

# Documento de Trabajo

## Working Paper

**The European Union Free Trade Agreements:  
Implications for Developing Countries**

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# The European Union Free Trade Agreements: Implications for Developing Countries

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## Summary

In a clear break with its former policy, partly due to the stalemate of the Doha Development Round negotiations and to the changes in the global economic balance, the European Union (EU) announced in 2006 its plan to seek comprehensive Free Trade Agreements with a series of countries and regions. To provide European industry with new opportunities for growth and development, these agreements need to be comprehensive in scope, provide for liberalisation of substantially all trade and go beyond multilateral disciplines. These agreements also have very important implications for developing countries: they certainly have potential to provide them with new trading opportunities, lock in reform and be powerful tools for economic growth. However, liberalisation between countries with vastly different levels of development, if it is too fast and too deep, could be very damaging for the weakest part. For liberalisation to benefit developing countries, these should be granted special and differential treatment so that they can protect their infant industries (via tariffs, subsidies, state intervention or any other tools) until they are strong enough to compete internationally.

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<sup>1</sup> The views expressed in this paper are the author's alone and do not necessarily reflect those of the European Commission.

## List of Acronyms

AA	Association Agreement
ACP	Africa, Caribbean and Pacific
AfT	Aid for Trade
ASEAN	Association of South East Asian Nations
CA	Central America
CAFTA	Central America Free Trade Agreement
CAN	Community of Andean Nations
CAP	Common Agricultural Policy
CPA	Cotonou Partnership Agreement
DDR	Doha Development Round of Trade Talks
EPA	Economic Partnership Agreement
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GSP	Generalised System of Preferences
IMF	International Monetary Fund
IPR	Intellectual Property Rights
LDCs	Least Developed Countries
MERCOSUR	<i>Mercado Común del Sur</i> (Southern Common Market)
MFN	Most Favoured Nation
NGO	Non-Governmental Organisation
ODA	Official Development Assistance
PPP	Purchasing Power Parity
SSM	Special Agricultural Safeguard Mechanism
TBTs	Technical Barriers to Trade
TDCA	Trade, Development and Cooperation Agreement
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organisation

## The Importance of Trade for Development

The fact that international trade is welfare-enhancing is one of the most fundamental doctrines in economics. International trade played a major role in the development of today's industrialised nations and, over the past two decades, rapid growth in some developing countries, especially in Asia, has been associated with significant and gradual trade liberalisation and export-oriented industrial policies. The increase in *per capita* incomes in these countries has led to –sometimes enormous– poverty reduction.

In the European Consensus on Development<sup>2</sup>, the EU, the world's biggest donor of development aid, stated that poverty eradication is the main objective of EU development cooperation. Also, the European Consensus stresses the important role that trade and regional integration can play for development and how the EU intends to help poor countries really benefit from trade, including commitments on additional assistance for capacity-building, market access, special and differential treatment and the reform of the Common Agricultural Policy (CAP) so as to reduce its trade-distorting effects. The European Consensus makes special mention of a development-friendly conclusion of the Doha Development Round of Trade Talks (DDR) and the Economic Partnership Agreements (EPAs) with Africa, Caribbean and Pacific countries (ACP) and supports flexibility and asymmetry regarding their implementation.

Unilaterally, the EU already grants generous market access to developing countries through its Generalised System of Preferences (GSP). This is an autonomous trade arrangement, compliant with World Trade Organisation (WTO) rules under the Enabling Clause,<sup>3</sup> through which the EU provides poorer countries with non-reciprocal preferential access –in the form of reduced tariffs– to the EU market.<sup>4</sup> Moreover, knowing that market access alone is not enough, the EU committed to increase its spending on trade-related assistance to €2 billion per year from 2010. The EU adopted its Aid for Trade (AfT) strategy in October 2007, with the aim of helping developing countries build the necessary capacity to trade.

At the multilateral level, the EU remains committed to a successful conclusion of the DDR, but this looks difficult now. The Round's crisis began in Cancún (Mexico) in 2003 due to disagreements between developed countries and some major developing countries; during the following years, negotiators tried to solve their differences. When, in the last attempt to finish the interminable round to date, Trade Ministers met in Geneva on 21 July 2008, the EU made a generous proposal, offering high tariff cuts in farming and industrial goods. Nevertheless, on 29 July the talks collapsed once more, this time due to a split between India and China, on the one hand, and the US, on the other, over the special agricultural safeguard mechanism clause for developing countries (SSM), a device to protect farmers in developing countries against surges of imports or price falls.

Although Trade Ministers, including the EU Commissioner for Trade Catherine Ashton, have expressed their commitment to strive to reach an ambitious and balanced agreement in the DDR

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<sup>2</sup> Joint statement by the Council and the representatives of the governments of the Member States meeting within the Council, the European Parliament and the Commission on European Union Development Policy: 'The European Consensus', *Official Journal of the EU*, 2006/C 46/01, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:046:0001:0019:EN:PDF>.

<sup>3</sup> The WTO legal basis for the GSP is 'The enabling clause', officially called the 'Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries', adopted under GATT in 1979 and enabling developed members to give differential and more favourable treatment to developing countries ([http://www.wto.org/english/docs\\_e/legal\\_e/enabling1979\\_e.htm](http://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm)).

<sup>4</sup> Council Regulation (EC) nr 732/2008 of 22 July 2008 applying a scheme of generalised tariff preferences for the period from 1 January 2009 to 31 December 2011 and amending Regulations (EC) nr 552/97, (EC) nr 1933/2006 and Commission Regulations (EC) nr 1100/2006 and (EC) nr 964/2007, *Official Journal of the EU* (2008/L 211/1), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:211:0001:0039:EN:PDF>.

and, at the Washington summit on 15 November, G20<sup>5</sup> leaders made a firm commitment to revive the round of world trade talks, the chances of completing the round soon –or of reaching an ambitious result– do not look certain.

Should the DDR finally fail, the major losers will be the poorest countries. They would lose the opportunity of increased market access to both developed countries and to the fast-growing markets of big emerging economies, which is equally important, as South-South trade already represents a big share of developing countries' trade and some of these big developing economies, like India, China and Brazil, are registering enormous growth rates. Also, the DDR intends to address many trade issues that are critical to promote development; one of its main objectives is to further free trade in agricultural goods and advance farm-subsidy reform in the developed world, a change that would principally benefit developing countries. Other areas of great importance for development included in the DDR negotiations are a substantial increase of trade-related assistance, the reduction of tariff escalation<sup>6</sup> and a new global extension of the principle of duty-free quota-free access to all products from all Least Developed Countries (LDCs).

Finally, if multilateral liberalisation fails, the likely alternative will be liberalisation through bilateral and regional Free Trade Agreements (FTAs). Regardless of the fact that FTAs are seen by many as less efficient than multilateral liberalisation<sup>7</sup> and of the debate on whether these deals help or hinder efforts to fully liberalise international trade, it is clear that a shift towards regionalism would put developing countries –especially the poorest of them– in a weaker position. As the process of the DDR talks has shown, major developing countries, like Brazil and India, or groupings of some of these countries, like the G-20 group of developing nations,<sup>8</sup> can play an influential role in multilateral negotiations, and LDCs can free ride on the major developing countries efforts and negotiating leverage if it is in their interest (which, as seen in the DDR, is not always the case). Moreover, while in the DDR LDCs are free from having to carry out any market opening and other poor developing countries would have to make only small commitments, in bilateral negotiations big economies like the EU hold far more negotiating power than developing countries and, as a consequence, these may have to make bigger concessions than those required from them in the DDR.

At the bilateral level, the EU is currently negotiating a series of FTAs with a number of developing countries. The EU states that development will remain a core function of the EU's trade policy and

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<sup>5</sup> The G-20 is a group of Finance Ministers and central bank governors from 19 of the world's 25 largest economies (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, UK and US) plus the EU. It is a forum for cooperation and consultation on matters related to the international financial system.

