

# TWIN SEEDS WP1

Working Paper n. 1-01

**How has shifting EU trade policy in multilateral, bilateral and unilateral contexts shaped EU-oriented GVCs?**

List of authors:

Author Name	Participant organisation name	Country
Louise Curran	TBS Education	France

## ABSTRACT

The objective of this paper is to explore how EU trade policy shifts in the 21st century have impacted on the evolution of EU-oriented GVCs in the manufacturing sectors and to build on this analysis to identify the most important areas of trade policy that will require analysis in the post-COVID context. In so doing I signpost the key policy areas where the TWIN SEEDS project should focus. To support the analysis, I draw on existing work and new data to highlight how trade policy evolutions at multilateral, bilateral and unilateral levels have encouraged EU firms to restructure their value chains in recent years. Building on this work, I update and expand a recently developed framework for analysing the impact of trade regimes on GVCs which will be used to guide our future research.

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## **1. Introduction**

The objective of this paper is to explore how EU trade policy shifts in the 21<sup>st</sup> century have impacted on the evolution of EU-oriented GVCs in the manufacturing sectors and to build on this analysis to identify the most important areas of trade policy that will require analysis in the post-COVID context. In so doing I signpost the key policy areas where the TWIN SEEDS project should focus. To support the analysis, I draw on existing work and new data to highlight how trade policy evolutions at multilateral, bilateral and unilateral levels have encouraged EU firms to restructure their value chains in recent years. Building on this work, I update and expand a recently developed framework for analysing the impact of trade regimes on GVCs which will be used to guide our future research.

The paper is structured as follows, I firstly present our approach and methodology, before putting the research in context, by providing a brief overview of the key changes in the global environment over the century so far, which have impacted on EU trade policy objectives and formulation. I then analyse the main evolutions at the different levels of trade policy and their impacts highlighting, in particular, novel issues that are likely to affect future trade and that will therefore require analysis in later WPs. Drawing on this work I propose a revised schema which will guide the trade policy related work in TWIN SEEDS going forward.

## **2. Approach and methodology**

This paper draws on a variety of existing work (including by the author) where scholars have interrogated the interactions between trade policy and GVCs, in a range of academic disciplines. These include international economics, international business, economic geography, development studies and international political economy. The objective is to leverage this work to develop a firm basis for the analysis of the trade policy impacts on GVCs that will be undertaken in later TWIN SEEDS WPs.

In the following discussion, when I refer to 'trade regimes', I am primarily referring to the bilateral agreements and unilateral preference provision which secure greater market access for certain suppliers. 'Trade policy' includes a wider range of measures, including trade defence. Finally, I also include discussion on a further set of policy measures with trade effects, which are not primarily seen as trade policy, but have (often significant) impacts on trade. This includes a wide range of Non-Tariff Measures (NTMs) which regulate whether and how goods enter the EU market.

Where necessary and where research is limited, I supplement existing work with novel analysis, particularly of trade flows. In most cases I use the data from the International Trade Centre (ITC) on merchandise trade flows. This database is based on UN trade data declarations, but it is cleaned and extended, notably by including mirror flows to

fill in gaps in declarations. It therefore provides a comprehensive and up to date basis for analysis. Where necessary, this data is supplemented with other international sources including OECD and UNCTAD.

The dynamics of trade is often a key issue, especially how flows react to policy interventions like the implementation of an FTA or integration into preferential market access schemes. For this analysis, I build on previous research by Ahipeaud et al. (2021) and DG Trade (2013) and use indices to facilitate the comparison of trends across countries with different trade volumes. I use the year before the relevant policy change as the reference year and compute trends on this basis. The trade index (Ti) for each year is calculated as follows, with year R the reference year and n the number of years since R.

$$\text{Trade index (Ti)} = (\text{Trade year R} / \text{trade year R+n}) * 100$$

Given that trade dynamics have varied extensively in the last two decades in reaction to a variety of factors, most notably the Global Financial Crisis (GFC) and the ensuing Eurozone crisis, trends in trade following policy change may also reflect wider market developments. Therefore, I also compare the overall index of trade flows, with the index of all trade for the same time period. This enables me to get a view of the relative performance of trade partners subject to policy change compared to others and isolate any effects that may be attributable to the policy intervention. The calculation is as follows:

$$\text{Rel Ti} = \text{Ti country A} - \text{Ti all trade}$$

For this relative trade index, values above zero indicate that trade grew more than all trade, while negative figures indicate the opposite.

### **3. Trade policy and global value chains – a framework for analysis**

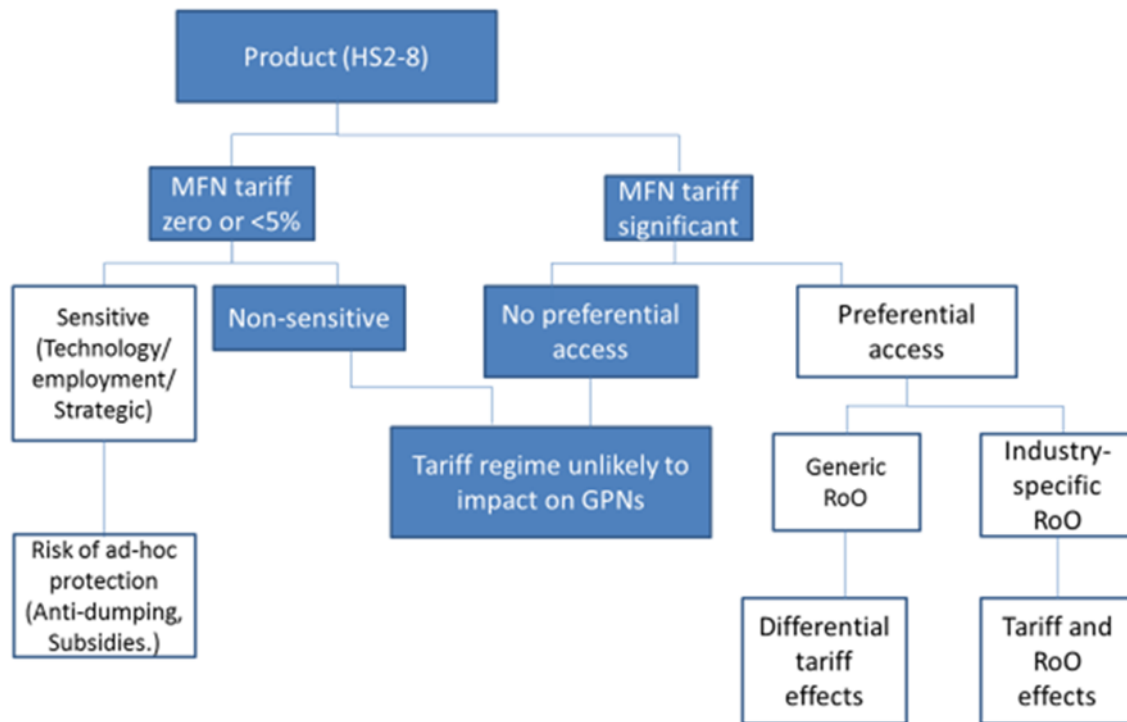
At its basic level, trade policy decides whether and how taxes (or other costs) will be applied to imports (and sometimes exports), which trade partners are subject to them under the various trade regimes and under what conditions. Although obviously the level of the tariff is important, if all suppliers paid the same costs at import (or export) then the various trade regimes would have no impact on GVCs, as lead firms would simply choose between competing overseas suppliers on the basis of relative costs. It is precisely because most countries provide preferential access to certain suppliers that trade regimes and their attendant rules are relevant to shaping GVC structures. Recent work by Curran, Nadvi and Campling (2019) provides a useful framework (reproduced in Schema 1) for analysing where and how trade regimes should be taken into account in GVC analysis.

