economic Policy Research, ‘Estimating the Economic Impact on the UK of a Transatlantic Trade and Investment Partnership (TTIP) Agreement between the European Union and the United States,’ *study produced for HMG* (2013).

³⁶ R. Baldwin, ‘Multilateralising Regionalism: Spaghetti Bowls as Building Blocs on the Path to Global Free Trade’, *Centre for Economic Policy Research Discussion Paper*, 5775 (2006). This has emphasised, as non-tariff barriers do not generate tariff revenue, classic trade diversion does not arise when tariffs are zero.

³⁷ The British Retail Consortium, *submission of evidence*.

Improving Operational effectiveness

4.47 A large number of responses highlighted their concerns with the effectiveness of the current decision-making processes. Calls for improvements included improved transparency of decision-making and better opportunities to engage and influence Commission officials.

Increase Transparency and Engagement

4.48 Comments highlight practical issues in the EU policy and decision-making process based on their own desire to improve their engagement with EU decision makers directly. The NFU 'believe that there is opportunity for the EU to communicate more clearly with stakeholders on a range of trade issues and issue progress updates'. They identify the lack of information from the European Commission on FTAs, in particular, as making it difficult for them to understand the impact of the Agreements on their members and to influence the process at an early stage.³⁸ The Council of British Chambers of Commerce in Europe also 'argue for more transparency at the EU level, more consistency in the application of EU law'. Greater transparency in EU decision-making would enable interested parties to establish better whether and when to get involved and engage the Commission and Member State governments.³⁹ This was echoed by the SMMT, which 'believes more could be done by the European Commission to ensure that its impact assessments are as robust and comprehensive as possible. Where necessary the Commission should draw on member states' expertise and all industry players as part of its economic data gathering to obtain a complete and balanced view'.⁴⁰ However, the Commission generally, but not exclusively, prefers to deal with EU-level bodies and prefers to receive a single view from, for example, a sector.

Influencing FTAs and Negotiations

4.49 The ability of the UK to influence EU decision-making was also identified as very important by a number of submissions. The Scottish Council for Development and Industry reported that their members' view of 'the need to ensure an influential and not marginalised voice in the EU'.⁴¹ The CBI noted that 'the UK should be very active in Europe to ensure that its interests are fully reflected at all stages of the negotiating process'.⁴² Similarly, the NFU commented on the importance of timely interventions by the UK 'there is tremendous opportunity for the UK government to engage much earlier and more closely with EU institutions and other Member States at the pre-consultation stage'.⁴³ Some, such as Diageo were positive about the UK's influencing to date, commenting that 'our broadly positive assessment of the value of the EU's role in trade policy is dependent to a large extent on the fact that the UK is able to influence that policy within the EU'.⁴⁴ In contrast, the SCDI report a difference of views among their members. While some felt the EU had been able to negotiate more favourable and/or earlier trade agreements, others are concerned that their interests are a low priority for the EU. For example, they refer to the salmon industry who point to a less favourable deal for exports to South Africa than for their competitors in Norway.⁴⁵

³⁸ NFU, *submission of evidence*.

³⁹ The COBCOE, *submission of evidence*.

⁴⁰ The SMMT, *submission of evidence*.

⁴¹ Scottish Council for Development and Industry, *submission of evidence*.

⁴² The CBI, *submission of evidence*.

⁴³ NFU, *submission of evidence*.

⁴⁴ Diageo, *submission of evidence*.

⁴⁵ The Scottish Council for Development and Industry, *submission of evidence*.

Increase Certainty

4.50 One further option could be to seek to increase the understanding of how complex rules are implemented, such as trade defence rules. The Commission consulted on proposals to modernise the Trade Defence Instruments in 2012 and has now begun discussions on implementing their proposal. This is a live issue. One element of the Commission's package of proposals is for guidelines on certain technical aspects of trade defence investigations (initially injury margin calculation, analogue country choice, Union interest test and duration of measures and expiry reviews). Such guidelines, while lacking any legal status, would provide valuable insight for companies on the issues considered and methodology employed by the Commission in its trade defence investigations. This will be particularly valuable for companies, especially SMEs, who are infrequently involved in such investigations.

Educate EU Citizens

4.51 A number of comments also highlight the general lack of understanding of EU decision-making processes. The British Irish Chamber of Commerce noted: 'The advantages of EU competence over trade and investment are not being communicated effectively to member states; an education deficit exists...' They argue that, as a result, 'the EU, at times, risks presenting itself as an obstacle to the economic development and recovery of its Member States'.⁴⁶ Further concerns include that 'it is difficult, in any given case, to know whether a specific matter falls within the exclusive or mixed competence of the Community' given the wide range of matters covered in any EU trade agreement, and the volume, complexity and frequency of change of EC legislation.⁴⁷ Simplification of processes and better communication of results could therefore be beneficial.

The Role of the Institutions

4.52 With three EU institutions – the Council, the Commission, and the Parliament – involved in trade and investment policy, the effectiveness of the institutions and their ability to work together is important. So too is the extent to which the institutions reflect, or not, British interests. TheCityUK asks: 'Do the policies and their institutional framework, originally devised so long ago, still meet the needs for which they were designed in the post-War era? Do they enable the EU to pursue trade policies optimally calibrated to the EU's present comparative and competitive advantage in the global economy?'⁴⁸

The European Commission

4.53 A number of respondents commented that the European Commission is trade liberal and its stance appears to be aligned with the UK's. However, the concentration of power with the Commission as a result of the Lisbon Treaty could be an issue for British interests in trade defence cases. The British Retail Consortium states that 'moves towards more ex officio investigations combined with a shift from Council Regulations to Commission Regulations means that the Commission will be able to assume the role of prosecutor, judge and jury in trade defence cases.' Their concern stems from the increased scope for the Commission to put in place individual anti-dumping measures and, if they so choose, to operate a more aggressive and confrontational policy based on the selective use of these measures.⁴⁹

⁴⁶ The British Irish Chamber of Commerce, *submission of evidence*.

⁴⁷ TheCityUK, *submission of evidence*.

⁴⁸ *Idem*.

⁴⁹ The British Retail Consortium, *submission of evidence*.

The European Parliament

- 4.54 The British Retail Consortium notes that the ‘greater involvement of the European Parliament in trade policy will add democratic legitimacy to the process’. However, they believe it will also make ambitious, trade liberalising deals more difficult to achieve.⁵⁰ This is because, according to the British Chambers of Commerce, ‘the desire to add non-trade issues into trade agreements is likely to be increased by the European Parliament. As well as allowing for retaliation, the bundling of other issues into trade agreements can slow down agreement and become an excuse for protectionism’.⁵¹
- 4.55 There are also concerns that the European Parliament is more susceptible to lobbying, in particular from those who advocate a protectionist agenda. TheCityUK notes that ‘the greater involvement of the Parliament in trade policy may open the risk of trade policy outcomes being subject to populist campaigns led by entities with little direct involvement.’ They report that it is with the European Parliament, rather than with EU negotiators, that they and their members have had to argue against protectionism.⁵² This may be more of an issue in some areas or sectors than others and be linked to interest within the Single Market. For example, Tate and Lyle highlights that ‘the European Parliament is more susceptible to pressure from the agricultural lobby than both the Council and European Commission. This means that ambitious trade agreements that include agriculture will be even harder to conclude [given the Parliament’s strengthened role in the CCP]’.⁵³
- 4.56 The Council of British Chambers of Commerce in Europe is similarly ‘not so far impressed with the increased powers given to the European Parliament’. They raise concerns that ‘MEPs are not able to ‘connect’ in any meaningful way with their constituents.’ They argue, ‘The challenge, therefore, will be to create a mechanism to defend European trade and investment interests without overwhelming national strengths and local diversities’.⁵⁴
- 4.57 One option might be to re-examine the role of the European Parliament in trade policy decision-making. Glyn Gaskarth proposes that the role played by the European Parliament in approving EU trade and investment deals should be replaced by national parliaments. As set out in Chapter 2, national parliaments are already involved in the ratification process of mixed agreements. Gaskarth also argues that any trade deal would only include those Member States whose national Parliaments ratify the deal.⁵⁵ However, such an approach would have to address problems of ‘carousel’ trade – if some countries ratify and others do not, different EU countries would apply different tariffs to exports from third countries. This would undermine the functioning of the Single Market, as set out in the box on page 11.

⁵⁰ Idem.

⁵¹ The British Chambers of Commerce, *submission of evidence*.

⁵² TheCityUK, *submission of evidence*.

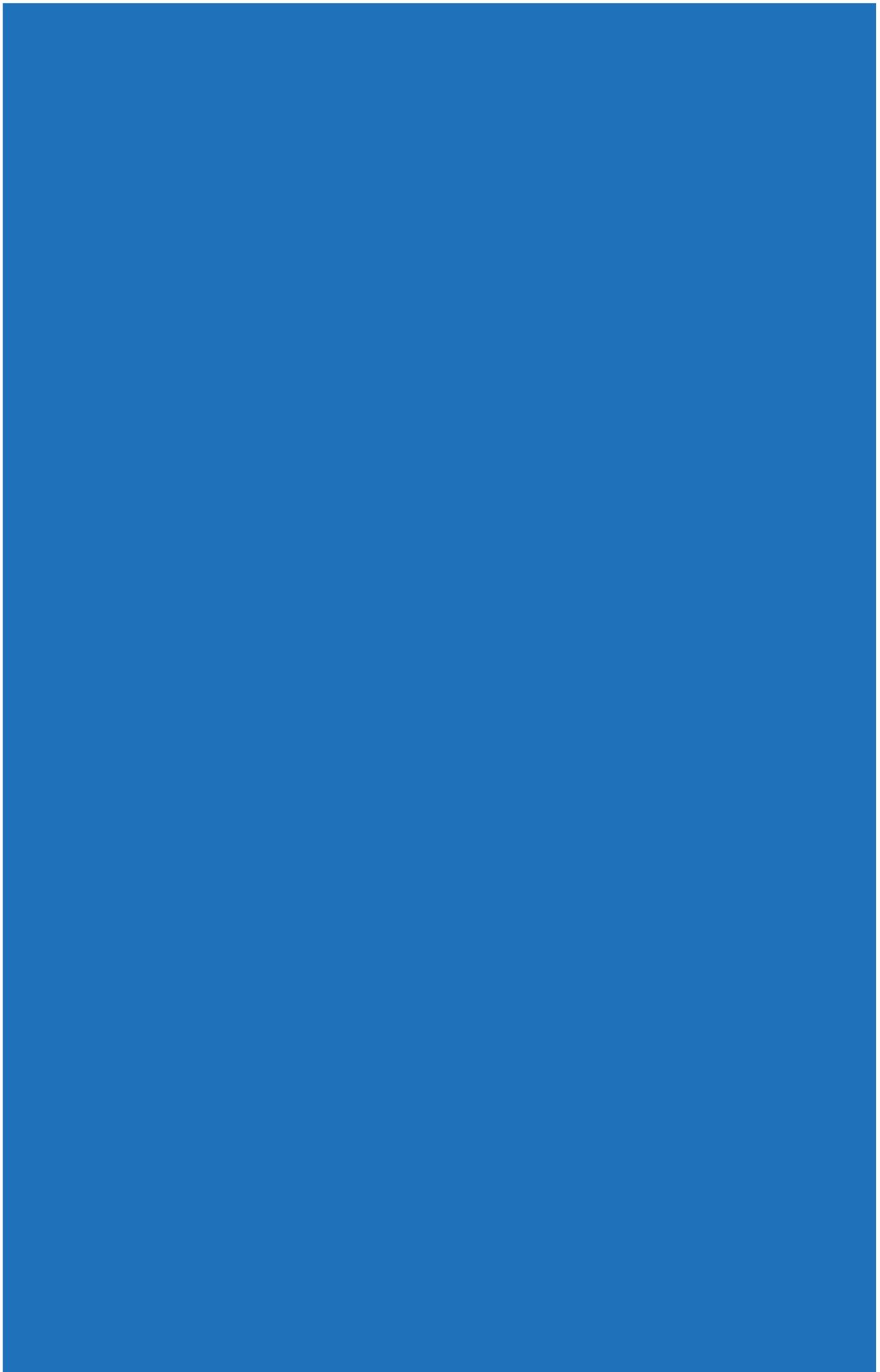
⁵³ Tate & Lyle Sugars, *submission of evidence*.