<sup>6</sup> Tariff escalation is the practice of setting lower import duties on raw materials and components and increasingly higher import duties on semi-processed products and finished products. This practice protects domestic processing industries, as low tariffs on raw materials cut their costs whilst high tariffs on manufactured products protect them from foreign competition, and discourages the development of processing activity in the countries where raw materials originate, mainly developing countries. As a result, for example, developing countries account for more than 90% of cocoa bean production, less than half of cocoa butter production, one third of cocoa powder and 4% of chocolate (UNCTAD, 2000).

<sup>7</sup> Opponents of regionalism argue that bilateral and regional FTAs undermine the global trading system because they violate the Most Favoured Nation (MFN) principle –that any concession given to one WTO member must be automatically extended to all other WTO members– and, as such, are always discriminatory. FTAs lower trade barriers only between the signatories, meaning that, besides creating trade between their members, they might also divert trade from lower-cost outsiders, so a country can end up paying more for its imports (Viner, 1953); even if an inside supplier becomes more competitive only because it can sell duty-free, the consumer might pay less, but the country is deprived of tariff revenue. Also, FTAs make countries less likely to agree to global tariff cuts, since freer world trade would erode the narrow gains they have won (Bhagwati, 2008).

<sup>8</sup> The G-20 of developing nations is a group of countries established on 20 August 2003. Its focus is on agriculture, the central issue of the Doha Development Agenda. It now comprises 23 countries: Egypt, Nigeria, South Africa, Tanzania, Zimbabwe, China, India, Indonesia, Pakistan, The Philippines, Thailand, Argentina, Bolivia, Brazil, Chile, Cuba, Ecuador, Guatemala, Mexico, Paraguay, Peru, Uruguay and Venezuela.

says that it will take into account the development needs of its partners as well as the potential impact any agreement may have on other developing countries. But, despite these promises, these FTAs have been widely criticised on the grounds that they might actually undermine the development of poor countries, as they go far beyond WTO obligations and, if handled wrongly, can be very damaging, given the vastly different levels of economic development of the parts.

### **The EU's Strategy for Competitiveness**

In a clear break with its former policy, the EU announced in 2006 its plan to seek new FTAs with a series of fast-growing economies, mainly in Asia. This was a surprising move on the part of the EU, whose trade efforts had previously been focused on the DDR, on the preferential arrangements with the ACP countries (its former colonies) and on the conclusion of FTAs with its partners in the broader European area, such as the countries of Eastern and Central Europe, the former Yugoslavia and the Mediterranean countries.

This shift towards bilateralism, that ended a *de facto* moratorium on the launch of new bilateral FTA negotiations in place since 1996, was partly due to the lack of progress in the DDR and also to the sharp changes in the global economic balance. The increasing weight of emerging economies such as China and India had triggered a response from EU competitors like the US and Japan, who actively pursued FTAs with these countries; this in turn forced the EU to also seek enhanced access to these countries so as not to see its exports face discrimination in new markets with enormous potential. Also, the rejection by developing countries to include the EU's main interests – such as the Singapore issues<sup>9</sup> in the DDR negotiations made the EU move towards bilateral FTAs.

The EU's negotiations of FTAs follow closely on the heels of the launch of the strategy to increase competitiveness and further the Lisbon goals<sup>10</sup> described in the document 'Global Europe: Competing in the World' (European Commission, 2006), which aims to put EU trade policy at the service of EU competitiveness. This entails accompanying the internal agenda for competitiveness with an external agenda to create opportunities abroad; in other words, liberalise international trade further, opening markets in which European companies can compete, thus providing European industry with new opportunities for growth and development. Alongside the right internal policies, competitiveness depends on greater openness and fairer, more transparent rules in other markets.

The document identifies multilateralism as the means to that end; however, the way in which the DDR talks are progressing shows that any eventual deal will not meet all the expectations of the EU, and the document also says that many issues 'remain outside the WTO at this time' so that they can only be addressed through FTAs. These issues include what the EU identifies as key to secure real access to other markets (the kind of openness it seeks is no longer about tariffs), namely non-tariff barriers, access to resources and what it calls new areas of growth. These areas are notably:

- Intellectual Property Rights (IPR): new market access for EU businesses is seriously reduced without appropriate IPR protection in other countries.
- Services: an area of European comparative advantage with great potential for growth in EU exports.

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<sup>9</sup> The term 'Singapore issues' refers to four working groups set up during the WTO Ministerial Conference of 1996 in Singapore, namely investment protection, competition policy, transparency in government procurement and trade facilitation. Disagreements between largely developed and developing economies – which expressly rejected the inclusion of the Singapore issues on the multilateral agenda – have so far prevented a resolution in these areas, despite repeated attempts to revisit them, notably during the 2003 Ministerial Conference in Cancun, Mexico, whereby no progress was made.

<sup>10</sup> At the meeting of the European Council in Lisbon (March 2000), the Heads of State or Government launched a 'Lisbon Strategy' aimed at making the EU the most competitive economy in the world and achieving full employment by 2010.

- Investment.
- Government procurement: deemed an area of significant untapped potential for EU exporters, since EU companies are world leaders in areas that are normally subject to government procurement, such as transport equipment, public works and utilities.
- Competition: anticompetitive practices as well as state-aid rules in third countries limit market access as they raise new barriers to trade.

This strategy entails an aggressive stance on the part of the EU, with a focus on economic potential. Therefore, the key economic criteria for new FTA partners should be market potential (economic size and growth) and the level of protection against EU export interests (tariffs as well as non tariff barriers). The competition matters, too: where EU negotiating partners have signed FTAs with competitors to the EU, the latter seeks full parity at least.<sup>11</sup> For these FTAs to deliver on the EU's needs, they need to be comprehensive in scope, provide for liberalisation of substantially all trade and go beyond WTO disciplines.

Coherent with its strategy for competitiveness, the EU is pursuing FTAs with a host of regions, since many of the issues it deems key cannot be addressed through the multilateral system. The Association of South-East Asian Nations (ASEAN), South Korea and the Common South Market (MERCOSUR) are priorities. The three are big markets showing strong growth, and the three are active in negotiating FTAs with EU competitors. The Andean Community of Nations (CAN) and Central America (CA), though not priorities, clearly have potential and are not to be surrendered to the US,<sup>12</sup> India and the Gulf Cooperation Council (GCC) are also of interest. Russia is deemed an important target, but the current situation seems to rule out an FTA.<sup>13</sup> China, although clearly meeting the economic criteria for FTA partners, is considered an exceptional case needing a different approach.

### **On the Negotiating Table**

The objectives of the EU's FTAs vary widely depending on the negotiating partner. A developed economy like South Korea, with a per capita GDP (PPP) of approximately US\$24,800 (IMF, World Economic Outlook 2007), is the EU's eighth-largest trade partner and the EU has been the single largest investor in South Korea since 1962. In the ongoing FTA negotiations with South Korea, enhancing EU competitiveness and promoting EU offensive interests, with a focus on market access, is paramount. The EU is also negotiating FTAs with more than 100 developing countries, grouped under various regional integration initiatives (see Annex I); trade with all these countries put together represented only 15,6% of total EU imports and 15,3% of total EU exports in 2007; however, many of these countries rely heavily on the EU market (see Annex II). In these cases, such as the EPAs with ACP countries or in the negotiations with CA and CAN, the objective is to build markets, rather than open them for EU companies; thus, the focus is on strengthening regional integration and improving the business environment.

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<sup>11</sup> The negotiations with South Korea, for example, ran into difficulties when the EU demanded a trade package equal to the South Korea-US FTA.