The key factors of importance that they underline are:

*The level of the Most Favoured Nation (MFN) tariff* - This is the standard tariff applied to all trade partners (or at least those which are members of the World Trade Organization (WTO)). If MFN tariffs are zero or very low, then the difference between trade costs for preferential and standard suppliers is limited and therefore trade regimes are unlikely to be core factors in relative competitiveness. In this case, the main case where trade policy may become relevant is if products become sensitive for political reasons, or because of rapidly growing competition (e.g. steel, renewable energy products), such that contingent measures such as anti-dumping duties provide temporary protection and distort trade flows (Curran, 2015).

*The extent of preferential access* - For products where the MFN tariff is significant (more than 5%) this increases trade costs and thus makes those suppliers subject to the tariff less competitive. If some suppliers benefit from tariff reductions, or don't pay any tariffs, trade regimes are likely to impact on GVCs. The greater the number of suppliers subject to preferential access, the lower the effect. Thus, for example, if all developing countries were accorded zero tariff access to the EU market for a certain good, the trade regime would be less impactful than if only Least Developed Countries (LDCs) benefited from preferential access.

*The Rules of Origin (RoO) applied to the preferential tariff* - All trade preferences are subject to certain conditions, most notably preferential tariffs are only applied to goods 'made in' the country subject to the preferences. The definition of 'made in' varies by trade regime and sector, sometimes significantly, but generally the RoO define the origin of a product in terms of a fundamental change in the nature of the product in a given country *or* the source of the intermediate products incorporated into the good *or* whether certain production processes are undertaken in the country *or* a combination of two of these. Almost by definition, regulations which require a certain set of production processes (or a certain percentage of the value-added of a product) to be undertaken in a given country impact on GVC structures by providing tariff advantages to products made in certain ways or using certain inputs compared to others.



*Schema 1 – A framework for integrating trade regimes into GVC analysis (Curran et al, 2019).*

In the rest of this paper, I will draw on this framework to support the analysis of how the shifting trade regimes of the EU this century have impacted on certain GVCs. However, I will also seek to expand the framework, to take into account a wider range of trade (and related) policy instruments and help us to anticipate the impact of recent and future policy shifts. The objective is to provide a more extensive framework on which to base the analysis within the TWIN SEEDS project and ensure that our work incorporates a comprehensive view of how trade regimes and other aspects of trade policy will impact on post-COVID GVCs.

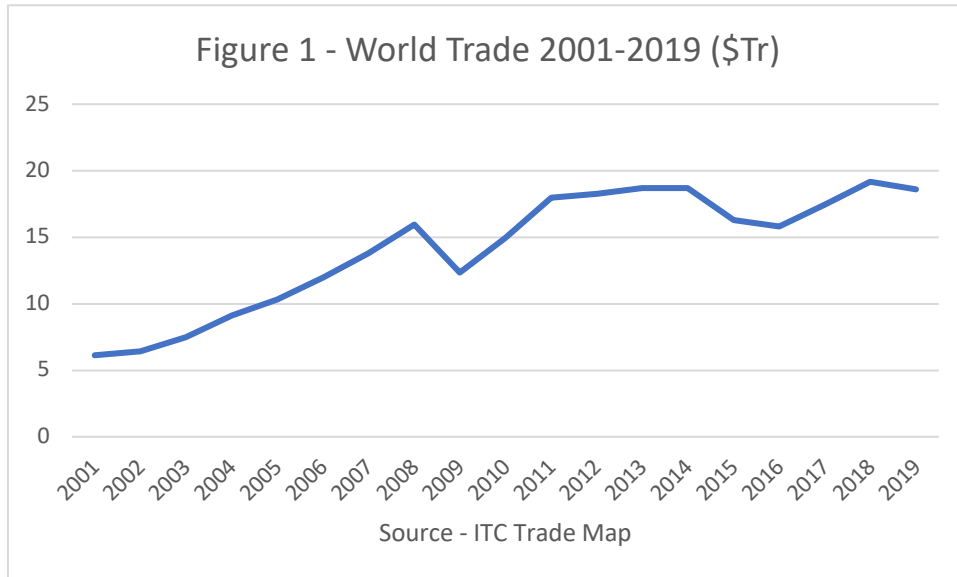
For example, the analysis will note that tariffs are not the only aspects of trade regimes and policy which impact on GVC choices. Non-tariff measures (NTMs) also increase trade costs and therefore agreements which reduce these barriers (such as mutual recognition agreements, or harmonized standards) can also favour certain sources over others. This is particularly the case in some of the EU’s recent Free Trade Agreements (FTAs) discussed below. This issue is explored in more detail in deliverable 1.4. which complements this analysis. In the last section, I will propose a revised, extended framework which includes such non-tariff factors and which will guide our work going forward.