⁵⁴ The COBCOE, *submission of evidence*.

⁵⁵ G Gaskarth, Civitas, *EU Renegotiation: Fighting for a Flexible Union* (2013).

Summary

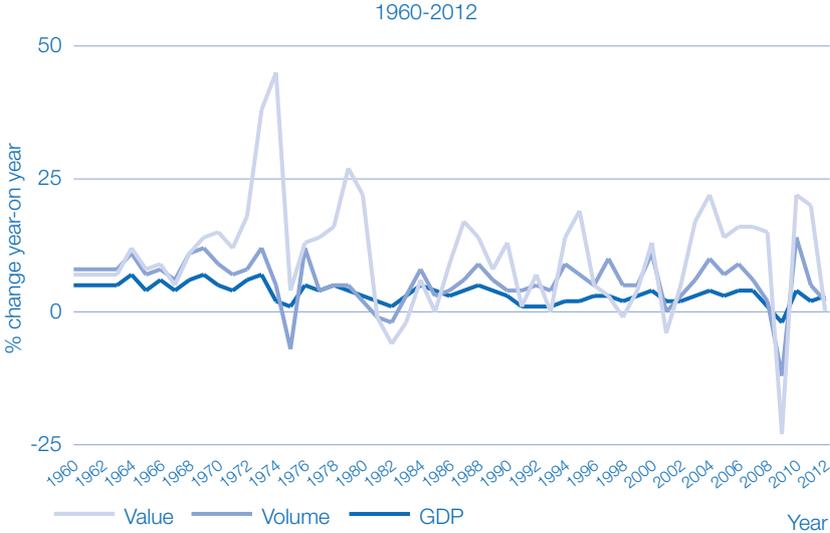
- 4.58 There are growing challenges to trade and investment policy, from agreements becoming more complex and the need to reflect the real world nature of business activity. The EU is negotiating or soon to negotiate a large number of agreements, including TTIP and an investment treaty with China. These present significant challenges as they push the boundaries of previous deals. But alongside these, there remain challenges related to the development of competence, including what the development of the Single Market means for trade negotiations and vice versa. There are different views as to how these challenges might be addressed. The range of options is not large and involves either strengthening the power of the EU or weakening it significantly.
- 4.59 This chapter outlines options that involve the UK having a different trade relationship with the EU. These options would have significant implications for the UK's relations with third countries as well as the EU. But gaining greater control over such relations with third countries means giving up benefits of access to the Single Market. As noted in Chapter 3, little support for these options has been presented in response to the Call for Evidence for this report.



Appendix A: Developments in UK and World Trade

A.1 World trade has grown rapidly over the last 50 years and has been a key driver of global growth. The volume of world merchandise exports has regularly grown faster than the world economy (GDP), although growth in trade has typically been more volatile.¹ The value of trade has been far more volatile than the volume of trade, mainly reflecting the volatility of commodity prices.

Chart A.1 Changes in Merchandise Exports and GDP

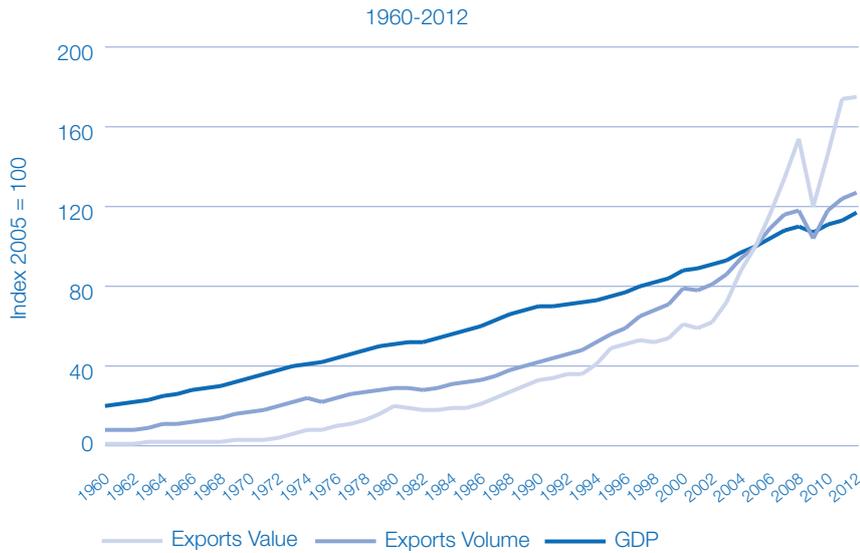


Source: COMTRADE database.

A.2 There was a sixteen fold increase in the volume of exports of merchandise goods between 1960 and 2012, three times the increase in global GDP. This growth in merchandise exports is due to a number of factors including increasing globalisation and the development of international supply chains, the growth of major (emerging) markets, rising household incomes across the world, greater taste for variety and choice, reductions in the costs of communication and transportation and the liberalisation of trade, including the reduction in tariff rates.

¹ Merchandise exports are used because available data on merchandise goes back further than available data on services. Data on global trade in services only goes back to 1980 but shows the same result.

Chart A.2 Growth in World Merchandise Exports

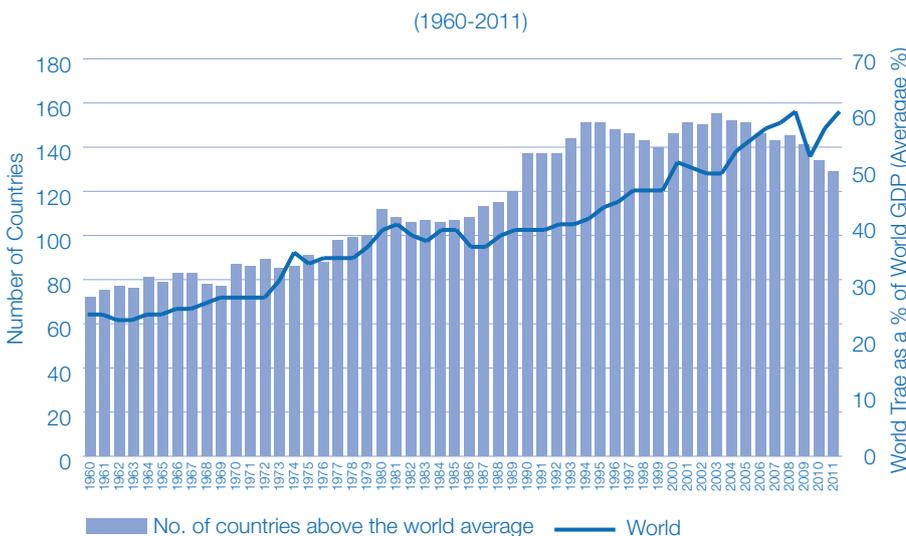


Source: COMTRADE database.

With More Countries Taking Part

- A.3 In addition to the increase in the volume and value of goods traded, there has also been an increase in the number of countries participating in world trade.
- A.4 A country is defined as actively participating in trade if its trade as a percentage of its GDP in a year is higher or equal to world trade as a percentage of world GDP in that year. Chart A.3 shows that, with the exception of the last few years following the recent 2008 crisis, more countries have been actively participating in world trade, reflecting the increasing integration of the world economy.

Chart A.3 Number of Countries Actively Participating in World Trade



Source: World Bank.

UK Trading History

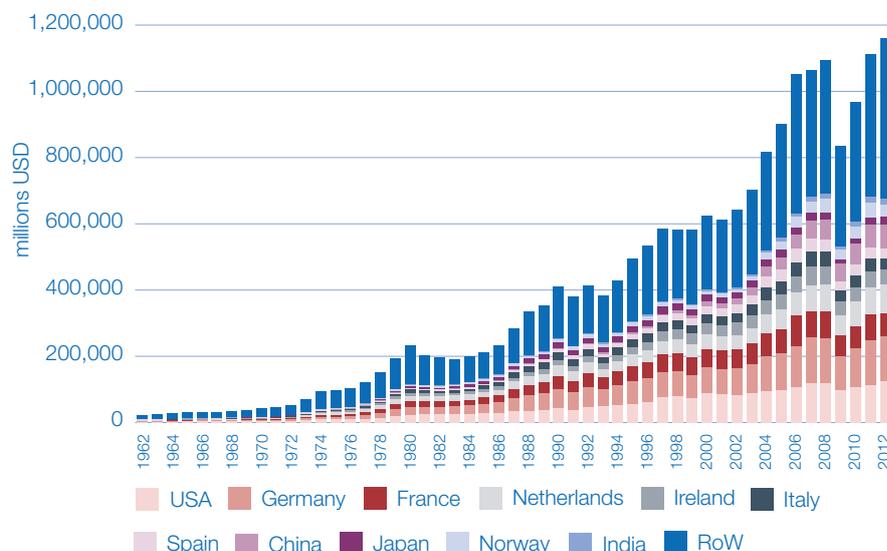
The UK Has a Long Trading History

- A.5 The UK has a long history as a trading nation.² During the eighteenth and nineteenth centuries the expansion of British trade went hand in hand with the expansion of the British Empire, trade was stimulated by growing commerce with its colonies and migration flows. For example, in 1686 British colonies in North America and the West Indies shipped goods worth over £1 million to London. Exports to the colonies consisted mainly of woollen textiles; imports included sugar, tobacco and other tropical groceries for which there was growing consumer demand. Such trade was conducted within the mercantilist framework of the Navigation Acts, which stipulated that all commodity trade should take place in British ships, manned by British seamen, trading between British ports and those within the Empire. Competition came from the empires of France, the Netherlands, and Spain. However, not all trade that flourished would be deemed desirable by modern standards, in particular the development of the slave trade.
- A.6 The extent to which the growth in British trade and industry was based on the growth of imperial commerce has been debated by historians, including the level of stimulus it provided to the domestic British economy, and hence to industrialisation.

UK Trade Has Been Increasing in Recent Decades

- A.7 Over the last 50 years, the UK has seen a significant increase in the value of trade. Although the UK trades with many countries, the EU is the UK's largest trading partner for trade in goods, accounting for about half of UK exports and worth over five times that of the levels traded with the US, on average. WTO trade data (measuring exports and imports) for 2011 show that the UK is the top trading partner for only one non-EU country, Norway. The UK is among the top three trading partners for five countries: Bahamas, Namibia, Ghana, St. Kitts and Nevis, St. Vincent and the Grenadines.
- A.8 Over the last decade UK trade in goods with the EU has gradually declined, reflecting difficulties in the Eurozone and an increasing role in world trade played by the emerging economies, in particular China, Brazil, Russia and India.

Chart A.4 UK Trade Volumes by Country (1962-2012)

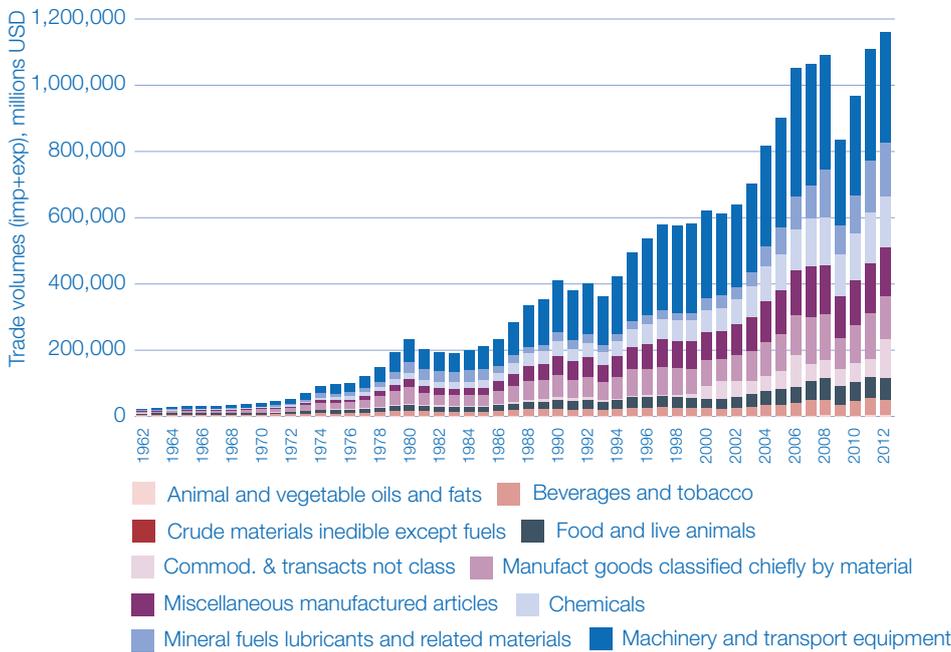


Source: COMTRADE database.