<sup>12</sup> Several of the Central American and Andean Community countries have been registering high levels of economic growth in recent years, and the US's traditionally strong economic influence in the area is very likely to increase with the implementation of the Central America Free Trade Agreement (CAFTA), that entered into force in 2006 in four CA countries, as well as due to the FTAs with Colombia and Peru.

<sup>13</sup> Russia is still negotiating its accession to the WTO, a prerequisite for any FTA with the EU, and a series of problems (such as Russia's limiting or cutting off altogether gas supplies to countries with which it has a commercial disagreement or the war in Georgia) have recently complicated bilateral trade relations between the EU and Russia; also, it might be argued whether Russia will ever agree to launch FTA negotiations with the EU, as its principal exports (oil and gas) will always be welcome in the EU market.

In practice, when negotiating, the different levels of development of EU partners are indeed taken into account in the design of the accompanying measures to trade liberalisation (such as enhanced development cooperation) and the when choosing the framework of the agreement. Regarding trade *per se*, all the FTAs that the EU is currently negotiating are WTO+,<sup>14</sup> comprehensive FTAs in the line described in ‘Global Europe, Competing in the World’:

- Regardless of the region or country, the EU wants its partners to adopt rules as developed as its own rules, liberalisation is normally to be achieved within 10 to 15 years (25 for the ACP countries), seeks commitments in all issues it deems key, and insists on the regional integration of its partners (‘size matters’ and the EU is looking for access to big markets).
- As for the accompanying measures and framework, sometimes trade liberalisation comes within an Association Agreement (AA);<sup>15</sup> at other times it is just an FTA. In the case of ACP countries, EPAs fall within the latter, although the other two pillars of what would be an AA are envisaged in the Cotonou Partnership Agreement (CPA).<sup>16</sup>

However, the rejection by some developing countries of issues the EU deems key makes reaching an agreement difficult. The different levels of political and economic power leave developing countries at a disadvantage in bilateral negotiations. With the 2004 and 2007 rounds of enlargement, the EU has become the most powerful trading block in the world and it increasingly uses its power ‘as a bargaining chip to obtain changes in the domestic arena of its partners’ (Meunier & Nicolaidis, 2006). It is the world’s leader in trade in goods, with a 17% share, and also the first trader of services, with a share of 28,5% of global trade in services (data for 2007, imports + exports, see Annex III). Increased access to the large and rich single European Market –with a population of 495 million people after the last enlargement in January 2007 and a per capita GDP (PPP) of €23.500 in 2006 (Eurostat, 2008)– can bring enormous benefits to developing countries through greater export-led growth. The opportunity cost for developing countries in case of failure to conclude an agreement is bigger than that of the EU. Thus, in exchange for preferential market access, developing countries may make concessions in other areas, including non-trade issues (such as the adoption of labour and environmental standards and human rights conventions)<sup>17</sup> that can sometimes clearly go against their interests. Negotiations thus tend to reflect a typical North-South cleavage: the EU aims at broad and comprehensive agreements, whereas developing countries normally focus on market access and do not want to include a great number of the other issues. This is one of the reasons why MERCOSUR, for instance, considered the potential deal not acceptable and the negotiations for a bilateral AA stalled in 2004.

Of course, the bigger the difference in economic development between the parties, the more common these imbalances and divergences are, as the EPA negotiations with ACP countries clearly show. Many of the ACP disagreed with both the content and process of the negotiations. They claimed that the EU dismissed the consideration of alternatives to far-reaching FTAs, tried to push through the EPAs issues that the ACP had expressly rejected at the multilateral level in the WTO,

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<sup>14</sup> ‘WTO +’ or ‘WTO plus’ is the term used to describe a Free Trade Agreement that includes issues that go beyond the parties multilateral obligations at the WTO.

<sup>15</sup> A European Union Association Agreement is a treaty between the EU and a non-EU country that creates a framework for co-operation between them. They generally have three pillars: trade, political dialogue and cooperation.

<sup>16</sup> The CPA is a partnership agreement between the EU and the ACP Group, signed in June 2000. Its main objective is to reduce poverty, consistent with the objectives of sustainable development and the integration of the ACP countries into the world economy. The CPA includes political dialogue and in addition civil society and social and economic actors are actively involved. Regarding trade, the CPA provides for setting up a new trade arrangement, characterised by reciprocal liberalisation in accordance with WTO rules.

<sup>17</sup> Developed economies such as the EU and the US have been trying to link trade and environmental, labour and Human Rights laws by including provisions on these issues in FTAs. Many developing countries have so far fiercely resisted this trend, as they think that they ought to decide on these issues for themselves; also, they see it as a form of protectionism for developed countries’ dying industries, whose higher labour costs and stricter environmental laws put them at a disadvantage when faced with competition from developing countries.

and did not give enough attention to the potential damaging effects that comprehensive EPAs could entail for development (floods of imports, loss of revenues from tariffs, destruction of infant industry, etc). For its part, the EU claimed that ACP countries needed to reform if they are to develop, that the former preferential trade regime had failed to promote economic development, was not WTO-compatible and was about to expire (at the end of 2007) and that ample liberalisation and more regional integration would bring about the standard gains from trade (more investment, lower prices for both industry and consumers, more transparency, etc). In the end, however, in order to secure market access to Europe, many ACP countries settled for interim agreements with the EU. To date, less than half of the ACP countries involved have concluded any form of agreement with the EU; the Caribbean was the only region that initialled a full EPA by the deadline of January 2008, and it has been the only one that has signed a full EPA with the EU, on 15 October 2008.

### **Implications for Developing Countries**

Trade agreements are important for development. Trade liberalisation helps to create bigger, more efficient, attractive and dynamic markets, thereby benefiting the economy at large. Bilateral trade agreements can also create political and economic ties between the parties, which in turn provide more stability.

However, FTAs between countries with vastly different levels of economic development may damage the weakest party. These FTAs are becoming more common and have been widely criticised by many in the development community. In its 2007 Trade and Development Report, the United Nations Conference on Trade and Development (UNCTAD) analysed the rising wave of North-South FTAs and the consequences these agreements may have for developing countries. Among other findings, the report concludes that:

- Reciprocity and national treatment (the obligation whereby foreign goods, services and economic operators must receive the same treatment as local ones) oblige developing countries to implement broad liberalisation in market access in goods, services and government procurement, which may result in surges of imports; moreover, tariff elimination, besides depriving developing countries of revenues, removes powerful instruments of industrial and agricultural policy to protect their infant industries.
- Market access gains for developing nations may be limited if agricultural subsidies in rich nations are not reduced; restrictive rules of origin, technical barriers to trade (TBTs) such as quality standards and supply-side constraints also limit the possible gains from improved access to developed countries' markets.
- Reduction of policy space for developing countries; many of the issues included in the current North-South FTAs 'reduce or fully remove policy options and instruments available to a developing country to pursue its development objectives' (UNCTAD, 2007).

The FTAs that the EU is currently negotiating certainly have the potential to provide developing-country partners with new trading opportunities and, by including issues such as investment, government procurement or competition, lock in reform in developing countries and be powerful tools for economic growth. Yet many of these issues, alongside having a great potential for development, may also be damaging. The challenge is finding the right balance between liberalisation and development and the right time to open up markets.

At first sight, it seems that developing countries have a lot to gain from liberalisation of trade in agricultural goods. The agricultural sector generates a very large proportion of GDP and employment in many developing countries, and plays an enormous role in the poorest of them, so enhanced access to the European market for their agricultural goods is an obvious way to promote development. Nevertheless, poor countries argue that any gains in market access will be limited as long as the EU keeps spending high amounts on agricultural subsidies, making it impossible for

their products to compete with European ones; furthermore, they argue that the CAP creates an oversupply of agricultural products that are then sold in the Third World at prices lower than the domestic ones, so opening up their agricultural markets to the EU could have harmful consequences for developing country farmers and for their food security as well.