#### 4. The overall context – trade growth stifled and shifts in the structure of trade

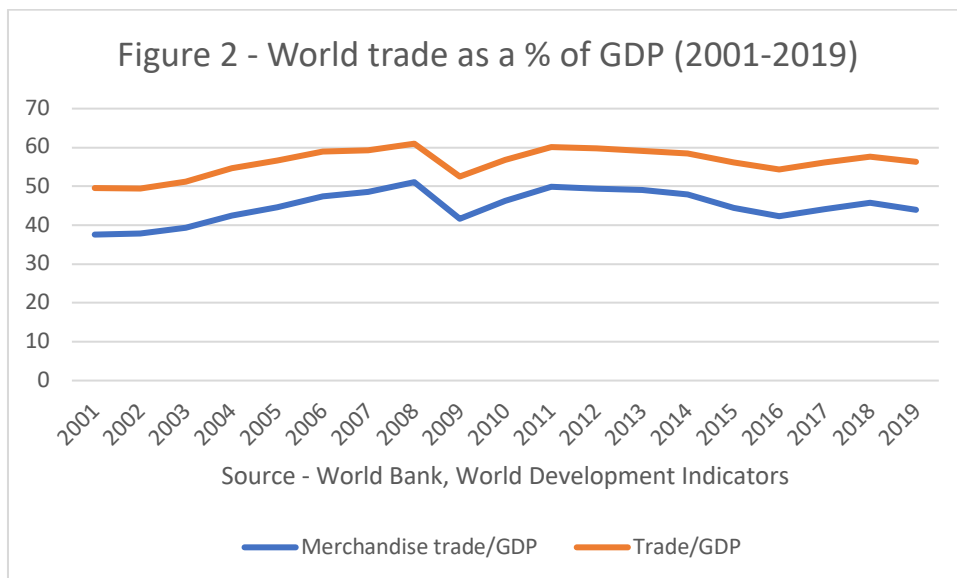
To understand recent shifts in the EU's trade regime it is important to put them into context. The first two decades of the 21<sup>st</sup> century have seen quite diverse trends. Strong integrationist trends dominated prior to the GFC in 2008-9. This was followed by a period of economic instability, especially in Europe and the emergence of a less dynamic, more sceptical context, with rising protectionism towards the end of the 2010s. During this period, the EU has remained a defender of the international trading system, while simultaneously pursuing its interests in its bilateral and unilateral relations with the rest of the world.

Wider geopolitical realities have meant that, whereas at the beginning of the century, the EU was confident that further trade liberalization could be achieved at multilateral level through the WTO process (most notably the Doha Round launched in 2001), by the end, its primary focus for trade liberalization was through a series of bilateral agreements with favoured trading partners (Leblond and Viju-Miljusevic, 2019). At the same time, the growing economic and political importance of the emerging markets motivated a change in the EU's trade relations with the developing world. While it started the century with a new more generous trade regime for the poorest countries (the LDCs) its preferential access scheme for middle-income countries has become progressively more restricted. Thus, over time, certain countries have benefitted from more favourable access to the EU market, while others have seen their access reduced or removed, stimulating shifts in EU firm's sourcing patterns, especially in certain industries subject to high MFN tariffs (Curran and et. 2019).

In terms of global trade trends, the context clearly shifted during the GFC. As Figure 1 indicates, the shock created by the crisis was such that the upward trajectory which had characterized global trade at the beginning of the century abruptly halted. In the period following the GFC trade rebounded to some extent, but never recovered its prior dynamism.



The change in the dynamics of world trade was also a reflection of wider difficulties in the world economy, as growth stalled. Figure 2 shows trends in trade as a % of GDP (both merchandise trade and all trade including services) the picture looks more stable over the period, although trade’s share of GDP in 2019 was lower than the peak in 2007-8, especially for merchandise trade.

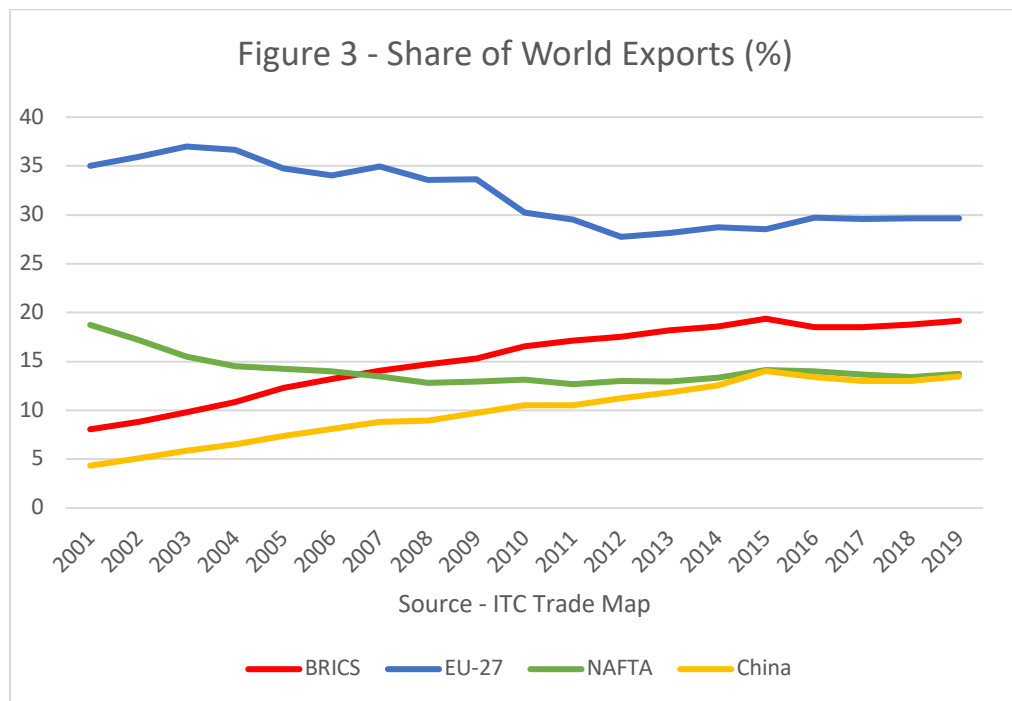


As trade was slowing, its structure was also changing. In particular, the share of world trade accounted for by the key emerging powers – Brazil, Russia, India, China and South Africa (the so-called BRICS) – increased rapidly, while that of the EU and NAFTA regions fell (Figure 3). As the figure shows, much of the loss in EU trade share occurred in the years following the GFC, while the falls in NAFTA’s share largely predated the crisis. The question of why the EU’s share of world exports declined so markedly between 2007 (35%) and 2012 (28%) is beyond the scope of this short paper. It is consistent with work which highlights a break in the trend towards increased specialization in trade after the