² See for example, K. Morgan, BBC, *Symbiosis: Trade and the British Empire* (2011).

A.9 The pattern of goods traded by the UK has evolved over time. The share of trade in chemicals and commodities has increased while trade in machinery and transport equipment has been gradually declining.

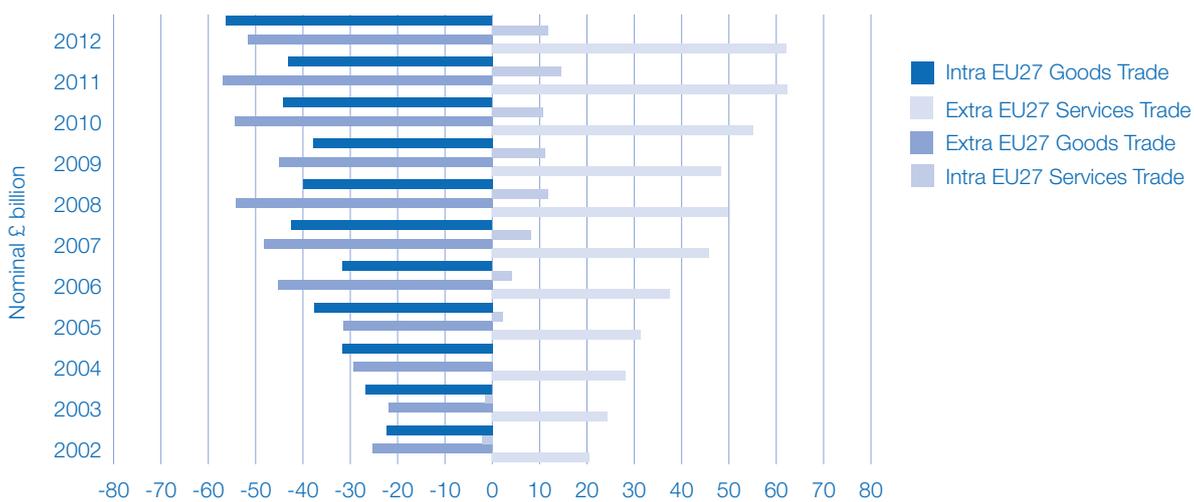
Chart A.5 Composition of UK Trade by Industry (1962-2012)



Source: COMTRADE database.

A.10 The UK has a mixed pattern of trade balance. The UK is a net-importer of goods both from the EU and the rest of the world, but is a net exporter of services.

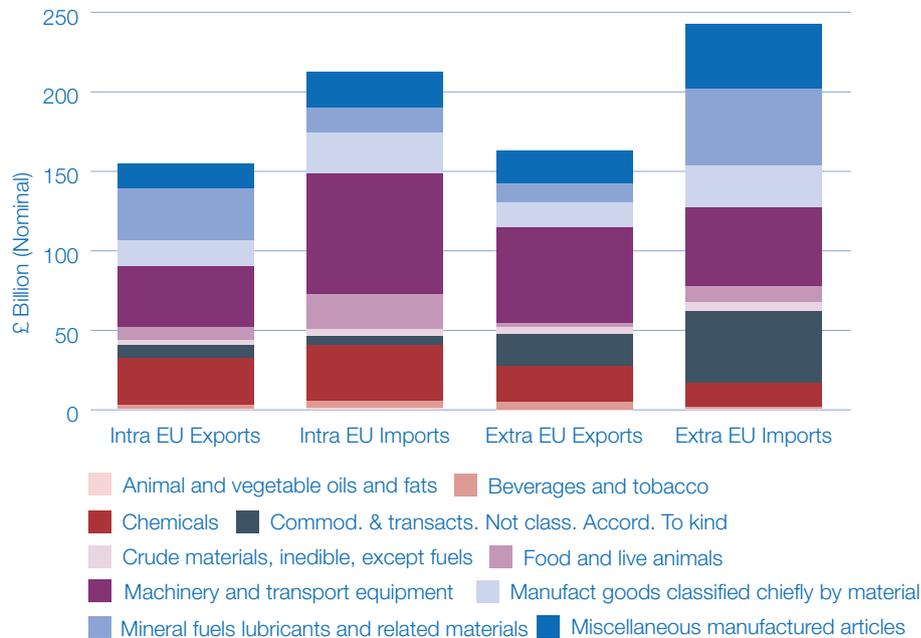
Chart A.6 UK Balance of Trade in Goods and Services



Source: ONS, *The UK Balance of Payments* (2013), available at <http://www.ons.gov.uk/ons/rel/bop/united-kingdom-balance-of-payments/2013/index.html>.

A.11 The total level of UK goods exported to both the EU and extra-EU are similar at approximately £150bn, in 2012. However, the composition of exported goods is different – see Chart A.7. For example the UK is a net-importer of ‘Machinery & transport equipment’ from the EU, it is a net-exporter of ‘Machinery & transport equipment’ to the rest of the world.

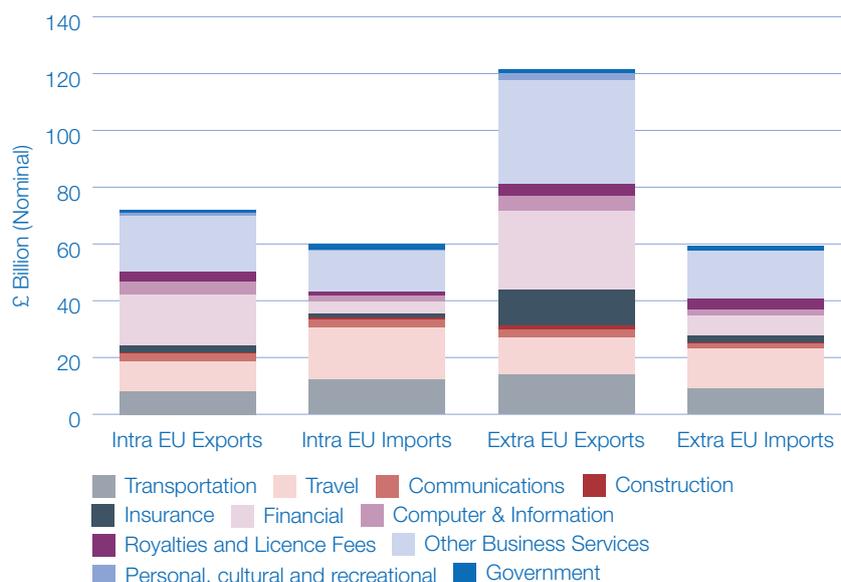
Chart A.7 The UK’s Intra-EU and Extra-EU Trade in Goods by Type of Good (2012)



Source: COMTRADE database.

A.12 As services have become a bigger part of the UK economy in recent decades, they have similarly become an increasing element of the UK’s trade, such as financial services and business services. The UK is a net exporter of services both to the non-EU and to the EU. ‘Financial Services’ and ‘Other Business Services’ dominate the UK’s services trade.

Chart A.8 Intra-EU and Extra-EU Trade in Services by Type of Service (2012)



Source: ONS, *The UK Balance of Payments* (2013), available at <http://www.ons.gov.uk/ons/rel/bop/united-kingdom-balance-of-payments/2013/index.html>.

Growth in Intra-Industry Trade

A.13 The aggregate trade statistics above do not fully show the growing complexity of trade and, in particular, the increase in intra-industry trade, that is, the import and export of same/similar goods. According to the OECD, the intra-industry share of manufacturing trade has increased significantly since the late 1980s across many OECD countries, although it varies by country (from around 30% for Iceland to 90% for Belgium). The UK has a 'high and stable intra-industry trade', with over 80% of manufacturing trade in the period 1997-2008 being intra-industry, having increased from around 70% in the late 1980s.^{3 4} Table A.1 gives examples of products that the UK both imports and exports.

Table A.1 Examples of Products that the UK Both Imports and Exports.

Product (8-digit)	UK imports, € (in Sept 2012)	UK exports, € (in Sept 2012)
Pure-bred horses	€18.9 million	€8.6 million
Cars and other passenger vehicles, >1,000cc but <=1,500 cc	€455 million	€65.3 million
Toxins and similar products (pharmaceuticals)	€4.3 million	€24.5 million
Printed books, brochures, and similar	€15.9 million	€31.5 million

Source: BIS analysis using Eurostat 8-digit level trade data.

A.14 Moreover, the UK imports the same product from several different countries – see Table A.2 for a selection of products and the number of countries from which they are imported. Reasons for this will include variations in characteristics of products and quality, to satisfy different consumer tastes, access to suppliers and ability of single suppliers to meet demand.

Table A.2 Examples of Products that are Imported from Several Countries.

Product	Number of countries that UK imported the product from, in 2012
Wrist watches, electronically operated	39
Medicaments containing penicillin	15
Steam turbines and other vapour turbines	5
Vacuum pumps	48
Coffee, not roasted, not decaff	71
Animal/vegetable fertilizers	20
Cotton, not carded or combed	20
Cathode-ray tube monitors	40
Bricks, blocks, tiles, and other ceramic goods of siliceous fossil	26
Glass mirrors other than rear-view mirrors, framed	54

Source: BIS analysis using data from WITS database, 2012 data.

³ OECD, 'Economic Globalisation Indicators', (2012).

⁴ OECD, 'Intra Industry and Intra Firm Trade and the Internationalisation of Production', Economic Outlook, (2002).

A.15 There are different types of intra-industry trade:

- Trade in similar products but with differentiated varieties (e.g. cars of a similar class and price range). The benefits of intra-industry trade are that it enables countries with similar factor endowments (such as skills and capital) to benefit from economies of scale by specialising in ‘niche’ products;
- Trade in products differentiated by quality and price (e.g. UK exports some high-quality or specialist footwear and imports lower-quality footwear); Trade in differentiated products may also reflect different factor endowments, particular skills of the workforce or high fixed research and development costs; and
- Trade in similar goods but which are at different stages of production. Specialisation of production across countries may be driven by comparative advantage, for example to use cheap unskilled labour for assembly purposes or specialised personnel for research and development.

A.16 The extent of intra-industry trade is typically much higher across categories of manufactured goods than it is across trade in non-manufactured goods, and highest for the more sophisticated manufactured products such as chemicals, machinery and transport equipment, electrical equipment and electronics.

A.17 In addition to the growth in intra-industry trade, in recent decades businesses have been adopting new operating models or specialising in specific tasks or parts of the production chain.⁵ This has led to the growth of complex supply chains, the full picture of which are not captured in gross trade statistics. One well known distortion to the trade statistics, caused by large amounts of trade going through key trading hubs, such as Rotterdam, is discussed in the report on the Free Movement of Goods Balance of Competences report published in parallel to this report.

Trade in Value Added (TiVA)

A.18 As a consequence of these developments and the increased complexity of trading relationships, gross trade statistics no longer tell the full story about trade and its importance for economies. One attempt to address is to look at trade in value added.

A New Way to Measure Trade

A.19 The OECD and WTO have developed a new approach to examine the true value of trade by looking at trade in value added, that is the content of trade that is attributable to the work and value added by an individual country. The TiVA data accounts for the growing interconnectedness and complexities of economies and trade. The famous example of this is the iPad: the majority of the labour to produce an iPad takes place in China while the majority of the value attributing to the high value elements of the work, such as design and marketing, accrue to the US.⁶

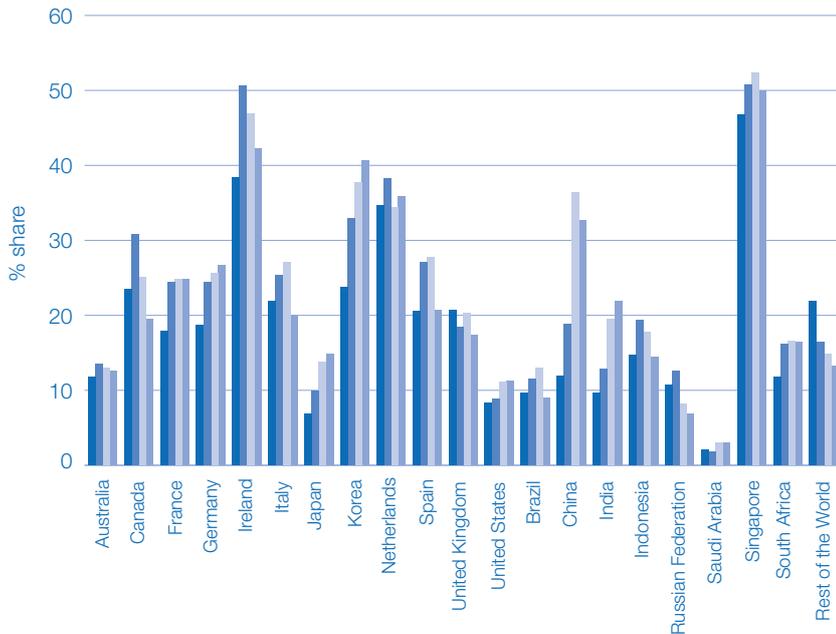
A.20 The increasing interconnectedness of production has meant that exports increasingly include inputs imported from abroad. In 2009 more than half of the world’s manufacturing imports were intermediate goods (primary goods, parts and components, and semi-finished products) to be used for making finished goods, and more than 70% of the world’s services imports were intermediate services, such as business services.