Despite the fact that it has so far attracted less attention, reciprocal liberalisation of trade in industrial goods may, in the long run, prove to be of much greater importance. Besides improved market access to the EU, a high amount of developing countries' imports from the EU are capital goods and intermediate inputs, so reducing tariffs on imports of industrial goods from the EU will in turn directly reduce the costs of production in developing countries. However, if it is not carried out with great care, liberalisation of trade in industrial goods could eventually amount to a development catastrophe (Chang, 2005), as the poor countries' industrial sectors are, in many cases, either in their infancy or non-existent. Although many of the developing countries' efforts in their trade negotiations with the EU have been directed at reducing agricultural tariffs and subsidies (a sector where they have a clear comparative advantage), in the long run they will have to diversify production and industrialise if they are to develop. If they specialise in agriculture, an activity subject to diminishing returns (the production situation where, beyond some point, each additional unit of input yields less and less output), they would specialise in being poor (Reinert, 2007). Industry, as opposed to agriculture, is an activity subject to increasing returns (the production situation where output grows proportionately more than the increase in inputs or factors of production), so it is vital that developing countries are able to use the necessary tools of industrial policy to protect their infant industries until they are mature enough to compete with their European counterparts.

As for liberalisation in other areas, the EU argues that the inclusion of investment chapters in the FTAs is key to development, as strict rules on investors' protection together with a good investment climate would attract additional Foreign Direct Investment (FDI) to developing countries, necessary to stimulate private enterprise, create jobs and provide tax revenue and technology transfer. However, it is uncertain that stricter rules on and liberalisation of investment will eventually have these effects. Other factors such as the level of corruption, natural resources, good infrastructures or strong growth are also very important to attract FDI. The resistance of developing countries to fully liberalise investment comes from their worries that it would prevent them from designing specific development-friendly investment policies, such as setting conditions for foreign investment via entry requirements and performance, for example by limiting speculative investment, imposing foreign ownership ceilings or establishing content requirements (obligations whereby a foreign firm has to buy a certain proportion of its inputs from local suppliers).

Services –intangible activities such as education, transport, telecommunications or banking– represent the fastest-growing sector of the global economy and already account for two thirds of global output, one third of global employment and nearly 20% of global trade (WTO, 2008). For the EU, services are at the centre of the competitiveness strategy, as they represent 77% of the EU's GDP and employment (European Commission, 2006). Trade in services has been growing spectacularly in the last few years and is now the fastest growing area of trade. In some developing countries, services are the most important economic sector and have greatly contributed to boost economic performance. It is now widely admitted that liberalising services can bring enormous benefits to an economy in areas essential to development, such as lower transport costs or a more efficient financial sector. Foreign suppliers can indeed help developing countries' governments to provide essential public and business services and thereby improve the well-being of their citizens, create new opportunities for local firms and generate employment. However, liberalisation of trade in services might also have negative consequences, as it could reduce a government's ability to regulate (barriers to trade in services are regulations rather than tariffs, and liberalising services reduces the regulatory capacity of a government) and ensure that affordable basic services –like healthcare or education, critical to human development and poverty reduction– are available to all

its citizens, including the poorest ones. The quality and efficiency of a public administration are very important factors in order to make liberalisation of trade in services beneficial, and many developing countries do not have the adequate administrative and regulatory capacity. Liberalisation needs to take place in a gradual and carefully sequenced way, determining with great care which activities within the services sectors should be liberalised and which should not.

Another area the EU identifies as key is competition policy; it wants to include competition provisions in its FTAs on the grounds that anticompetitive practices and state aid can limit the benefits of enhanced access to third countries' markets. Competition policy is important for developing countries too; their markets, weaker and smaller than the EU's, are particularly vulnerable to anticompetitive practices, as they can easily be abused by dominant companies. But, when liberalisation takes place between countries with very different levels of economic development, competition law must be designed with care; if it is to eventually achieve the effects associated with competitive markets (such as stimulate innovation, increase efficiency or drive down prices), competition policy must be flexible and asymmetrical in favour of the weakest party (UNCTAD, 2005). Local firms in developing countries cannot compete in equal terms with European ones; if the competition provisions included in an FTA are too strict (as for example dramatically limiting the volume of state aid a developing country can give to its industry), instead of promoting more competition they might end up killing it altogether.

IPR are those, such as copyright, patents or trademarks, that give the inventors or owners of intellectual property –creations of the mind such as musical, literary, and artistic works; inventions; and symbols, names, images, and designs used in commerce– the exclusive right to derive certain benefits from their original idea or creation, thereby providing an incentive for the author or inventor to develop and share the information. They are essential to promote innovation and technological change but also have consequences for access to knowledge and information, all crucial issues for developing countries, as they have an impact on industrial policy, public health and education. Too strong a protection of intellectual property rights can lead to 'intellectual monopolies', harm the public interest and restrict access to knowledge or technology transfer. The challenge is finding an optimal situation between promoting innovation and guaranteeing public access to intellectual property, by using measures that allow technology transfer or reverse engineering.<sup>18</sup>

Government procurement provides yet another good example of an area that has a great potential for development but could be very damaging if handled wrongly. The gains from liberalisation for developing countries are clear, as rules to promote transparency and accountability in government procurement activities could help alleviate poverty through greater efficiency in public services delivery, as well as improve public expenditure procedures and reduce corruption (Evenett, 2002). Also, the EU member states deem transparency and accountability in government procurement vital for the EU to support Official Development Assistance (ODA), and it would help justify an increase in aid. However, there are reasons why the developing countries resist it. For one thing, they see government procurement as an instrument for the development of their industrial policy; juicy contracts with the government can help rear infant industries, and developing countries do not want to surrender this instrument to foreign contractors against whom local firms are unable to compete. Other reasons are fears of predatory pricing by foreign companies, leading to the eventual creation of monopolies that drive local firms out. Finally, developing countries may well be sceptical on their capacity to take advantage of public markets in the EU, and so they may feel that they are giving away an area with potential for development without, in practice, getting anything in return.

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<sup>18</sup> Reverse engineering is the process of discovering the technological principles of a device, object or system through an analysis of its structure, functions and ways of operating. It often involves taking something apart and analysing its workings in detail and then try to make a new, machine, device or programme that does the same functions but without copying anything from the original.

As seen, all the issues the EU wishes to include in its FTAs have important development implications for its partner countries. Liberalisation in these areas could, if managed properly, lead to economic growth, but it could also hamper it, reduce the policy space of poor countries and force them to accept measures that are not coherent with their development strategies.

### **Is There a Way Forward? The Role of Industrial Policy**

On the one hand, there is the EU commitment that development is a principal function of EU Trade Policy and that it will take the development needs of its partners into consideration. On the other, to put trade at the service of European companies so that they can compete worldwide, the EU needs far-reaching FTAs that, alongside the tariff liberalisation required by article XXIV<sup>19</sup> of the General Agreement on Tariffs and Trade (GATT), must include controversial issues that remain for the moment outside the WTO, such as the Singapore issues, expressly rejected at the multilateral level by developing countries. Are these FTAs compatible with the EU commitments on development?

The EU argues that they are compatible, wielding the standard principles in favour of trade liberalisation. The creation of large markets between poor countries would stimulate trade between them and private sector investment; larger markets with strict rules would attract foreign investors, so opening up to foreign investment would benefit the local economies: both consumers and industry would benefit from cheaper imports, the arrival of much needed capital and enhanced access to the advanced countries' markets. Trade liberalisation, to promote development, must be broad and deep, including trade in services, the removal of other TBTs and the adoption of policies conducive to a good trade and investment climate (transparency, measures against corruption and competition policy). The EU knows that the implementation of such measures is costly, and would provide the appropriate development assistance to poor countries to help them carry out the necessary domestic reforms and adjustment measures, tackle supply-side constraints and support institutional and productive-capacity development. Finally, enshrining all this in a formal, binding bilateral agreement would provide the process of reform in the developing partner with credibility.