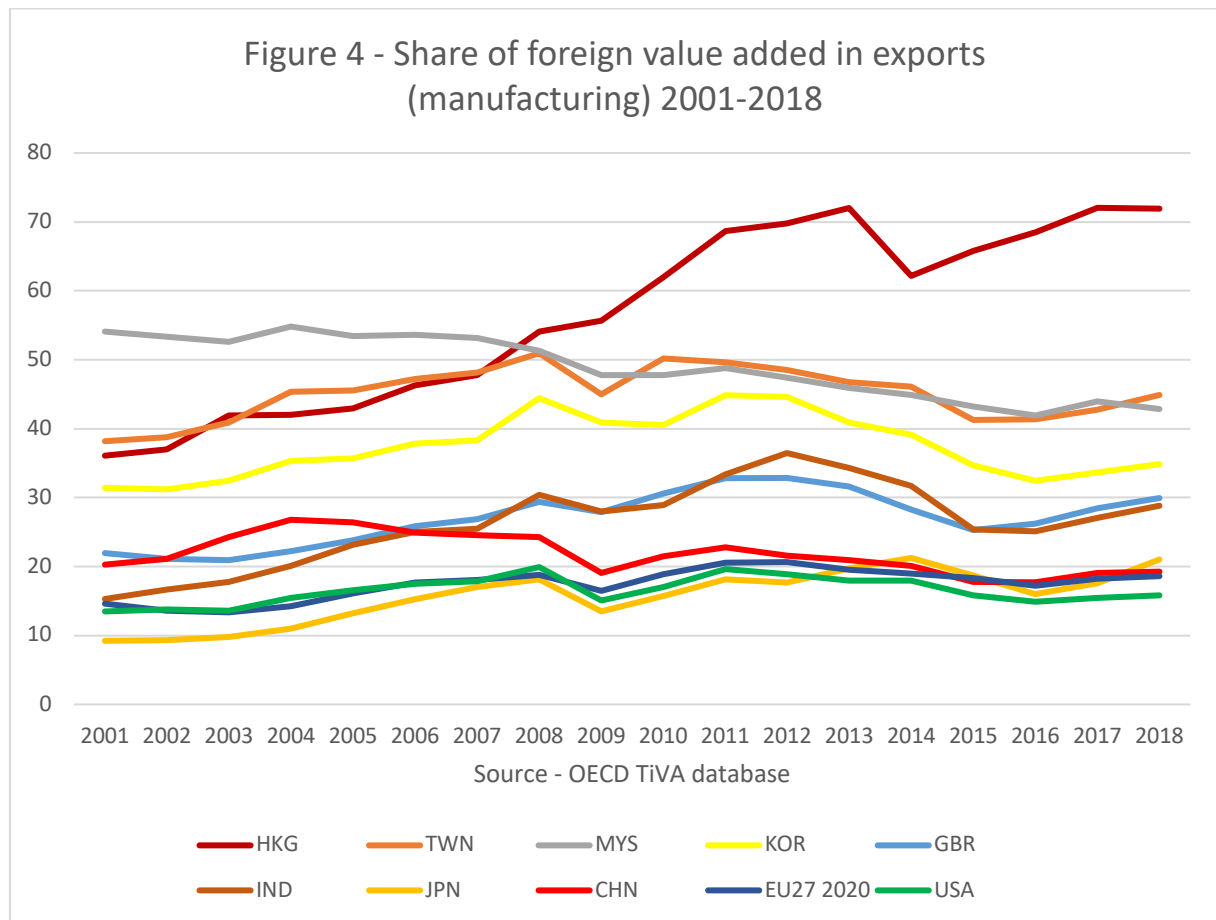
GFC, which coincided with changes in the spread of production within and between EU member states (Cutrini, Gardiner and Martin, 2023), as well as a trend towards increased internal circulation and reduced dependence on GVCs (Fan and Liu, 2021). As trade growth almost inevitably slows during economic crises, the difficulties experienced in the Eurozone and the sovereign debt crisis following the GFC certainly contributed to the declining importance of the EU in world trade.

The BRICS share increased steadily until 2014. Since then, regional trade shares have been fairly stable. The rising importance of China was a key motor for this growth, with its share of BRICS' trade increasing considerably over the time, from 54% in 2001 to 70% in 2019. As discussed below, these shifts had important implications for EU (and global) trade policy.



The data above use gross trade flows. For some time it has been recognized that the growth of GVCs and the resulting increase in the exchange of intermediate products and their embedded value in subsequently traded products means that gross trade figures don't necessarily represent flows of 'added value'. The OECD has developed alternative trade measures available through their trade in value added (TiVa) database which has been computed up to 2018. The figures on the extent to which foreign value added (FVA) is integrated into exports in manufacturers for some key world traders are presented in Figure 4. These figures show quite significant differences, as well as important changes over time. Like the figures for all trade above, most countries saw a fall in FVA during the GFC in 2009 and, although integration rebounded in most cases, in most big economies, trends have been fairly flat or falling since. The largest increase in FVA over the period was in Hong Kong, while the figures for Malaysia show a fall