⁵ See for example, R. Baldwin and S. Evenett, *Value Creation and Trade in 21st Century Manufacturing: What Policies for UK Manufacturing, The UK in a Global World* (2012).

⁶ See K. Kraemer, G. Linden and J. Dedrick, ‘Capturing Value in Global Networks: Apple’s iPad and iPhone,’ *PCIC Working Paper* (2011).

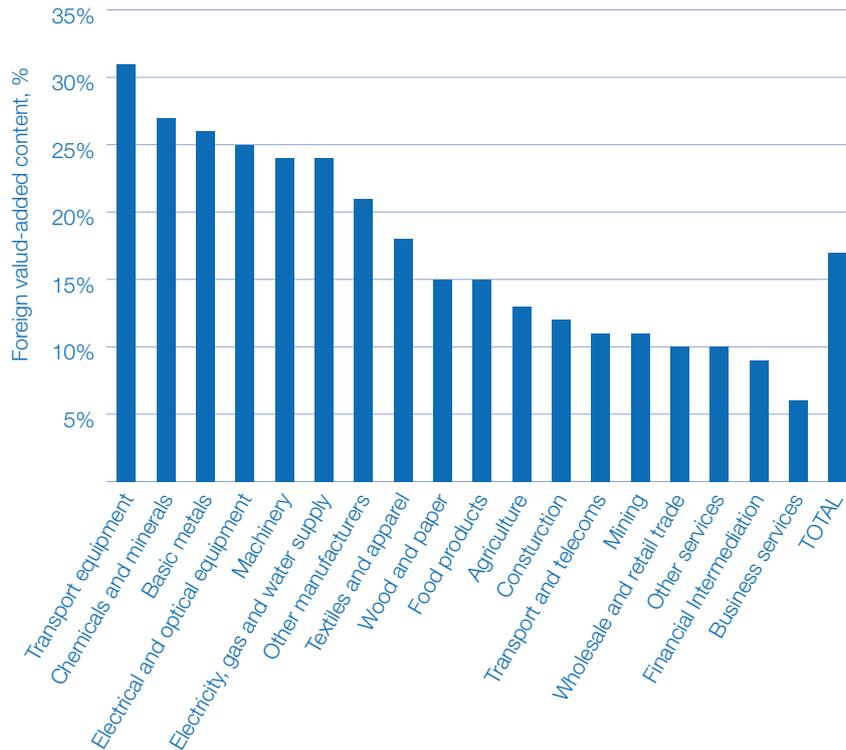
A.21 The TiVA database shows that the foreign value added in exports rose from 20% in 1995 to 25% in 2005 before falling back slightly after the crisis to 24% in 2009. There was however, some variation by country with the largest increases being in the countries most heavily involved in global manufacturing supply chains such as China and Korea. In 2009, the UK's domestic value-added of its exports was 83%. This is relatively high compared to other OECD countries, reflecting the increasing specialisation of UK exports in services.

Chart A.9 Evolution of Foreign Value Added's Contribution to Selected Countries Gross Exports between 1995 and 2009



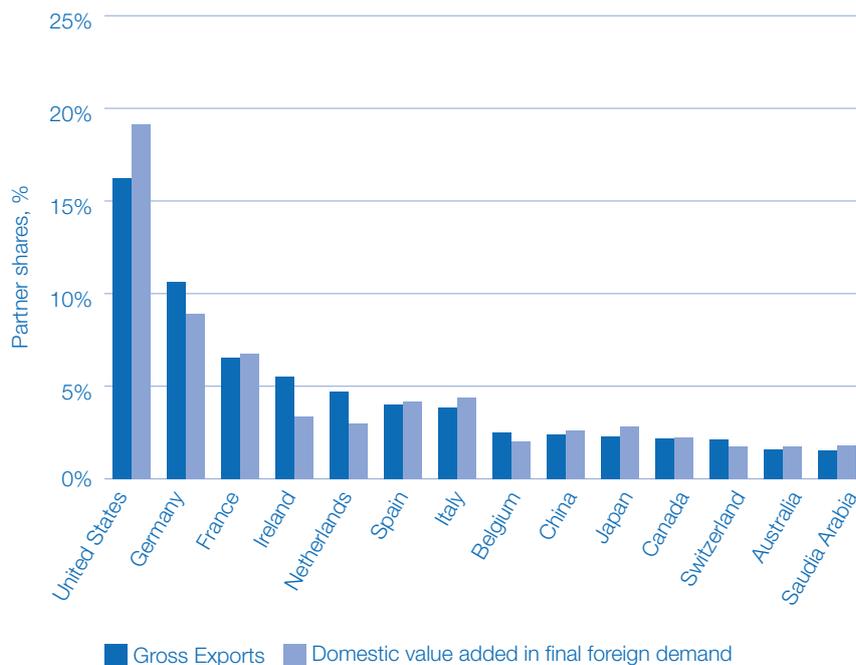
Source: OECD TiVA database.

A.22 The amount of foreign value added in UK exports varies by sector. For goods, the foreign content of the UK's exports was highest in the Transport Equipment industry (31%), closely followed by the Chemicals and minerals, Basic metals, Machinery and Electrical equipment industries, where around 25% of the value of exports consists of foreign value added.

Chart A.10 Foreign Value-Added Content of UK's Gross Exports, by industry, %.

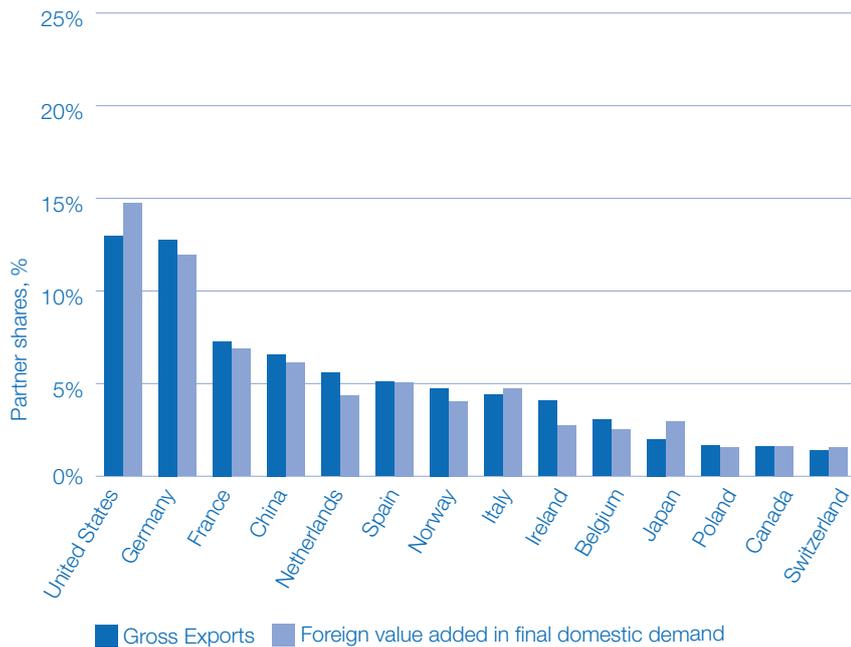
Source: OECD Stat, 2009 data.

A.23 The UK's bilateral trade relationships with other countries can also be reassessed using trade in value added data. Fig 3 shows exports in gross and value-added terms. Fig 4 shows imports.

Chart A.11 UK Exports, Partner Shares, in Gross and Value-Added Terms (as a % of total), 2009

Source: OECD Stat, 2009 data.

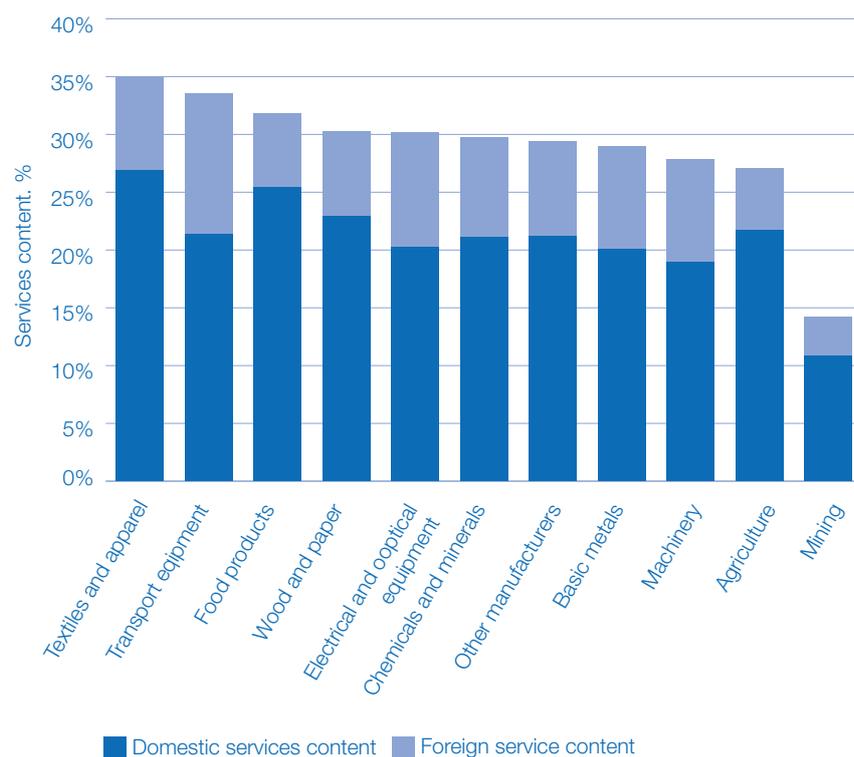
Chart A. 12. UK Imports, Partner Shares, in Gross and Value-Added Terms (as a % of total), 2009



Source: OECD Stat, 2009 data.

A.24 From these figures it is clear that the UK-US bilateral relationship is stronger in value-added terms than in gross terms. There is more UK value added exported to the US and the US is the UK's main source of value added imports. This is because the exports of UK value added to the US include those UK exports which are exported to other European countries and used as intermediate inputs in their exports to the US. Meanwhile, the importance of nearby trading partners such as Ireland and the Netherlands is reduced.

A.25 The TIVA data also reveals the amount of services which are embedded in manufacturing exports. In 2009, in value added terms about 58% of the UK's exports reflected services. This is higher than the OECD average of 48% and is driven in large part by the UK's high proportion of exports of services in gross terms.