Developing nations, critics of North-South FTAs and other actors –like Non Governmental Organisations (NGOs)– counter the EU position with the arguments stated above. Many developing countries simply lack the capacity to trade and are thus unable to take advantage of enhanced access to developed markets; even if they did, developed country subsidies and much more advanced production methods make it impossible for developing countries to compete with local products. Formal bilateral binding agreements would seriously reduce their policy space by taking away many instruments to promote economic development. The development assistance promised by the EU is not enough and, more often than not, it is ineffective.

The arguments from both sides are valid. As the EU correctly points out, trade liberalisation, though not a magic bullet for development, can be a powerful tool, as many of its benefits come not from exports, but from imports: imports of cheaper or better goods give consumers more for their money and, by sharpening competition, raise domestic productivity; developing countries need to reform if they are to develop and, with the global economy becoming ever more integrated, closed markets do not seem to make sense. The claims that the EU is furthering its own commercial interests while wrapping them in nice development talk and forcing developing countries into signing comprehensive FTAs make no sense, as the last minute deals with ACP countries to secure their

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<sup>19</sup> To be WTO compatible, Free Trade Agreements must comply with the reciprocity required by GATT Art. XXIV (8)(b), which says that duties and other restrictive regulations of commerce must be 'eliminated on substantially all the trade between the constituent territories in products originating in such territories'. Nevertheless, there is no agreement among WTO members on the meaning of 'substantially all the trade'. In the Doha Round negotiations there have been proposals to revise Article XXIV so that it would explicitly allow non-reciprocal relations in FTAs between developed and developing countries.

access to the European market prove.<sup>20</sup> Indeed, the EU wants to open markets abroad for its industry, yet trade is not a zero-sum game but rather one that, well managed, can bring benefits to all; as the world's biggest trading power, the EU knows that the development of poor countries is in its interest, too, as the consequences of poverty go far beyond world trade and are much more dangerous for Europe than the lack of access to developing countries' markets.

Yet as developing countries correctly point out, too, although they acknowledge that trade is important for development and that they need to integrate into the world economy, if they liberalise too quickly and too deeply their industries could be simply wiped out, since premature exposure to competition can be devastating; market access to developed countries is not enough, as they lack capacity to trade and compete, and liberalisation would deprive them of important instruments to rear their infant industry. If the answer were as simple as free trade, these countries would have already liberalised unilaterally. But no country has ever developed by just opening up; rather, 'all of today's rich countries used protectionism and subsidies, while discriminating against foreign investors' (Chang, 2007).

In fact, those trade restrictions have been an explicit part of the growth strategies of the most successful countries (Stiglitz & Greenwald, 2006). Before opening up their markets, all of the now developed countries knew that they would not develop by producing and exporting agricultural goods but through industrialisation. Therefore, they used extremely activist industrial policies to shift away from agriculture towards manufacturing and industry, and turned to *laissez-faire* policies only once their industries were mature enough to compete internationally. Even Adam Smith praised England's 18th-century policy of high tariffs and the Navigation Acts that protected English shipping and manufacturing industries against foreign competition, calling them 'perhaps, the wisest of all commercial regulations of England' (Smith, 1976). As for developing countries, while the result of their industrial policies in the last decades is mixed, some of them succeeded spectacularly using import substitution, planning, and state ownership; indeed, it is difficult to come up with real winners in the developing world that are not a product of industrial policies of some sort (Rodrik, 2004; Amsden, 2008).

History therefore provides some important lessons for developing countries. Despite the fact that agriculture remains in many cases their major economic activity and enhanced market access, together with the CAP reforms currently underway, will benefit agricultural exporters in the EU's developing FTA partners, these countries have to ensure that this is not in the detriment of their manufacturing industries and, therefore, of economic development in the long term. Once qualitative differences between economic activities –those that are subject to increasing returns and those that are not– are introduced in international trade theory, the gains from trade do not only come from specialisation, as David Ricardo's theory claims, but from economies of scale, as bigger markets allow the firms engaged in activities subject to increasing returns –in other words, industrial activities and services– to expand production (Krugman, 1979, 1990). Specialisation in agriculture, subject to diminishing returns, could lock developing countries in a vicious circle of poverty.

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<sup>20</sup> Many organisations claimed that the EU was forcing ACP countries to sign comprehensive FTAs before the January 2008 deadline by threatening to withdraw the generous market access the ACP enjoyed to the EU. This is simply not right. The non-reciprocal preferences in trade between the EU and the ACP were discriminatory and thus illegal at the WTO, and January 2008 marked the expiry of the WTO waiver necessary to maintain those preferences during the negotiating period. In the end, the EU allowed the ACP to keep their market access through interim deals. In the last minute rush most ACP countries did not promise too much: 'to cut tariffs on over 80% of EU imports, but not before 2022. The claim by strident non-governmental organisations, that the EU was intent on prising open ACP markets to satisfy its own commercial interests, was always overblown. Most ACP markets are just too small to excite such mercantile greed' (*The Economist*, 3/1/2008).

The EU's developing FTA partners should therefore identify how an FTA with the EU might help them to put trade policy and liberalisation at the service of industrial policies that encourage industrialisation, restructuring, technological change and diversification. To that end, protection of infant industries in the first stages of industrialisation (via tariffs, subsidies, state intervention, capital controls, monopoly rights, content requirements or other tools to encourage industrialisation and diversification) may be necessary to promote a diversified economy and create jobs. If developing countries succeed in creating competitive industries, trade will eventually be a necessary condition for development but, for that, liberalisation should take place only when these industries have grown to be sufficiently large to compete internationally.

## Conclusions

The notion that free trade is always beneficial for all parts involved, going back more than two centuries to the theories of Adam Smith and David Ricardo, must be regarded with the utmost caution in the case of bilateral liberalisation between countries with vastly different levels of development. As the 19th-century German economist Friedrich List, father of the infant industry argument, put it, 'free competition between two nations... can only be mutually beneficial in case both of them are in a nearly equal position of industrial development, and that any nation which owing to misfortunes is behind others in industry, commerce, and navigation... must first of all strengthen her own individual powers, in order to fit herself to enter into free competition with more advanced nations' (List, 1841). In other words, for liberalisation to benefit developing countries, these must be allowed to first build their industries.

Fortunately for developing countries, they do not face a choice of either autarky or free trade, but rather one among different trade regimes with different degrees of liberalisation. The recent success of the so-called East Asian Tigers (Taiwan, South Korea, Hong Kong and Singapore), or China shows that careful and gradual liberalisation can lead to poverty reduction; their export-oriented models of economic growth, coupled with high protection of infant industries until they were ready to compete internationally, provides a good example of how to put trade at the service of development.

To make trade really work for the poor, the EU should continue to provide and enhance special and differential treatment towards developing countries so that they can protect their infant industries (via tariffs, subsidies, state intervention or any other tools) until they are strong enough to withstand European competition; a more pro-poor interpretation of GATT Article XXIV is also needed. Regarding autonomous measures, the EU should continue to provide these countries with enhanced market access and assistance to really benefit from it: the GSP and Aft are powerful instruments for development, but more efforts are needed to increase aid effectiveness, and market access also implies the reduction of trade-distorting subsidies.

Developing countries, the EU and other international donors should keep on working together to increase aid and its effectiveness; reforms in many developing countries have enhanced their capacity to use resources productively, which calls for an increase in ODA. Alongside a scaling up of aid, the emergence of new donors, such as China, and of new modalities of aid, promises more resources and innovation, but it also means a new challenge for aid effectiveness.