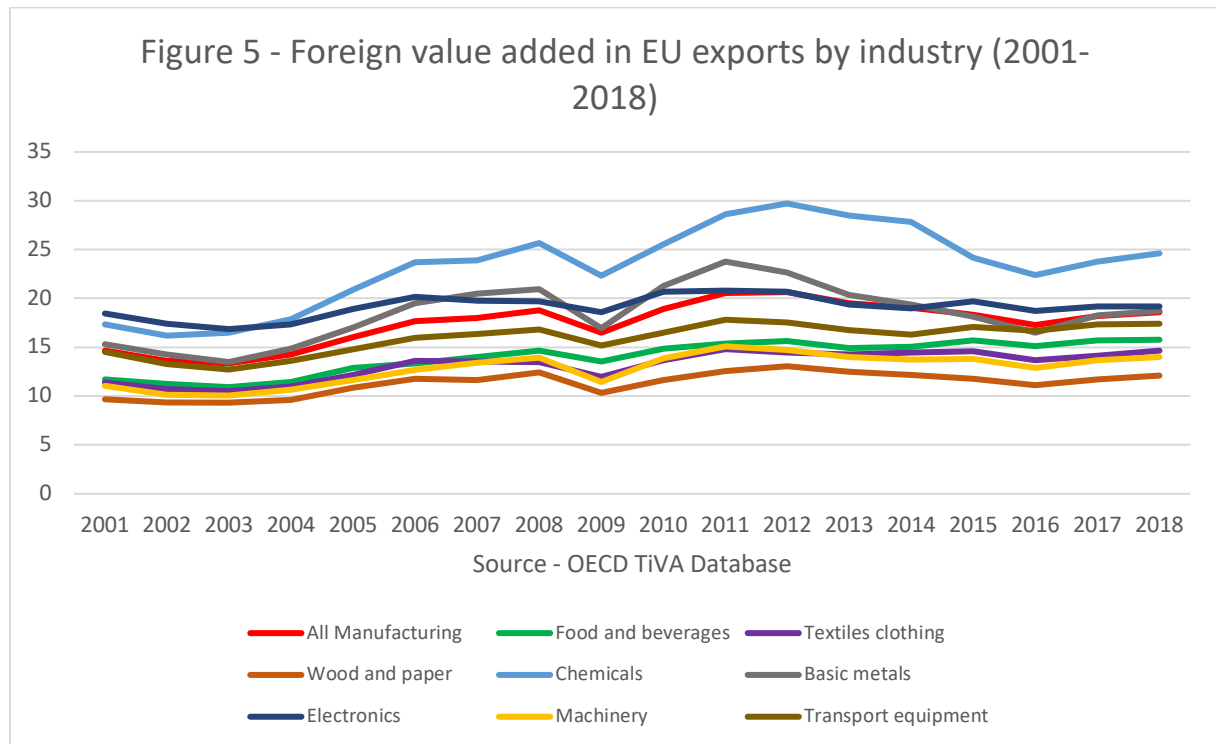
and those for Taiwan an increase, followed by a more recent fall. These three countries are amongst those with the highest share of FVA in their exports.



The core industrialised countries – Japan, US and the EU – have lower levels of FVA. Although they have seen less extreme volatility over the period, all have witnessed increases. The levels for Japan more than doubled (from 9 to 21%), the EU increased from 14.5 to 18.5% and the US from 13.5-16%. For both the US and EU rates peaked in 2011-2012. India, Korea and the UK saw important increases until 2012-13, after which FVA fell. China also experienced an increase followed by a fall, although the latter occurred earlier, with FVA peaking even before the GFC. Overall, these figures point to an increase in the importance of cross border production networks – GVCs – in the key traders in the beginning of this century, followed by a fall in the second decade of this century. Although Korea, UK, India and Japan all saw increases in the latest years available.

To explore the situation in the EU in more detail, we extracted data on FVA from TiVA by manufacturing sector. The data indicate both that FVA has increased in all sectors over the period covered by the database, but also that levels peaked in most sectors in 2011-12. The industrial sector with the highest FVA is chemicals, followed by electronics. The lowest levels are in wood and paper and food and beverages. These

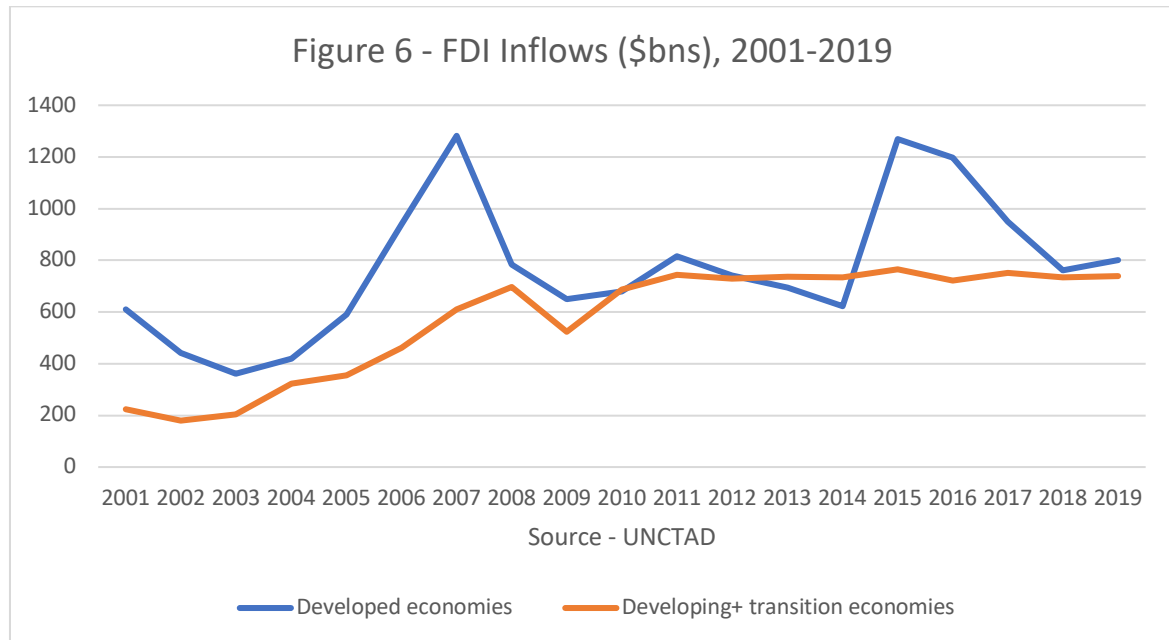
figures indicate that dependence on overseas inputs for exports varies extensively across EU industrial sectors, with chemicals twice as dependent on FVA as wood. They also indicate, like the earlier figures, that this dependence increased this century, although the peak levels of FVA were mostly seen a decade or so ago.



Finally, another key vector of global integration – Foreign direct Investment (FDI) – has also experienced significant shifts this century. FDI inflows (Figure 6) exhibited strong growth prior to the GFC, however, apart from a revival in 2015-6 in developed countries, levels of cross border investment have also plateaued in recent years. Analysis indicates that the growth rate in developed countries was the key variable explaining FDI flows following the GFC (Guris, Sacildi and Genc, 2015), when growth was anaemic for several years. However, FDI doesn't seem to have picked up as the GFC receded.