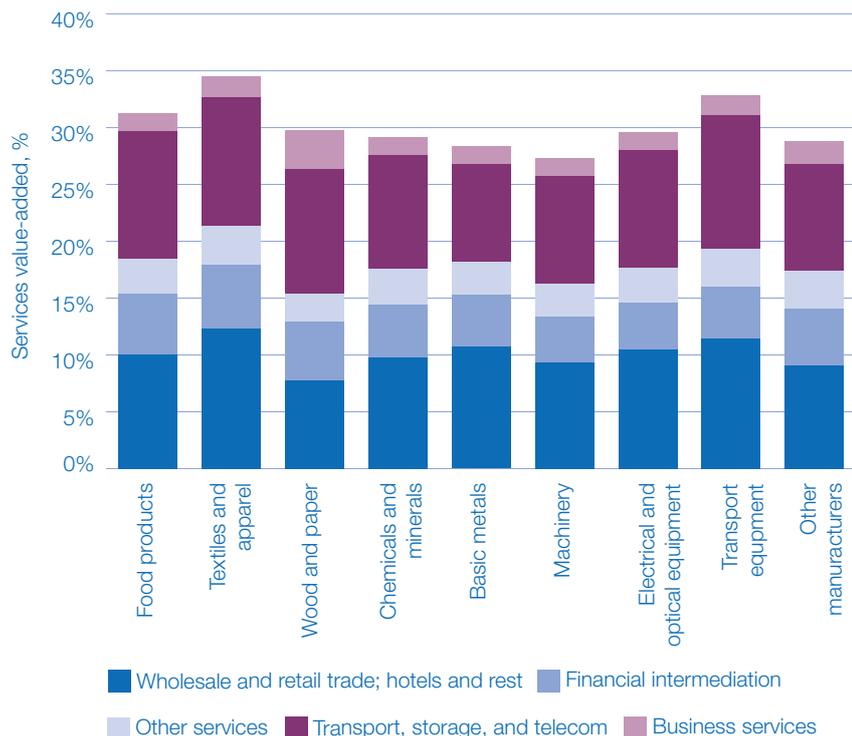
Chart A. 13. Services Content of Gross Exports, by Industry, 2009

Source: OECD Stat, 2009 data.

A.26 These data show that trade in manufacturing goods has become increasingly about service-related activities, as firms increasingly use specialist logistics, communications services, business services etc. In addition, services help firms to differentiate, customise and upgrade their products, enabling them to capture more value.

A.27 Almost one third of the value of UK manufacturing exports represents services value added, comparable to other large European economies, in 2009. Moreover, different manufacturing industries show a similar distribution across service sectors.

Chart A. 14. Services Value-Added in UK Manufacturing Exports, %, 2009.

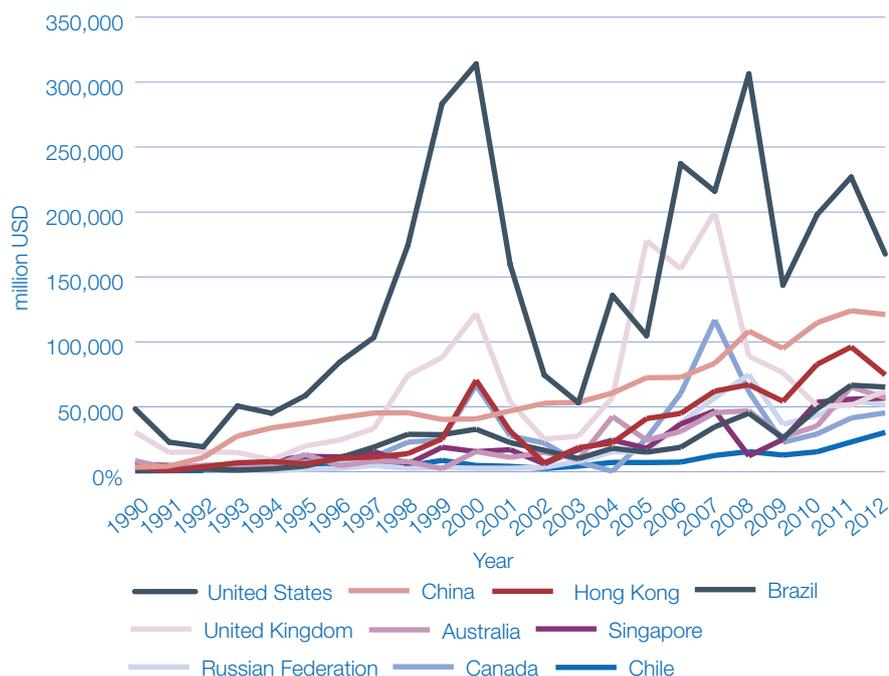


Source: OECD Stat, 2009 data.

Foreign Direct Investment (FDI)

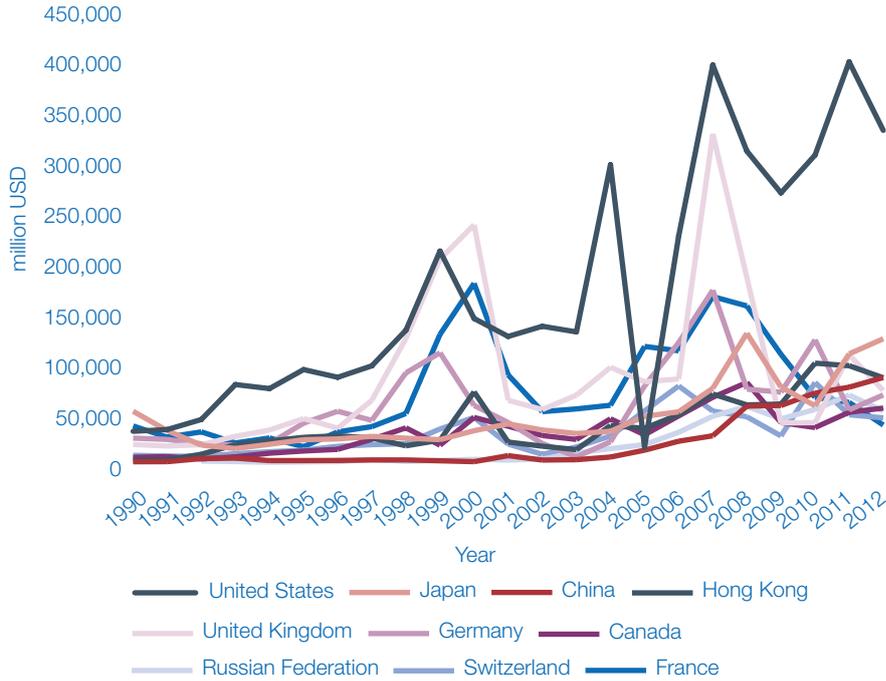
A.28 The UK’s inflows and outflows of FDI are among the highest in the world. According to UNCTAD data, in 2012 both its FDI inflows and FDI outflows exceeded \$50 billion, ranking it among the five countries with highest FDI inflows and outflows – see Charts A.15 and A.16 below for more detail.

Chart A.15 FDI inflows.



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

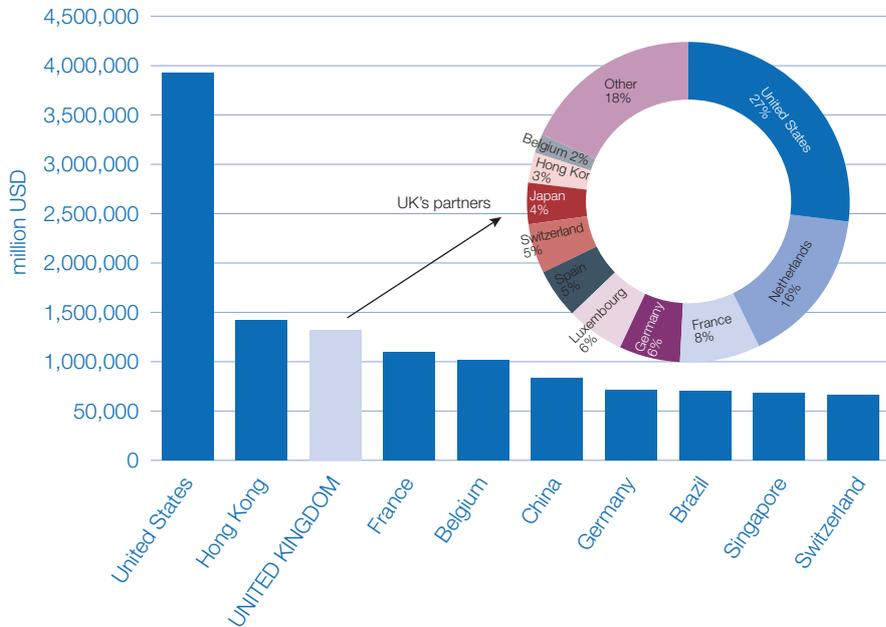
Chart A.16 FDI outflows.



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

A.29 According to 2012 UNCTAD data, the UK has the third highest inward FDI stock in the world, behind USA and Hong Kong (albeit very close to Hong Kong). The UK’s main investors come from the USA, the Netherlands, France and Germany (see Chart A.17 below).

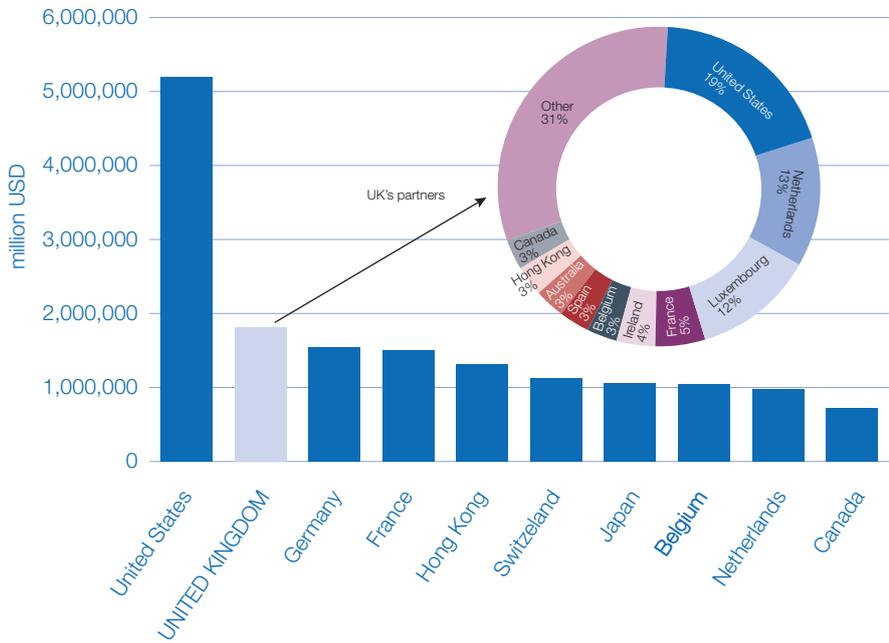
Chart A.17 Countries with Highest Inward FDI Stock.



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics); and OECD.

A.30 The UK has the 2nd highest outward FDI stock in the world, behind only the USA. The main destinations for UK outward investment are the USA, the Netherlands, and Luxembourg – see Chart A.18 below.

Chart A.18 Countries with Highest Outward FDI Stock.



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics); and OECD.

Appendix B:

Developments in the World Trade and Investment System

The World Trade Organisation

- B.1 The main purpose of the World Trade Organisation (WTO) is to help countries that face trade barriers to lower them and open markets. In some circumstances its rules support maintaining trade barriers – for example, to protect consumers or prevent the spread of disease.
- B.2 The WTO agreements, negotiated and signed by the bulk of the world's trading nations, provide the legal ground rules for international commerce – see Table 1.1 in Chapter 1. They are essentially contracts, binding governments to keep their trade policies within agreed limits. Although negotiated and signed by governments, the goal is to help producers of goods and services, exporters, and importers conduct their business, while allowing governments to meet social and environmental objectives. The system's overriding purpose is to help trade flow as freely as possible. The WTO's main activities include:

Trade negotiations – The WTO agreements cover goods, services and intellectual property. They spell out the principles of liberalisation, and the permitted exceptions. They include individual countries' commitments to lower customs tariffs and other trade barriers, and to open and keep open services markets. They set procedures for settling disputes. These agreements are not static; they are renegotiated from time to time and new agreements can be added to the package.

Implementation and monitoring – WTO agreements require governments to make their trade policies transparent by notifying the WTO about laws in force and measures adopted. Various WTO councils and committees seek to ensure that these requirements are being followed and that WTO agreements are being properly implemented.

Dispute settlement – The WTO's Dispute Settlement procedure resolves trade quarrels between countries and is vital for enforcing the rules and therefore for ensuring that trade flows smoothly. Countries bring disputes to the WTO if they think their rights under the agreements are being infringed.

Building trade capacity – WTO agreements contain special provision for developing countries, including longer time periods to implement agreements and commitments, measures to increase their trading opportunities, and support to help them build their trade capacity, to handle disputes and to implement technical standards.