Finally, developing countries should not bury their heads in the sand; they should take a forward looking approach, establish first their own development strategies and industrial policies and then identify how an FTA can serve as a catalyst in the process; the strategies will undoubtedly vary depending on the characteristics of the country concerned, but four areas are essential to achieve sustainable and inclusive growth: (1) sound macroeconomic policies; (2) an industrial policy coherent with their level of development; (3) a good private investment climate; and (4) good governance. A comprehensive FTA could help advance in the right direction in all four.

Development implies change, and developing countries must undertake much needed reforms to diversify, raise productive and institutional capacity (reforms that go beyond plain trade policy and include other areas such as education or health), build up their industries and achieve stability so as to be able to gradually open up their markets and eventually join the world economy.

*Enrique Valerdi Rodríguez*  
*European Commission*

## **ANNEX I. EU Free Trade Agreements and Bilateral Trade Relations**

### **Concluded FTAs**

#### *Euromed (nine countries): Euro-Mediterranean Agreements*

Since the first Euro-Mediterranean Conference in 1995, the EU and Mediterranean countries have been involved in talks with the object of forming, by 2010, a single Euro-Mediterranean Free Trade Area. Exports to the EU have grown by an average 10% a year since 2000, whereas imports from the EU have increased by 4% since 2000. In 2007, 42% of total Euromed countries' imports came from the EU and 41,3% of their exports went to the EU.

To date, bilateral AAs have been concluded with eight of the nine countries (Syria has not yet concluded an AA with the EU). Associated countries enjoy duty-free access to the EU market for manufactured goods and preferential treatment for exports of agricultural, processed agricultural and fisheries products. Tariffs will gradually be dismantled for EU exports to the Mediterranean region –the process has already been completed in Tunisia–. The objective is substantially liberalised trade in goods and services between the EU and its Mediterranean partners, who already enjoy very open access to EU services markets. Further progress, including attracting new investment to the region, is being negotiated.

#### *South Africa: Trade, Development and Cooperation Agreement (TDCA)*

South Africa is the EU's largest trading partner in Sub-Saharan Africa. In 2007, 36.4% of total South African imports came from the EU and 34.9% of its exports went to the EU. The outward flow of EU FDI to South Africa in the year 2000 amounted to €2.5 billion, bringing the stock of EU FDI in the country to €9.7 billion.

The TDCA between the EU and South Africa was signed on 11 October 1999 and has been in force provisionally and partially since January 2000 and fully since May 2004. Its main objective is to create a free-trade area between South Africa and the EU over an asymmetric, transitional period of 12 years –meaning that the EU and South Africa will open their markets to each other at a different pace–. Since the provisional application of the TDCA in January 2000, South African exports to the EU went up by 46%. From 2003 to 2005, trade flows between the two parties increased by 21%. Almost 90% of imports from South Africa are either at zero duty or under tariff preferences. By the end of the transitional period (2012), the TDCA foresees that 95% of South Africa's exports to the EU and 86% of the EU's exports to South Africa will receive duty free treatment.

#### *Chile: EU-Chile Association Agreement*

Trade with Chile represents 0.7% of EU imports and 0.4% of EU exports, placing Chile as 36th in the ranking of the EU's main trade partners. The EU accounts for 23.9% of Chile's exports and 13.8% of Chile's imports, and is Chile's leading trading partner.

Signed in November 2002, the agreement has been provisionally in effect since 1 February 2003. Besides covering political dialogue and cooperation issues, it is the trade chapter in the Association Agreement that stands out as the most far-reaching in all of the EU's regional agreements to date,

going well beyond the parties' respective obligations at the WTO. It covers a free trade area in goods, services and government procurement, liberalisation of investment and capital flows, the protection of intellectual property rights, co-operation for competition and an efficient and binding dispute-settlement mechanism.

#### *Mexico: Economic Partnership, Political Coordination and Cooperation Agreement*

The EU is Mexico's second main trading partner and an important contributor to Mexico's FDI. In 2007, 12% of total Mexican imports came from the EU and 5,6% of its exports went to the EU. The EU's participation in Mexico's trade in 1990 was above 10.9% and before the FTA it reached its lowest point in 1996 to an amount of only 6.1%. The EU's main exports are power generating machinery, transport material and chemical products, while Mexico's main exports are machinery, energy, transport equipment, automotive products, chemical products and agricultural products.

The Economic Partnership, Political Coordination and Cooperation Agreement, known as the Global Agreement, between the EU and Mexico, was signed on 8 December 1997 and entered into force on 1 October 2000. It is very comprehensive, including trade in goods, services, procurement, competition, IPR, investment and related payments. Trade flows within the FTA grew by 25.5% since its entry into force. The EU's market share of Mexico's total trade after the FTA has shown a recovery. In 2001, it accounted for 7.2% of total EU trade (10.3% of Mexican imports came from the EU and 4% of Mexican exports went to the EU).

### **Negotiations suspended**

#### *MERCOSUR (4 countries): Association Agreement EU – MERCOSUR*

The EU is MERCOSUR's second-largest trading partner after the US, accounting for 19.6% of total MERCOSUR trade (imports + exports). MERCOSUR ranks 8th among the EU's trading partners, accounting for 3% of total EU trade in 2007. In 2007, 21% of total MERCOSUR imports came from the EU and 18.7% of its exports went to the EU. The EU is MERCOSUR's main market for agricultural exports. EU exports to MERCOSUR focus largely on industrial products including machinery, transport equipment and chemicals. The EU is the largest investor in MERCOSUR.

As of 2008, 16 negotiating rounds have been conducted. The agreement should go beyond the respective obligations of the parties in the WTO. In October 2004, at a MERCOSUR-EU trade negotiators meeting, Ministers concurred that the offers on the table did not reach the degree of ambition that both parties expected and decided to give negotiations more time. MERCOSUR was not satisfied with the EU's agricultural market access provisions and the EU found MERCOSUR's proposals to open their telecommunications sector and upgrade protection of European geographical indications lacking. Negotiations have only taken place at a technical level since 2004. With greater clarity on the likely result of the Doha Round, full negotiations might be launched again, although it could be argued that any results will be closely linked to CAP reform in Europe.

### **Advanced stages of negotiations/Concluded**

#### *ACP (76 countries): Economic Partnership Agreements (EPAs)*

For most ACP countries –and for virtually all African ACP countries– the EU is the main trading partner; market access for ACP nations is very good (around 98% of ACP goods can enter the EU duty-free). Trade between the ACP and the EU has remained important for the ACP, for which the EU is the leading market (22.3% of ACP exports go to the EU) and the second biggest supplier (25.2% of ACP imports come from the EU); also, the EU is still the largest market for ACP agricultural goods –a crucial market for them as agriculture is by far their largest sector in terms of employment–. Trade with the ACP has, however, remained of little importance for the EU (2.9% of total EU exports and 3% of total EU imports in 2007). The main products traded are: as regards ACP exports, petroleum, followed by cocoa beans and diamonds; and as regards EU exports,

machinery, followed by oil, vehicles, ships/boats and medicines. EU investment flows to the ACP increased from €1,922 million in 1996 to €4,319 million in 2002, which accounted for a 3.3% share of total EU outflows. The relative importance of the ACP as a destination for investment has increased. EU capital employed in the ACP increased from 2.5% of total EU outward stock in 1996 to 3.1% in 2002.

In the CPA, the EU and the ACP agreed to replace the former preferential trade regime by reciprocal free trade agreements (EPAs). After difficult negotiations in which the ACP countries stated they were not ready to sign comprehensive EPAs, only the Caribbean initialled a full EPA by the deadline (1 January 2008). To establish a new WTO-compatible trade regime from 1 January 2008 and secure generous market access for ACP, most African non-LDCs and two Pacific non-LDCs concluded interim agreements with the EU. LDCs were allowed to maintain their market access to Europe under the special regime 'everything but arms'.