The stability of FDI flows, despite difficult economic headwinds, may also be related to changes in its nature, especially from emerging markets. Differences have been identified in trends depending on the motivation for FDI. Comparisons of Chinese and India Outward FDI (OFDI) show that their trajectory diverged after the GFC. Market-seeking Indian OFDI fell in concert with stalling growth in key markets, while Chinese asset seeking OFDI expanded, as assets became cheaper (Athreye, Saeed and Saad Baloch, 2021). In the EU context, Meunier (2014) argues that increased Chinese OFDI in the EU was related, both to falling asset prices and reduced political resistance to such investment against a backdrop of economic hardship in many countries. She concludes: *'European policy-makers clearly prioritized short-term concerns (e.g. unemployment)*

over long-term concerns (e.g. cultural identity, national security).’ (op cit. 300). In more recent years, the EU policy environment has shifted once again, with national security concerns and the protection of strategic and high-tech industries re-emerging as core concerns (Dudas and Rajnoha, 2020). Later WPs will explore this evolution and its implications for trade and investment patterns.



Overall, these figures indicate that the growing integration of the global economy that had characterized the last decade of the 20<sup>th</sup> century and the first years of the 21<sup>st</sup> plateaued several years before the pandemic, with trade flows stagnating and GVC integration falling. This trend, which has been dubbed ‘slowbalisation’ or ‘deglobalisation’, reflects a variety of interconnected changes in geo-politics and technology (Aiyar et al. 2023; Antras, 2020; Linsi, 2021; The Economist, 2019). Antras (2020) has argued that this slowdown was inevitable, as the growth that had characterized global integration in the early 20<sup>th</sup> century was unsustainable. Others are less sanguine and see this shift, coupled with the COVID pandemic, as indicative of a bifurcation of the world economy (Linsi, 2021), which will bring significant economic consequences (Aiyar et al. 2023). In this complex context of shifting trade patterns coupled with changing geopolitics, the EU’s trade policy has also had to adapt.

Partly as a result of these global shifts, the nature and context of trade negotiations has changed over time. After an optimistic launch in 2001, the WTO multilateral negotiations - the ‘Doha’ round - ran into difficulties. Although the EU traditionally favored a multilateral approach, it began to look to other avenues for market opening and economic opportunities (Leblond and Viju-Mijusevic, 2019). At the same time the rise of the emerging economies, especially China, created new competitive threats and opportunities, that required coordinated responses. These evolutions have resulted in

important changes in trade policy over the period, which have in turn encouraged the restructuring of the EU's GVCs.

At the same time, the policy context internally has become more complex, with the increasingly important role of the European Parliament and a rise in the salience of trade in public discourse (Meunier and Czesana, 2019). Added to this, the EU has both enlarged (through the access of the Central and Eastern European (CEE) countries) and reduced in size (with Brexit). These shifts impacted, not only the policy making process, but also the trade policy priorities of the EU. In the remainder of this paper, we will briefly explain these contextual changes in EU policy making, before exploring the evolution of trade policies and how these changes have impacted on EU-oriented GVC structures over time.

## **5. Contextual Shifts in Trade Policy Making**

### **5.1. Lisbon Treaty – The rise of the EP and the inclusion of investment**

The Lisbon treaty, which came into force in 2009, resulted in several institutional changes which impacted trade policy, most notably the extension of veto powers to the European Parliament (EP) and the extension of EU competence to international investment, but not investor-state dispute settlement (ISDS), resulting in 'mixed competence' (between the EU and member state levels) in this area (Armanovica and Bendini, 2014). Both shifts (especially the latter) increased the number of veto players in EU trade negotiations, a characteristic which has been shown to have a strong impact not only on the chances of negotiations succeeding (Mansfield, Milner and Pevehouse, 2008), but also on the nature of trade agreements, such as their depth, transition periods, escape clauses and dispute settlement provisions (Allee and Elsig, 2017). This increasingly complex policy environment inevitably impacted EU trade policy.

In relation to the first change, the capacity of the EP to shape and even veto trade agreements has had real impacts. In 2012 the willingness of the Parliament to reject a negotiated treaty– the Anti-Counterfeiting Trade Agreement (ACTA) –underlined the importance of this policy change and heralded a new phase of (more complex) policy making (Dur and Mateo, 2014; Farrand, 2015). Since then, the EP has been seen to have an important influence on trade policy at both bilateral (Curran et al, 2021; Frennhoff Larsén, 2017; 2020) and unilateral (EPRS, 2018) contexts. How this shift has affected the various EU trade regimes and the GVCs which depend on them will be discussed below.

At the same time, the second key shift of the Lisbon Treaty - the expansion of EU policy making powers to investment, previously an exclusively Member State competence - has further complicated the policy-making environment. With competence on investment now shared between the Commission and the Member States (and even some regions), the number of 'veto players' in the policy process expanded significantly

to include 28 national parliaments and 10 regional assemblies which had responsibility for investment (Curran et al, 2021). This change coincided with the negotiations of what would have been the EU's biggest FTA to date – the Trans-Atlantic Trade and Investment Partnership (TTIP) with the US – which, as its name suggests, included investment. This proposed agreement proved to be the most controversial trade negotiations ever undertaken by the EU (Young, 2016; De Ville and Siles-Brügge, 2017; Meunier and Czesana, 2019). Although discussions were suspended when Trump acceded to the US presidency, controversy on the investment aspects of the agreement spilled over into the parallel negotiations with Canada (Young, 2016), which were temporarily blocked by the government of Wallonia, following concerns about investment protection.

## 5.2. Rise in scepticism about globalization/GVCs and the importance of SD concerns

The second key shift in the policy environment is linked in some ways to the previous point. As the nature of EU policy making changed and expanded, so debate and controversy about it intensified and salience for the public increased (De Ville and Siles-Brügge, 2017; Meunier and Czesana, 2019; Curran and Eckhardt, 2022). At the same time skepticism about trade and globalization was increasing worldwide, not only from the traditional critics on the left, but increasingly from the former defenders of global integration on the right (Horner et al. 2018). Especially since the GFC, free trade has emerged as a key target of the populist right, which questions openness and international exchange in a far more fundamental way than traditional critics on the left. They promote a zero-sum world view and exploit what Lamp (2019) terms '*the jobs-as-property metaphor*'. Analysing the rhetoric of the former Trump administration, he notes: '*The conception of jobs as akin to physical objects suggests a straightforward way to remedy the situation: one simply has to "take the jobs back" from the winners of globalization, namely, the foreign workers who now have the jobs previously held by US workers*'. (op.cit: 1366).