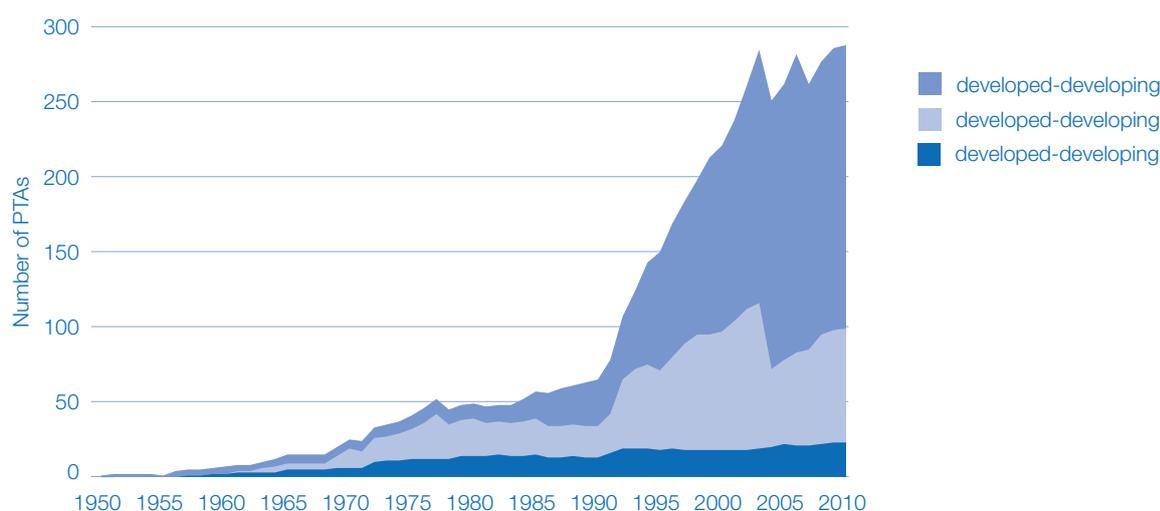
Outreach – The WTO maintains regular dialogue with non-governmental organizations, parliamentarians, other international organizations, the media and the general public on various aspects of the WTO and the on-going Doha negotiations, with the aim of enhancing cooperation and increasing awareness of WTO activities.

Non-Tariff Measures have Grown in Importance

- B.3 From the origins of the GATT in 1947, over time, trade negotiations have gradually expanded beyond tariffs to include non-tariff measures (NTM). In particular, the 1986-94 Uruguay round of negotiations included the first significant expansion in issues beyond tariffs to include trade in services, intellectual property, and dispute settlement. A key driver of the expansion of negotiations has been the need to address the development of measures which substitute the reduction in tariffs with alternative forms of trade barriers, e.g. quantitative restrictions on imports. However, the GATT's approach towards NTMs was not as aggressive as its approach to tariffs. Therefore as tariffs have come down, NTMs have acquired growing popularity.
- B.4 The WTO's approach to NTMs represented a significant tightening of obligations relative to GATT in a number of areas. These included:
- The WTO Safeguard Agreement prohibiting the use of various forms of border NTMs that had become popular in the last decade of GATT;
 - The WTO Subsidies and Countervailing Measures (SCM) Agreement, which strengthened significantly the prohibition against export subsidies; and
 - The WTO Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) Agreements, which represented a significant strengthening of the non-discrimination/national treatment obligations regarding certain kinds of domestic regulations.

An Increasing Number of Preferential Trade Deals

- B.5 There has been an increase in the number of Preferential Trade Agreements (PTAs) negotiated between countries, either bilaterally or between groups of countries, as negotiations at the WTO have taken longer and longer to complete. In 2010, there were almost 300 preferential trade agreements (notified and not notified) in force. However, despite the number of agreements, only 16 per cent of global merchandise trade receives preferential treatment.

Chart B.1 Cumulative Number of PTAs in Force by Country Group

Source: WTO Trade Report 2011.

Which Cover an Increasing Number of NTM Issues

B.6 In addition to the growing complexity of multilateral negotiations, bilateral and regional trade deals have also expanded in terms of the issues they seek to address. In particular, many recent bilateral PTAs include commitments on NTMs that are substantially more stringent than those contained in the GATT or the WTO. They tend to cover technical barriers to trade, intellectual property, services, investment, dispute settlement, and more. For instance, about one-third of bilateral PTAs in force today contain services commitments. A large number of PTAs also address technical barriers to trade.¹ The most common TBT provisions in PTAs are mutual recognition of conformity assessment, harmonization of technical regulations, transparency provisions, and provisions that establish institutional machinery such as a committee.

The EU FTA with South Korea is the Most Ambitious FTA currently in Force

The **EU-South Korea FTA** entered into force in July 2011. It is the most comprehensive EU FTA to date. The below is a summary of its contents.

Chapter 1 on Objectives and General Definitions defines the objectives of the agreement and provides definitions to be used throughout the text.

Chapter 2 on National Treatment and Market Access for Goods establishes the objective of removing both customs duties and regulatory obstacles called Non-Tariff Barriers (NTBs) on trade in goods. The provisions allow for a transitional period to help domestic producers adapt.

Chapter 3 on Trade Remedies deals with the use of trade defence instruments, reaffirming the rights and obligations set out in the WTO, but stressing the need to limit the use of these instruments to when it is necessary.

¹ R. Piermartini and M. Budetta, 'A Mapping of Regional Rules on Technical Barriers to Trade,' *Regional Rules in the Global Trading System* (2009).

Chapter 4 on Technical Barriers to Trade aims to reduce obstacles to trade arising from technical regulations, standards, conformity assessment procedures and similar requirements.

Chapter 5 on Sanitary and Phytosanitary Measures aims to facilitate trade in animals, plants and animal and plant products, while maintaining a high level of human, animal and plant health.

Chapter 6 on Customs and Trade Facilitation addresses cooperation in customs, for example by pursuing harmonisation of documentation and data requirements.

Chapter 7 on Trade in Services, Establishment and E-Commerce commits the parties to the agreement to liberalise service supply, including investment in services sectors (e.g. legal services, financial services, telecommunications and construction services), and investment in non-services sectors (e.g. manufacturing), making it easier for EU suppliers and investors to supply services and invest in South Korea and their South Korean counterparts to do likewise in the EU.

Chapter 8 on Payments and Capital Movements includes provisions to ensure the free movement of capital, which also allow the parties to apply measures to protect the stability of their financial systems.

Chapter 9 on Government Procurement commits the parties to open up procurement opportunities beyond their WTO 'Government Procurement Agreement' commitments, in areas where EU contractors would have a particular interest, such as works concessions and public-private partnership contracts.

Chapter 10 on Intellectual Property sets out rules on the protection and enforcement of intellectual property rights, including copyright, designs, and geographical indications. These rules complement and update WTO commitments.

Chapter 11 on Competition commits the parties to prohibit and sanction certain practices, for example some sorts of subsidies, which distort competition and trade.

Chapter 12 on Transparency sets out certain commitments intended to ensure efficient and predictable regulatory environments.

Chapter 13 on Trade and Sustainable Development establishes shared commitments, including on labour and environmental standards, and a framework for cooperation in this area.

Chapter 14 on Dispute Settlement sets out the process for resolving disputes between the parties relating to the implementation of the FTA.

Chapter 15 on Institutional, General and Final Provisions establishes certain committees and working groups to monitor the implementation of the FTA.

The FTA also includes three **Protocols** on: 'Rules of Origin' (i.e. the definition of the 'economic nationality' of products); 'Mutual Administrative Assistance in Customs Matters'; and 'Cultural Cooperation'.

Further information: http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145203.pdf.

The full FTA:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:127:FULL:EN:PDF>.

B.7 According to WTO, the sorts of provisions that bilateral PTAs may include can be broken down into 52 policy areas, which are classified into two groups: 14 areas of WTO+ provisions, which fall under the current mandate of the WTO and are already subject to some form of commitment in WTO agreements; and 38 areas of WTO- provisions, which are outside the current mandate of the WTO. See Table B.1. Some of the recent PTAs contain commitments to cooperate across an even wider set of policy areas, such as poverty alleviation, rural development and tourism.²

Table B.1 List of WTO+ and WTO- Provisions.

WTO+ areas	WTO- areas	
PTA industrial goods	Anti-corruption	Health
PTA agricultural goods	Competition policy	Human rights
Customs administration	Environmental laws	Illegal immigration
Export taxes	Intellectual Property Rights	Illicit drugs
Sanitary and Phytosanitary measures	Investment measures	Industrial cooperation
State trading enterprises	Labour market regulation	Information society
Technical barriers to trade	Movement of capital	Mining
Countervailing measures	Consumer protection	Money laundering
Anti-dumping	Data protection	Nuclear safety
State aid	Agriculture	Political dialogue
Public procurement	Approximation of legislation	Public administration
Trade Related Investment Measures	Audiovisual	Regional cooperation
Trade in Services	Civil protection	Research and technology
Trade Related Aspects of Intellectual Property Rights	Innovation policies	Small and Medium Enterprises
	Cultural cooperation	Social matters
	Economic policy dialogue	Statistics
	Education and training	Taxation
	Financial Assistance	Terrorism
	Energy	Visa and asylum

Source: WTO Trade Report 2011.

² J. Whalley, 'Recent Regional Agreements: why so many, why so much variance in form, why coming so fast, and where are they headed?', *The World Economy*, 31 (4) (2008) p 517-532.

B.8 The increase in the number of issues covered by PTAs is shown in the following charts.

Chart B.2 The average number of WTO+ provisions by PTAs over time

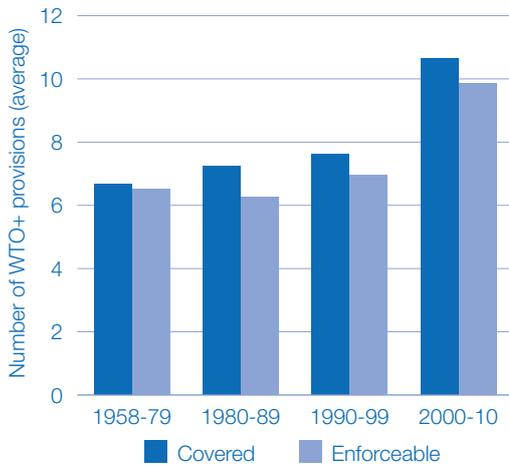
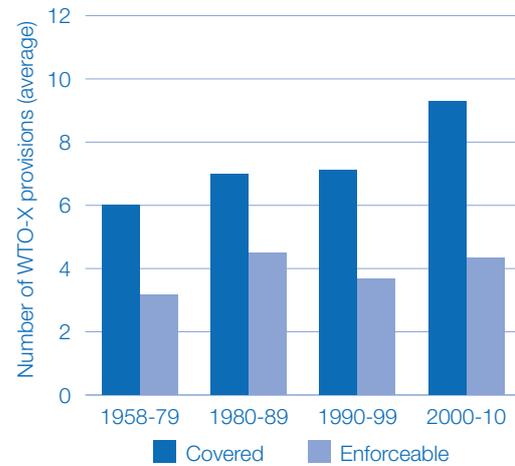


Chart B.3 The average number of WTO-X provisions by PTAs over time



Source: WTO Trade Report 2011.

Including Regional Trade Deals

B.9 In addition to the growth in bilateral trade agreements, there has been a growth in regional trade agreements. Nearly all of the WTO's members have notified participation in one or more regional agreement, some members are party to twenty or more.³ In the period 1948-1994, the GATT received 124 notifications of regional agreements; since the creation of the WTO in 1995, over 400 additional arrangements covering trade in goods or services have been notified. About half of world trade is now covered by a regional agreement of some form.⁴

B.10 Regional trade agreements have increasingly concentrated on non-tariff measures (e.g. harmonization of standards, rules on investment, intellectual property and services) rather than preferential tariffs. In many cases, they have not lead to the creation of heavily protectionist regional blocks but help tackle specific non-tariff barriers within the region.

³ See 'WTO Key Facts' available at www.wto.org/english/tratop_regfac_e.htm. Examples of regional trade agreements include: the European Union (EU) and the European Free Trade Area (EFTA); the North American Free Trade Agreement (NAFTA); Mercosur – a customs union between Brazil, Argentina, Uruguay, Paraguay and Venezuela; the Association of Southeast Asian Nations (ASEAN); the Common Market of Eastern and Southern Africa (COMESA); and the South Asian Free Trade Area (SAFTA).

⁴ R Baldwin, '21st Century Regionalism: Filling the gap between 21st century trade and 20th century trade rules,' *WTO Staffing Working Paper* (2011).

Table B.2 WTO- and WTO+ Provisions in Regional Trade Agreements.