In total, 35 ACP countries initialled either a full or an interim agreement by the end of 2007. Negotiations for full, comprehensive EPAs are ongoing. The Caribbean is the only region that has signed an EPA (15 October 2008).

### **Under negotiation**

#### *India: EU-India FTA*

The EU is the principal market for India's exports (21.9% in 2007) and also its leading supplier (18.6% of total Indian imports in 2007). EU-India trade has grown impressively and doubled from 2003 to 2007. For the EU, India accounts for 2.4% of its exports and 1.8% of its imports. The EU's principal exports to India are machinery and transport equipment and manufactured goods, whereas its main imports from India are manufactured goods. EU investment in India has more than trebled from 2003 to 2006.

Negotiations were launched in June 2007. The EU expects the FTA to be fully WTO-compatible, ambitious and comprehensive, covering not only trade in goods and services but also investment, and paying special attention to non-tariff barriers and rules and regulations such as IPR, competition, government procurement and transparency. However, and despite the joint commitment (expressed by both sides at an EU-India summit in September 2008) to speed up the talks, conclusion is still far away. Besides, India has stated it wants to exempt a number of sensitive products from the deal.

#### *CA (six countries): EU-CA Association Agreement*

Most of CA's trade (74%) is with the US and Latin America. The EU's share in CA trade (imports + exports) has remained stable at around 11% over the past 10 years. In 2007, 10.1% of total CA imports came from the EU and 16.5% of its exports went to the EU. The structure of CA exports to the EU is dominated by agricultural products, followed by integrated circuits and components for data processing. The most important exports from the EU to CA are machinery, chemicals, ships, boats, vehicles and fuels. In terms of foreign investment, Costa Rica and Panama are the two countries attracting the most EU FDI, although the US is still the principal investor in the region.

In April 2007, the EU adopted its negotiating mandate for an AA with CA. In the trade area, the EU wants a comprehensive FTA that will deal with all trade components, be fully consistent with WTO rules, and reinforce regional integration in the region. The sixth round of the negotiations will take place in Brussels in January 2009. The EU expects to conclude the negotiations in 2009.

#### *CAN (four countries): EU-CAN Association Agreement*

The EU is, after the US, the second-largest trading partner for the CAN, whereas the CAN ranks 35th among the EU's main trade partners, with imports and exports totalling 0.6% of EU world trade. In 2007, 12.2% of total CAN imports came from the EU and 16.6% of its exports went to the

EU. EU imports from Andean countries comprise raw materials, notably mining, agriculture and agro-industry. EU exports are focused on manufactured goods, notably machinery, chemical products and transport equipment. The EU is also the leading investor in CAN and accounts for a significant share of total FDI in the region, mainly in sectors such as financial services, mining, oil extraction and manufacturing.

The EU adopted its negotiating mandate together with that for CA. Also with the CAN, the EU wants a comprehensive FTA that will deal with all trade components and be fully consistent with WTO rules. Negotiations were nevertheless put on hold in July 2008 due to disagreements between both parties and also between the members of the Andean Community themselves. Abandoning the block-to-block approach, individual negotiations for the trade chapters of the AA were launched in January 2009 with Colombia and Peru (the two Andean countries that have an FTA with the US), and various sources have indicated that Ecuador is likely to join; the President of Bolivia, Evo Morales, has nonetheless said that this approach cannot be accepted and that it will deepen the crisis in the CAN.

*ASEAN (10 countries): EU-ASEAN FTA*

The EU is ASEAN's second-largest trading partner, accounting for 11.7% of ASEAN trade (2007). Significantly, 12.8% of ASEAN exports are destined for the EU, which makes it ASEAN's second-largest export market after the US, and 10.8% of ASEAN imports come from the EU. ASEAN as an entity is the EU's fifth-largest trading partner. ASEAN's trade with the EU has been growing steadily over the past five years, with an average annual growth rate of 4%. The EU's main exports to ASEAN in 2006 were chemical products, machinery and transport equipment, and its main imports from ASEAN were machinery and transport equipment, as well as chemicals, textiles and clothing. The EU is by far the largest investor in ASEAN countries: 27% of total FDI inflows from 2001 to 2005 come from the EU, compared with 15% from the US.

In April 2007 the Council authorised the Commission to start negotiating an FTA with ASEAN. In May 2007, the two sides confirmed their shared desire to enhance economic relations by establishing an FTA providing for comprehensive trade and investment liberalisation and agreed to start negotiations. The fifth round was held in Manila in June 2008. ASEAN's lack of regional cohesion and its scarce resources (the group is currently negotiating a large number of FTAs) has complicated the negotiations. The EU's former Trade Commissioner Peter Mandelson said that it would take at least three years to complete the negotiations, and that the eventual outcome was not likely to achieve the level of ambition desired by the EU.

*GCC (six countries): EU-GCC FTA*

The GCC is currently the EU's fifth-largest export market and the EU is the top trading partner for the GCC. In 2007, 31% of total GCC imports came from the EU and 21.9% of its exports went to the EU. The main EU exports to the GCC are machinery and transport materials (power generation plants, railway locomotives and aircraft as well as electrical machinery and mechanical appliances), whereas its main imports from the GCC are fuels and derivatives (70% of total EU imports from the region in 2006).

The 1988 Cooperation Agreement contained a commitment from both sides to enter into negotiations on an FTA. The negotiations were initiated in 1990 but soon reached a standstill. In 1999, the negotiations regained momentum after GCC created a customs union. Negotiations resumed in March 2002 with a new, wider mandate covering market access for goods and services, IPR, competition, dispute settlement, rules of origin, human rights, illegal immigration and terrorism. The aim of the agreement is to provide for progressive and reciprocal liberalisation of trade in goods and services, aiming to ensure a comparable level of market access opportunities, taking account of GCC countries' level of development.

#### *South Korea: EU-South Korea FTA*

South Korea is the EU's eighth-largest trade partner (2% of total EU exports and 2.8% of imports in 2007) and the EU has become South Korea's second most important trade partner (14.3 % of all Korean exports and 10.8% of all Korean imports in 2007). EU trade with South Korea has enjoyed an annual average growth rate of 11% between 2003 and 2007. The EU has been the single largest foreign investor in South Korea since 1962, and accounted for almost 45% of all FDI inflows into Korea in 2006.

South Korea was designated a priority FTA partner in the Global Europe trade policy strategy of 2006. The objective is a comprehensive and ambitious FTA, including far-reaching liberalisation of services and investment. The negotiations are advanced, but there are some disagreements. Both sides complain that the other is unwilling to match concessions commensurate with those already contained in the South Korea-United States (KORUS) FTA signed in June 2007. The last round of talks –the seventh to date– took place in Seoul in late August. Some progress on issues of concern to the EU, including standards and certification requirements and increased protection of geographical indications, was reported.

#### *Ukraine: EU-Ukraine FTA*

The EU is the Ukraine's leading trade partner. EU-Ukraine trade reached over €34 billion in 2007, and has been growing steadily in the recent years. In 2007, 45.6% of total Ukrainian imports came from the EU and 31% of its exports went to the EU. For the EU the Ukraine is its 16th-largest trading partner and its 13th-largest export market. The EU is also the largest foreign investor in Ukraine with a growing share every year (71.7% by the end of 2005). Most FDI goes to the financial sector, followed by domestic trade, real estate, metallurgy, food, beverages and tobacco production, construction and machine building.

Negotiations were launched in February 2008, after the Ukraine joined the WTO (a prerequisite for the FTA). The agreement aims for 'deep convergence', not just cutting tariffs but addressing red tape for exporters by aiming for similar regulatory standards and norms in both economies.