When Trump arrived in the White House, his radical anti-trade agenda resulted in major shifts in US policy, not only towards China, the main target of the 'job-as-property' metaphor, but also towards the EU and other allies. The US administration instigated new tariffs on EU steel and aluminium imports and proceeded to block the dispute settlement procedure in the WTO, further fragilizing the multilateral trading system (Curran and Eckhardt, 2022). As usually happens in such cases, the EU instigated retaliatory tariffs. Although these measures were suspended following the inauguration of President Biden<sup>1</sup>, the US trade conflict with China has not abated. In some ways, the

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<sup>1</sup> [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_21\\_5721](https://ec.europa.eu/commission/presscorner/detail/en/IP_21_5721)

Biden administration has intensified its conflictual approach, most notably by blocking the export to China of high-tech products especially in the electronics sector (Sullivan, 2022).

Although the rhetoric on trade in the EU has not been as toxic as in the US, populism has had wide-ranging impacts on policy, especially through the Brexit vote. The UK decision to leave the EU had enormous implications for both parties (Matthes and Busch, 2016; Pisani-Ferry et al. 2016) and one of the policy areas most affected was trade policy (Hestermeyer and Ortino, 2016). Although the EU and the UK formalized Brexit on the 1<sup>st</sup> of January 2021 by reaching agreement on a trade deal, many aspects of the future relationship with the EU remain unresolved and there are inevitably more barriers to trade than would have been the case if the UK had stayed in the EU (Landler 2021). The potential impact of Brexit on GVCs will be discussed in Section 7.5 below.

More broadly, the widespread campaign against TTIP (and CETA), although focused on investment protection (Siles-Brügge, 2017), also brought criticisms about trade more widely to the fore, undermining support for openness and globalisation (Bauer, 2016), even in countries like Germany, where the population had traditionally been very positive about trade (Jungheer et al, 2018). Many of the criticisms on trade emerging from civil society are linked to concerns that exchange is not undertaken under fair terms, because some countries may benefit from lax environmental and social regulations, giving them an unfair advantage on the market and resulting in unsustainable production systems (Rodrick, 2018). At the same time, there are long standing concerns on the political left about the conditions under which workers in the global south are integrated into GVCs and the need to take stronger action to secure decent work and safe working environments (Horner et al, 2018).

In the EU context, these concerns have resulted in the increased politicization of trade, including through wide-spread civil society campaigns (Young, 2019a). These have, in turn impacted on policy positions, especially through the EP. As a 2014 review of the EP's role in trade policy highlighted: *The growing role of public opinion in the EU and globally has simply made it impossible to overrule or simply ignore this constant quest for a better and fairer world.* (Armanovica and Bendini, 2014:13). As we will discuss below the increasing importance of concerns about the impact of trade on sustainable development have led to several trade policy shifts in recent years.

### **5.3. The changing geometry of the EU**

Finally, another factor which has influenced the priorities within EU trade (and other) policies since 2000 is the changing nature of its membership. Firstly, the expansion of the EU to 28 members, including several former members of COMECON from Eastern Europe and, most recently, the unprecedented shrinking of the EU, due to Brexit.



Although most analyses of these shifts have focused on the impact on trade patterns rather than trade policy (Curran and Zignago, 2012; Vandebussche, Connell and Simons, 2022; Vecchiu and Makhouf, 2014), it has been argued that both evolutions will also impact the latter. Specifically, some observers hold that they have strengthened protectionist forces within the EU and undermined its commitment to market opening (Elsig, 2010; Schneider-Petsinger, 2019).

In relation to enlargement, there have been surprisingly few analyses of the impact of this important contextual change on EU trade policy. In as much as the impact of enlargement has been studied, scholars have tended to explore development policy (Lightfoot, 2008), or foreign policy more broadly (Finke, 2020). In a rare analysis, Elsig (2010) explored how enlargement impacts on trade policy, noting how the new member states interests were more linked to the EU's internal market than external market opportunities, which could be expected to dampen their enthusiasm for liberalization. However, in reality, he finds substantial heterogeneity in their positions on trade. It also seems likely that, as their position in EU GVCs shifts over time, their positions may also have changed.

In terms of Brexit, the UK has long been seen as a 'pro-trade' voice within the Union. For example, it was amongst the countries that most consistently argued against anti-dumping duties (Nielsen and Svendsen, 2012). Thus, it was widely feared that its exit would strengthening more protectionist voices within the Union (Schneider-Petsinger, 2019). However, de Ville and Siles-Brügge (2019), have argued that such analysis disregards the dynamic nature of policy making. They consider that the process of Brexit itself has shifted policy stances of the remaining members and made the EU an even stronger advocate of free trade. Whether this remains the case in the face of post-COVID trade tensions, is an issue which will be addressed in later WPs.

## **6. Multilateral Trade Policy**

Multilateral (ML) trade policy, as the name implies, involves liberalizing market access for all WTO members. In terms of our analytical framework in Schema 1, ML liberalization creates a more level playing field and, all other things being equal, reduces the likelihood of trade regimes having significant impacts on GVCs going forward. However, reductions in MFN tariffs change the status quo, reducing the relative advantage that preferential exporters had enjoyed to a given market. This process, known as 'preference erosion', has the potential to reduce incentives to involve the poorest countries in GVCs, as the comparative advantage they enjoy over suppliers subject to MFN tariffs is 'eroded'. At the beginning of the century, when the Doha Round was launched, there was a lot of concern in developing country exporters about potential negative effects of further ML liberalization (Francois, Hoekman and Machin, 2006; Curran, Nilsson and Frontini, 2007). However, as efforts to secure agreement were



consistently blocked for a variety of reasons (Dupont and Elsig, 2012), such concerns have dissipated.

In the event, the key advance in trade policy terms over this century was the implementation of the Uruguay Round (UR), starting in 1995 and the creation of the World Trade Organization (WTO) to replace the prior General Agreement on Tariffs and Trade (GATT). With no agreement on the Doha multilateral negotiations, the key means by which liberalization has advanced under the WTO is through new accessions to the organisation. Of these, by far the most significant was that of China, which joined in 2001. This assured the guarantee of Most Favoured Nation (MFN) tariffs for Chinese goods exported to other WTO members and secured reductions in tariff levels for WTO exporters to China. Although clearly not the only factor behind the increased importance of China in world trade in the last two decades, the stability which WTO membership provided to its exporters and importers certainly helped to encourage trade.