	Pre-WTO	1995-2000	DDA ⁵ era, post 2001
WTO+ issues			
Customs	13	11	56
Anti-Dumping	12	8	53
Countervailing Measures	4	5	52
Export Taxes	8	8	41
State Aid	10	9	34
Trade Related Aspects of Intellectual Property Rights	6	4	41
Trade in Services	7	2	39
State Trading Enterprises	5	3	35
Technical Barriers to Trade	2	2	36
Sanitary and Phytosanitary	2	1	35
Public Procurement	5	0	32
Trade Related Investment Measures	6	2	31
WTO- issues			
Competition Policy	11	9	39
Movement of Capital	6	5	38
Intellectual Property Rights	5	2	39
Investment	4	1	35

Source: WTO Trade Report 2011.

And An Increasing Number of Plurilateral Agreements

B.11 In addition, there has been a growing importance in the amount of trade covered by of plurilateral agreements. In 1990, trade between parties to plurilateral agreements made up around 10 per cent of intra-PTA trade in 1990, but this share rose to 50 per cent by 2008.

- **The Trade in Services Agreement (TiSA)** negotiations are now well under way, following the launch of negotiations on 18th March 2013. 50 WTO Members (counting the EU as 28), accounting for two-thirds of global trade in services, are participating. The UK has positioned itself as a strong supporter of the TiSA, given both our strong services industry interest and the Prime Minister's commitment to 'coalitions of the willing' taking forward trade liberalisation. There has been a strong focus on negotiating an agreement (a) which can be integrated into the WTO ('docked' into the General Agreement on Trade in Services (GATS)) at a later date and (b) which is open to accession by non-participants either during the negotiation or after agreement is reached.
- **The Information Technology Agreement (ITA)** is an agreement under the auspices of the World Trade Organisation (WTO). It is not a formal treaty. There were 29 signatories to the Ministerial Declaration on Trade in Information Technology Products in 1996. It now has 78 participants, with the EU counting as 28. The ITA is solely a tariff cutting mechanism, in which participants commit to each other to adjust their WTO schedule of commitments to set their bound tariffs at zero for the products covered. These presently encompass printed circuit board manufacturing equipment; flat panel display manufacturing equipment; capacitor manufacturing equipment;

⁵ Doha Development Agenda.

audio, radio, television and video apparatus; telecommunications products; electrical/electronic machines; instruments; and parts and inputs for IT products. Periodically, the product coverage of the ITA is reviewed, a provision set out in the Declaration. The UK has been a consistent advocate of the need to update the ITA to accommodate technological advances since 1996.

- **The Agreement on Government Procurement (GPA)** establishes an agreed framework of rights and obligations among its Parties with respect to their national laws, regulations, procedures and practices in the area of government procurement. It aims to open up as much of government procurement business as possible to international competition, subject to certain financial thresholds. It is designed to make laws, regulations, procedures and practices regarding government procurement more transparent and to ensure they do not protect domestic products or suppliers, or discriminate against foreign products or suppliers. Political agreement on the outcome of the re-negotiation of the Agreement was confirmed in March 2012. The agreed outcomes are: a revised text (modernised and close to the EU procurement Directives), improved market access and an agreed programme for future work. The new GPA will come into force once it has been ratified by two thirds of the signatories (Armenia, Canada, Hong Kong China, Iceland, Israel, Japan, Korea, Liechtenstein, the Netherlands with respect to Aruba, Norway, Singapore, Switzerland, Chinese Taipei, United States (37 States only) and the European Union (all Member States)).
- **The Anti-Counterfeiting Trade Agreement (ACTA)** is a plurilateral trade agreement negotiated by a number of parties including the US and EU, with the aim of tackling large scale intellectual property infringement, in particular by organised crime. It aimed to set minimum standards for trade mark, design and copyright enforcement, in order to ensure greater commonality in the protection of intellectual property rights and as such was supported by the UK. However, it was the focus of widespread public concern about the impact on civil liberties and the rights of individual internet users (though it would not have required the UK to change its domestic law in any way). Public suspicion was further increased by a lack of transparency and public consultation surrounding the negotiation of the treaty.
- In the first exercise of its new powers under the Lisbon Treaty, the European Parliament rejected the adoption of ACTA by the EU in July 2012 due to its concerns over the balancing of the protection of IP with the rights of EU citizens. To date, Japan is the only state to have ratified ACTA and, as a minimum of six ratifications are required, the agreement has not entered into force. In this instance, it is difficult to say whether or not EU involvement was a critical factor in either the negotiation of the agreement or its ultimate rejection, or whether a similar sequence of events would have played out at Member State level had the EU not been involved. The experience of non-EU states suggests that ACTA would have faced the same challenges regardless of EU involvement.

The OECD and Rules on Investment

B.12 The OECD Declaration on International Investment and Multinational Enterprises was first adopted in 1976.⁶ It is a policy commitment by adhering governments to provide an open and transparent environment for international investment and to encourage the positive contribution multinational enterprises can make to economic and social progress. All 34 OECD countries and 11 non-OECD countries have subscribed to the Declaration. The Declaration consists of four elements:

- National Treatment is the commitment by a country to treat enterprises operating on its territory, but controlled by the nationals of another country, no less favourably than domestic enterprises in like situations. Adhering countries are required to notify their exceptions to National Treatment for examination. This instrument was underpinned in 1988 by a unanimous pledge of all adhering countries to refrain from introducing new exceptions ('standstill pledge').
- Adhering countries agree to co-operate so as to avoid or minimise the imposition of conflicting requirements on multinational enterprises.
- Adhering countries recognise the need to give due weight to the interest of adhering countries affected by their laws and practices in this field and endeavour to make measures as transparent as possible.
- Guidelines for Multinational Enterprises are recommendations on responsible business conduct addressed by governments to multinational enterprises operating in or from adhering countries.

B.13 The OECD's Code of Liberalisation of Capital Movements and the Code of Liberalisation of Current Invisible Operations constitute legally binding rules, stipulating progressive, non-discriminatory liberalisation of capital movements, the right of establishment and current invisible transactions (mostly services) in OECD and adhering countries. Implementation of the Codes, in particular by removal of restrictions on cross-border capital flows and trade in services involves 'peer pressure' exercised through policy reviews and country examinations to encourage unilateral rather than negotiated liberalisation.

⁶ OECD, Declaration on International Investment and Multinational Enterprises, REV (1991).

Appendix C: The UK's Bilateral Investment Treaties (currently in force)

	Country
1	Albania
2	Antigua & Barbuda
3	Argentina
4	Armenia
5	Azerbaijan
6	Bahrain
7	Bangladesh
8	Barbados
9	Belarus
10	Belize
11	Benin
12	Bolivia
13	Bosnia & Herzegovina
14	Bulgaria
15	Burundi
16	Cameroon
17	Chile
18	China
19	Congo
20	Cote d'Ivoire
21	Croatia
22	Cuba
23	Czech & Slovak Republics
24	Dominica
25	Ecuador
26	Egypt
27	El Salvador
28	Estonia
29	Georgia

	Country
30	Ghana
31	Grenada
32	Guyana
33	Haiti
34	Honduras
35	Hong Kong
36	Hungary
37	India
38	Indonesia
39	Jamaica
40	Jordan
41	Kazakhstan
42	Kenya
43	Korea Republic
44	Kyrgyz Republic
45	Laos
46	Latvia
47	Lebanon
48	Lesotho
49	Lithuania
50	Malaysia
51	Malta
52	Mauritius
53	Mexico
54	Moldova
55	Mongolia
56	Morocco
57	Mozambique
58	Nepal

	Country
59	Nicaragua
60	Nigeria
61	Oman
62	Pakistan
63	Panama
64	Papua New Guinea
65	Paraguay
66	Peru
67	Philippines
68	Poland
69	Romania
70	Senegal
71	Sierra Leone
72	Singapore
73	Slovenia
74	South Africa
75	Sri Lanka
76	St Lucia

	Country
77	Swaziland
78	Tanzania
79	Thailand
80	Tonga
81	Trinidad & Tobago
82	Tunisia
83	Turkey
84	Turkmenistan
85	UAE
86	Uganda
87	Ukraine
88	Uruguay
89	Russia (signed with USSR)
90	Uzbekistan
91	Venezuela
92	Vietnam
93	Yemen
94	Serbia (signed with Yugoslavia)

Appendix D: Tariffs of Major UK Export Partners (export to which is no less than 1% of total UK exports)

Country	Approx. % of total UK export ¹	EU has FTA?	Average tariffs, bound, %/MFN applied,%		Low (<=3%) average bound tariff (avg. bound,% /avg. MFN applied,%) ²	Medium or high (over 5%) average bound tariff (avg. bound,%/avg. MFN applied,%) ²
			Non-Agric.	Agric.		
USA	13.7	No (<i>but negotiations ongoing</i>)	3.3/3.3	4.9/4.9	Chemicals (2.8/2.8), minerals/metals (1.7/1.7), machinery (1.5/1.5), petroleum (1.4/1.3), fish (1.0/0.9), wood/paper (0.4/0.4),	Agricultural/ food: dairy products (19.2/19.1), sugars/confectionary (16.9/16.6), beverages/tobacco (16.3/15.4); Non-agricultural: clothing (11.4/11.4), textiles (7.9/7.9).
China	3.5	No	9.2/8.7	15.7/15.6	None (all applied tariffs are over 3.0 on average as well)	Agricultural/food: sugars/confectionary (27.4/27.4), cereals (23.7/24.3), beverages/tobacco (23.3/22.3), fruit/vegetables (14.9/14.8), coffee/tea (14.9/14.7), dairy products (12.2/12.0); Non-agricultural: cotton (22/15), transport equipment (11.4/11.5) fish (11.0/10.8), textiles (9.7/9.5), machinery (9.0/8.3), minerals/metals (8.0/7.4).
Switzerland	2.3	Yes	3.0/2.4	59.7/43.5	Petroleum (2.3/0.0), transport equipment (2.1/1.7), minerals/metals (1.5/1.5), fish (1.4/0.3), chemicals (1.1/1.1), machinery (1.0/0.8), cotton (0.0/0.0).	Agricultural/food: dairy products (175.6/163.4), animal products (161.0/156.4), cereals (53.5/21.7), beverages/tobacco (51.3/42.7), fruit/vegetables (38.3/22.6); Non-agricultural: clothing (13.2/8.0), textiles (7.3/6.5).
Russia	1.9	No	na/8.7	na/14.3	Bound tariffs not published. All applied MFN tariffs are above 3.0, except cotton (0.0).	Bound tariffs not published. Applied MFN tariffs vary from 0 for cotton to 24.7 for animal products. Agricultural/food: beverages/tobacco (35.2), animal products (24.7), cereals (18.7), dairy products (17.7), sugars and confectionary (13.3), fish (12.3); Non-agricultural: clothing (13.2), wood/paper (12.7), textiles (10.7), transport equipment (10.4), minerals/metals (9.8), leather/footwear (7.6).
Hong Kong	1.8	No	0.0/0.0	0.0/0.0	All	None
UAE ³	1.8	No	12.6/4.7	25.2/6.8	None (all applied tariffs are over 3.0 on average as well)	Agricultural/food: beverages/tobacco (119.6/45.3), animal products (39.4/3.4), all other food categories (15.0/3.0 to 5.0); Non-agricultural: clothing (15.0/5.0), textiles (14.9/5.0), minerals/metals (14.8/4.9), transport equipment (13.8/4.0), machinery (12.0/4.5), wood/paper (12.0/4.7).
Japan	1.6	No (<i>but negotiations ongoing</i>)	2.6/2.6	22.8/23.3	Chemicals (2.3/2.2), minerals/metals (1.0/1.0), wood/paper (1.0/0.8), machinery (0.1/0.05), transport equipment (0.0/0.0), cotton (0.0/0.0)	Agricultural/food: dairy products (150.6/178.5), cereals (73.4/68.3), sugars/confectionary (52.0/28.4), beverages/tobacco (18.0/15.4), coffee/tea (14.3/16.3); Non-agricultural: leather/footwear (10.9/12.0), petroleum (9.8/0.5), clothing (9.2/9.1), textiles (5.6/5.5).
South Korea	1.6	Yes	10.2/10.2	56.1/48.6	Wood/paper (2.8/2.2), cotton (2.0/0.0)	Agricultural/food: cereals (161.1/134.4), dairy products (69.8/67.5), fruits/vegetables (63.8/57.5), beverages/tobacco (43.1/31.7), fish (14.8/16.0). Non-agricultural: clothing (28.4/12.6), textiles (16.5/9.1), leather/footwear (12.1/7.8), machinery (9.2/6.1), petroleum (8.9/4.6).
Australia	1.6	No	11.0/3.1	3.5/1.4	Cereals (2.7/1.3), animal products (1.5/0.4), cotton (1.2/0.0), fish (0.7/0.0), petroleum (0.0/0.0)	Agricultural/food: beverages/tobacco (10.5/3.6), sugars/confectionary (8.7/1.9), dairy products (5.3/4.9); Non-agricultural: clothing (41.2/8.9), textiles (18.6/4.3), leather/footwear (15.2/4.2), transport equipment (12.6/5.8), machinery (9.0/2.9).
India ³	1.6	No (<i>but negotiations ongoing</i>)	34.6/9.8	113.1/31.4	None (all applied tariffs are over 6.0 on average)	Agricultural/food: dairy products (65.0/33.7), other agric./food vary from 100.0 to 160.0/from 20.0 to 60.0; Non-agricultural: vary from 27.0 to 40.0/ from 6.9 to 21.5.