Sources: European Commission (DG Trade and DG External Relations), *The Economist*, IMF (Direction of Trade Statistics).

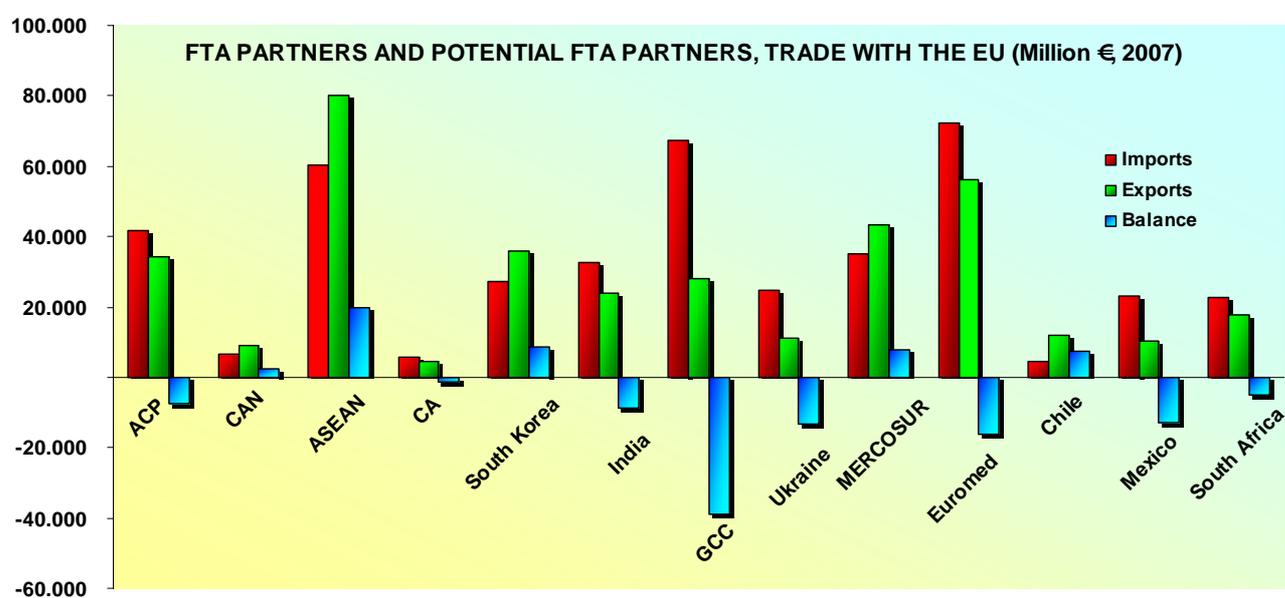
## ANNEX II. FTA PARTNERS' TRADE WITH THE EUROPEAN UNION

### POTENTIAL FTA PARTNERS TRADE WITH EU (2007, Million €)

Country/Region	Imports from EU	% of total imports	Exports to EU	% of total exports	Balance
ACP	41.595	25,2	34.304	22,3	-7.292
CAN	6.404	12,2	8.986	16,6	2.582
ASEAN	60.228	10,8	80.142	12,8	19.914
CA	5.751	10,1	4.310	16,5	-1.440
South Korea	27.296	10,8	36.041	14,3	8.745
India	32.507	18,6	23.756	21,9	-8.752
GCC	67.195	31,0	28.164	9,0	-39.031
Ukraine	24.687	45,6	11.284	31,0	-13.403
MERCOSUR	35.297	21,0	43.244	18,7	7.947

### FTA PARTNERS TRADE WITH EU (2007, Million €)

Country/Region	Imports from EU	% of total imports	Exports to EU	% of total exports	Balance
Euromed	72.493	42,0	56.289	41,3	-16.205
Chile	4.384	13,8	11.769	23,9	7.385
Mexico	23.251	12,0	10.256	5,6	-12.995
South Africa	22.620	36,4	17.667	34,9	-4.953



EU: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom  
 ACP: Angola, Antigua and Barbuda, Bahamas, Barbados, Belize, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Congo (Brazzaville), Congo (Kinshasa), Cook Islands, Côte d'Ivoire, Djibouti, Dominica, Dominican Republic, Equatorial Guinea, Eritrea, Ethiopia, Fiji, Gabon, Gambia, Ghana, Grenada, Guinea, Guinea-Bissau, Guyana, Haiti, Jamaica, Kenya, Kiribati, Lesotho, Liberia, Madagascar, Malawi, Mali, Marshall Islands, Mauritania, Mauritius, Federal States of Micronesia, Mozambique, Namibia, Nauru, Niger, Nigeria, Niue, Palau, Papua New Guinea, Rwanda, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, Sao Tome and Principe, Senegal, Seychelles, Sierra Leone, Solomon Islands, Somalia, Sudan, Suriname, Swaziland, Tanzania, Togo, Tonga, Trinidad and Tobago, Tuvalu, Uganda, Vanuatu, Zambia, Zimbabwe.

CAN: Bolivia, Colombia, Ecuador, Peru

ASEAN: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam.

CA: Costa Rica, Guatemala, Honduras, El Salvador, Nicaragua, Panama

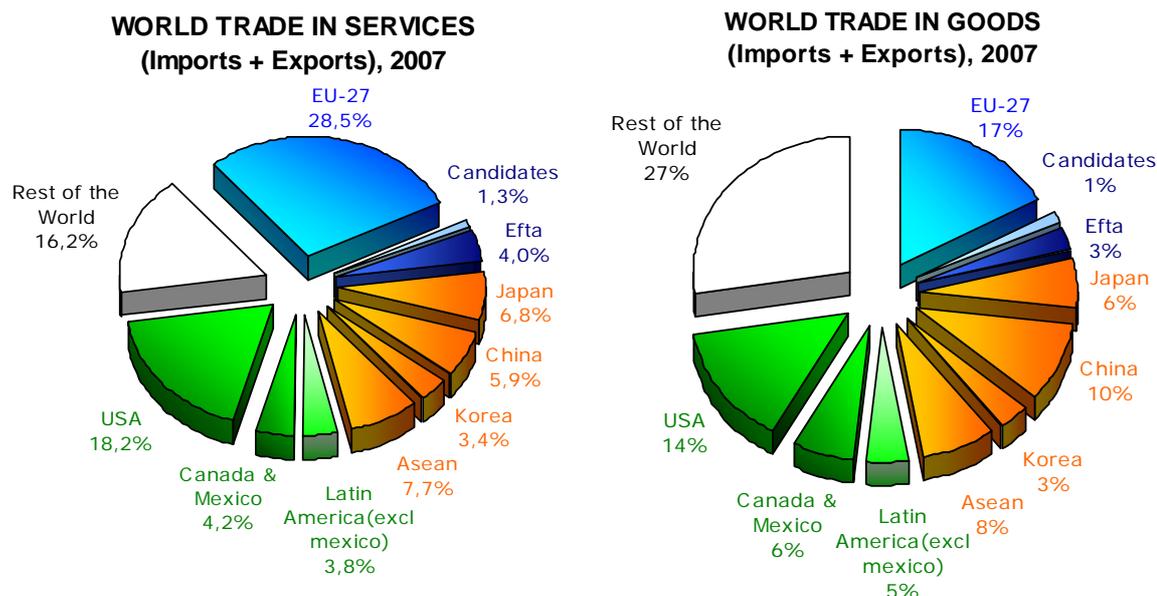
GCC: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates.

MERCOSUR: Argentine, Brazil, Paraguay, Uruguay, Venezuela

Euromed: Algeria, Egypt, Gaza and Jericho, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia.

*Source: IMF, direction of trade statistics (DOTS)*

## ANNEX III. EUROPEAN UNION SHARE OF GLOBAL TRADE



Source: European Commission, Directorate General for Trade

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