Country	Approx. % of total UK export ¹	EU has FTA?	Average tariffs, bound, %/MFN applied,%		Low (<=3%) average bound tariff (avg. bound,% /avg. MFN applied,%) ²	Medium or high (over 5%) average bound tariff (avg. bound,%/avg. MFN applied,%) ²
			Non-Agric.	Agric.		
Canada	1.5	Yes, but not applied yet	5.3/2.5	18.0/18.0	Minerals/metals (2.7/1.0), wood/paper (1.5/1.0), cotton (0.8/0.0)	Agricultural/food: dairy products (246.9/246.8), animal products (29.5/30.5), cereals (23.6/20.3), coffee/tea (9.8/10.4); Non-agricultural: clothing (17.2/16.9), textiles (10.7/3.8), leather/footwear (7.4/4.0), petroleum (6.8/0.5).
Singapore ³	1.4	No (<i>but negotiations on-going</i>)	6.4/0.0	26.9/0.2	None; but all applied tariffs are below 3% on average	Agricultural/food: beverages/tobacco (267.5/2.4), cereals (11.6/0.0), fish (10.0/0.0), animal products (8.9/0.0), dairy products (7.0/0.0), most other food categories about 10/0.0; Non-agricultural: minerals/metals/clothing/leather/footwear (10.0/0.0), machinery (6.0/0.0), transport equipment (6.0/0.0)
Turkey ³	1.2	Yes (Customs Union)	17.0/4.8	61.0/41.7	Petroleum (2.7/3.1)	Agricultural/food: dairy products (169.8/128.6), animal products (132.8/110.4), sugars/confectionary (107.3/88.6), coffee/tea (80.3/31.6), beverages/tobacco (79.6/36.0), cereals (68.6/32.9), fish (50.0/32.8); Non-agricultural: clothing (27.3/11.5), wood/paper (26.5/0.9), textiles (24.5/6.5), leather/footwear (23.0/2.4)
Norway ³	1.2	Yes	3.2/0.5	132.7/55.8	Leather/footwear (2.9/0.0), machinery (2.5/0.0), chemicals (2.5/0.0), minerals/metals (0.9/0.0), cotton (0.0/0.0), petroleum (0.0/0.0)	Agricultural/food: animal products (351.4/174.6), dairy products (322.5/69.4), cereals (232.4/75.3), sugars/confectionary (82.1/25.7), beverages/tobacco (40.7/26.7); Non-agricultural: clothing (11.1/8.4), textiles (7.3/0.5).
Saudi Arabia	1.0	No	10.5/4.9	17.3/4.8	None (all applied tariffs are over 3.0 on average as well)	Agricultural/food: beverages/tobacco (114.2/20.6), other agric/food categories around 12.0/around 4.0; Non-agricultural: 10.0-15.0 for most categories/3.5-6.0 for all categories.

Note:

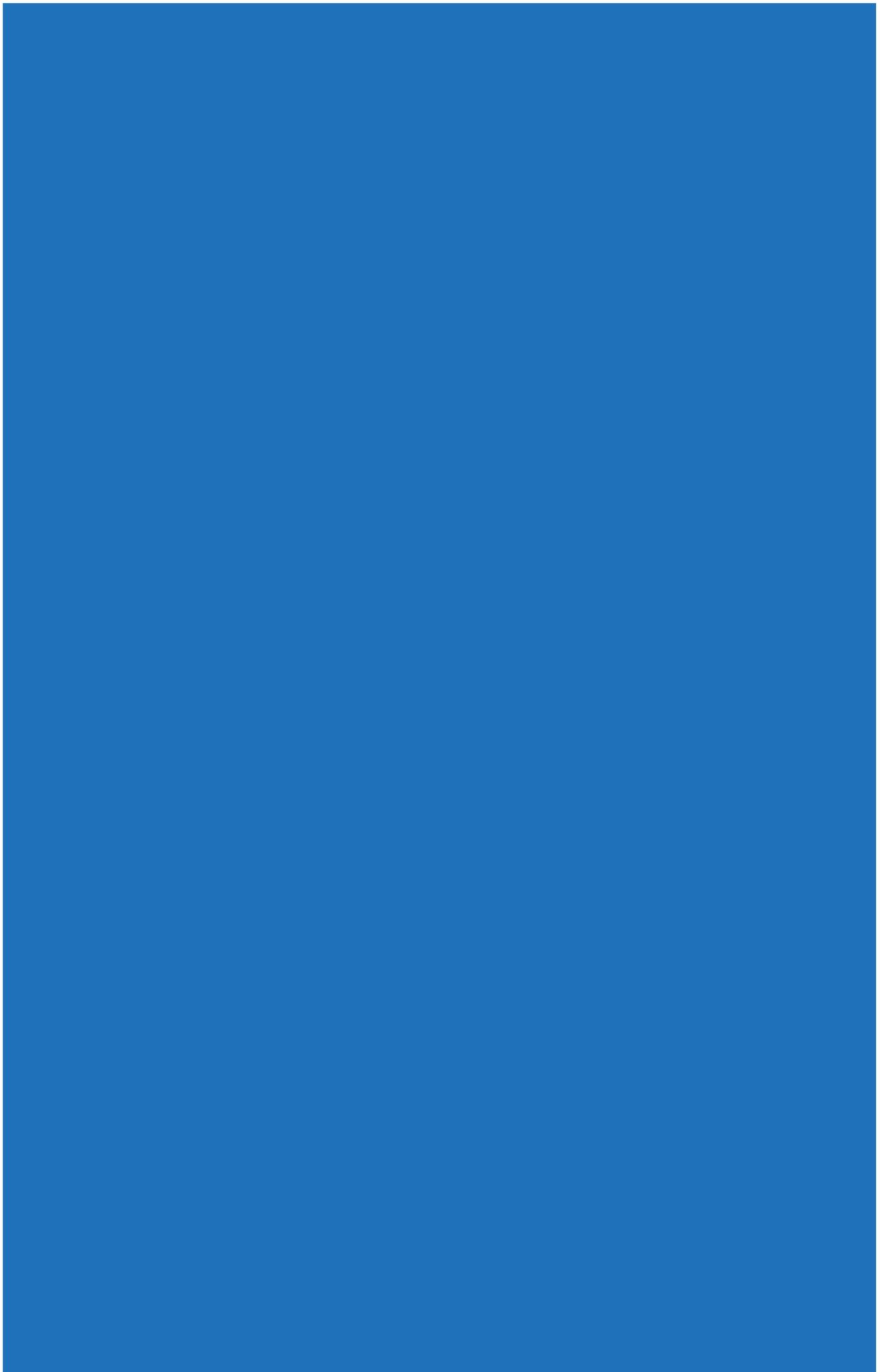
– The table lists MFN tariffs. The EU exporters will face low or zero tariffs in countries that the EU has FTAs with – in those cases the table shows what the EU exporters would have to pay in the absence of FTAs (illustrates how beneficial FTAs are for exporters).

– In some cases applied tariffs slightly exceed bound tariffs due to the methodology used by the WTO to calculate them.

¹ Source: Office of National Statistics.

² Source: WTO, 2011 or 2010 data (2010 where 2011 is not available).

³ Average applied tariff of this country is at least 10 percentage point lower than average bound tariff.



Annex A:

Submissions to the Call for Evidence

3 Verulam Buildings

AB Sugar

ABPI (Association of British Pharmaceutical Industry)

ADS

Airline Operators Committee Cargo

AMDEA (Association of Manufacturers of Domestic Appliances)

Association of International Courier & Express Services (not published)

BAE Systems plc

Bearder, Catherine, MEP

British Art Market Federation

British Ceramic Confederation

British Chambers of Commerce

British Chemical Engineering Contractors Association

British Exporters Association

British Influence

British Irish Chamber of Commerce

British Retail Consortium

British Standards Institution

BT

Business for New Europe

CBI

Chartered Institute of Logistics and Transit (UK)

Civitas

Cocks, Matthew

Committees on Arms Export Controls, House of Commons

Commonwealth Environmental Investment Platform (CEIP)

Competitive Enterprise Institute

Council of British Chambers of Commerce in Europe

Diageo

EEF

Engineering Council

Federation of Small Businesses (FSB)
Freedom Association
Freightliner Group
Fresh Start Project
Government of Alberta
Government of Australia
Government of Japan
Hall, Fiona, MEP, Leader of the UK Liberal Democrats in the European Parliament
Holmes, Dr. Peter and Prof. Jim Rollo, University of Sussex
International Meat Trade Association
Jones, Barry M
Law Society
Lloyd's
NATS
National Farmers Union (NFU)
Northern Ireland Executive
Romanian businesses
Rüdiger Bengs, Wolf
Russell, Malcolm
Sanofi
Scotch Whisky Association
Scottish Council for Development and Industry
Scottish Government
Senior European Experts group (SEEG)
Society of Motor Manufacturers and Traders (SMMT)
Tata Steel UK Ltd
Tate & Lyle Sugars
Telefonica
TheCityUK
TUC
UK Chamber of Shipping
Universities UK and the UK Higher Education International Unit
Welsh Government

Annex B: Attendees at Events

Three consultation events were held in June and July. Attendees included:

ADS Group
Babcock International Group PLC
BAE Systems
Boeing
BP
Bradbury, Dave, Langdon Systems
British Exporters Association
British Water
CBI
EEF – the manufacturers' organisation
Green, Brian, Airline Operators Committee Cargo
Law Society
Lloyd's of London
MacSwiney, Peter, ASM
Price, Ben, Dechert LLP
Quinti
Royal Institute of British Architects
Rollo, Prof. Jim
North East of England Process Industry Cluster (NEPIC).
Siegl, Chris
Siemens
Society of Motor Manufacturers and Traders
Tate & Lyle
TUC
UK Chamber of Shipping
UK Steel

Observers included:

European Commission
Local Government Association
Murray, Thomas, Republic of Ireland Government
Todd, Ray, Isle of Man Customs and Excise

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Annex D: List of Acronyms

ACE	Architects Council of Europe
ACP	African, Caribbean and Pacific countries
ASEAN	Association of South-East Asian Nations (Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Burma and Cambodia)
BCC	British Chambers of Commerce
BIT	Bilateral Investment Treaty
BRIC	Brazil, Russia, India and China
CBI	Confederation of British Industry
CCP	Common Commercial Policy
DDA	Doha Development Agenda
EC	European Commission
ECA	Export Credit Agency
ECJ	European Court of Justice
EEA	European Economic Area
EEC	European Economic Community
EPA	Economic Partnership Agreement
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GSP	Generalised System of Preferences

ICSID	International Centre for the Settlement of Investment Disputes
JHA	Justice and Home Affairs
LDC	Least Developed Countries
MFN	Most Favoured Nation
NFU	National Farmers Union
NTM	Non-tariff measure
OECD	Organisation for Economic Co-operation and Development
PTA	Preferential Trade Agreement
SCM	Subsidies and Countervailing Measures
SME	Small or Medium Enterprise
SPS	Sanitary and Phytosanitary Measures
TDI	Trade Defence Instrument
TEC	Treaty Establishing the European Community
TFEU	Treaty on the Functioning of the European Union
TiVA	Trade in Value-Added
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organisation