### **6.1. Implementation of the Uruguay Round.**

Given that multilateral liberalization since 2000 has mainly been limited to the implementation of the agreements negotiated in the UR, this section will focus on the impacts of these changes. Since the implementation of such agreements tend to be staggered over time, many UR commitments were only fully applied this century. Probably the most notable and impactful in manufactured goods was the phasing out of clothing and textile import quotas under the now defunct Multi-Fibers Arrangement (MFA), which was finally completed in 2005. Quotas are a protectionist instrument which place quantitative limits on imports from defined suppliers. The capacity of quotas to guide buyer's choices has been widely acknowledged in the literature.

Quota restrictions under the MFA distorted trade in several ways, but two were particularly important for GVC structures. Firstly, the limits on exports from the most competitive producers meant that demand for relatively low-cost goods was undersupplied – creating demand for goods from alternative sources (Gereffi, 1999). The development of these alternative low-cost suppliers was often stimulated by foreign direct investment from quota limited countries, a strategy known as 'quota-hopping' (Staritz, 2011). Overall, the strategy served more to increase the number of actors in the sector than to protect producers in the developed world. As Gereffi (1999) concludes *'Protectionism by the industrialized nations also diversified the scope of foreign competition, as an ever widening circle of exporters was needed to meet booming North American and European demand* (Op.cit.: 51). Secondly, the fact that a country's exports of given goods are fixed by volume (not value) by the importing country, motivated companies whose exports were constrained to maximize the gains

from that particular market by prioritizing the export of their higher value items – effectively upgrading their exports.

Research on the clothing and textile sector during the MFA and its phase out, confirmed that such trade regimes can have significant effects on sourcing patterns and on pricing strategies. Specifically, placing quantitative limits on exports from named sources encouraged companies based there to concentrate exports in their highest value goods and to seek lower cost alternative sources for other lower quality goods – in other words to upgrade their own production and diversify sourcing. Once the system was dismantled, the consequences were not only lower prices, but a further restructuring of the supply chain to concentrate production in the most cost competitive countries, rather than those which had available quotas (Curran, 2008a and 2008b).

The role of quota restrictions in fostering new entrants to the industry had been appreciated for some time. This effect and the way in which constrained countries often supported the development of new suppliers, including through direct investment, had been noted by Davenport (1990) and Khanna (1990), prior to the work by Gereffi and his co-authors, which confirmed this trend. In effect, by limiting key exporters, quotas opened the possibility to many developing countries in East Asia and elsewhere to access developed country markets. Kaplinski and Morris (2006) consider that the quota system was the key reason behind the development of the industry in Sub Saharan Africa (SSA): *'These quotas alone explain the establishment of an export-oriented clothing industry in low-income SSA economies, as predominantly East Asian producers took advantage of SSA's unused quota access into the US and the EU.'* (op. cit.: iv.)

However, this quota-driven market access was temporary. As liberalisation advanced in the early 2000s, several countries and development agencies became concerned about the potential negative impacts of the forthcoming quota-free regime on certain developing countries, including Pakistan (World Bank, 2004), North African suppliers (Ben Hammouda et al., 2005), India and Bangladesh (Anathakrishnan and Jain-Chandra, 2005; Mlachila and Yang, 2004). The concern was that quota limitations in importing countries had, over time, actually become market access guarantees, preventing certain highly competitive suppliers – primarily China – from monopolizing the market. The aforementioned studies forecast large increases in exports from China and reductions in exports from several vulnerable developing countries.

Studies undertaken after liberalization found that, in the event, the key negative effects of quota liberalisation on exports were felt in higher cost countries – Korea, Hong Kong and Taiwan - where access to quota had maintained export levels, despite falling competitiveness (Curran, 2007a; Curran, 2008a; Curran, 2008b). Some developing

countries did experience reductions in exports however, with global falls in Morocco and Tunisia of -8% and -6% in 2005 (Curran, 2008b). However, these losses were partly recovered in 2006, at least for Morocco on the EU market (Curran, 2007b).

Furthermore, the liberalisation was not fully instigated, at least not straight away. As Chinese exports rose rapidly strong political pressures for protection emerged in both the US and EU. As a result, 'voluntary export restraints' (VERs) were negotiated with the Chinese authorities in June 2005 (Bown and Crowley, 2016). These VERs capped growth in Chinese exports in the EU market, providing some breathing space for exporters from other developing countries, whose exports tended to rebound in the second half of the year (Curran, 2008a).

However, the VERs did not protect several more marginal suppliers like Mauritius on the EU market and Lesotho in the US, whose exporters suffered some of the largest falls in percentage terms once quotas were removed. These small, comparatively high-cost producers struggled to compete with Chinese exports on their key markets (Brenton and Hoppe, 2006; Kaplinsky and Morris, 2006). Thus, quota restrictions seem to have created opportunities for non-traditional suppliers to the EU clothing market, which the liberalization under the UR agreement reversed. Although temporary restrictions on China helped to mitigate these effects, the VERs ended at the end of 2007.

In terms of the impact of quotas on prices, the tendency for quota limitations to encourage the export of higher priced goods was noted, not just by Gereffi and his co-authors but by earlier writers on the clothing industry (Faini and Heimler, 1991). This effect, as well as the fact that quota, as a limited resource, had to be bought, had direct impacts on consumers through higher prices. For example, a report for the UK government concluded that UK consumers would gain £980m from price reductions in the case of full liberalization (Silberston, 1989). Indeed, following the beginning of the liberalisation process in the EU in 1995, as import volumes rose, prices for consumers fell. The EU clothing retail prices remained stable and latterly even fell slightly over the 10 years from 1996-2005 as trade slowly liberalized. At the same time, the retail price index for all products increased by 19 points (Curran, 2006).

Overall, these shifts in the structure of EU-oriented clothing GVCs in response to initial trade restrictions and then multilateral liberalization, confirmed the importance of trade policy – particularly the imposition of quantitative restrictions on named sources - to the shaping of these chains. More recently, the shift towards greater protectionism has included several instances of quota and VERs being negotiated both to limit exports (the EU-US agreement which ended the steel tariffs) and encourage exports (the US-China agreement to reduce the trade deficit by encouraging US exports in certain key sectors) (Bown, 2021). In this evolving context, it is important to recall that

the prior research discussed here has clearly demonstrated that past efforts to manage trade through quotas had several unintended consequences. Most importantly, import quota restrictions on key suppliers increase prices (because suppliers seek to maximise their turnover and because of the cost of quota) and encourage the entry of non-quota restricted sources into GVCs. They do not necessarily achieve their primary objective of increasing domestic sourcing.

Given recent shifts towards more widespread government intervention in the market, analysis of the impact of trade regimes on industrial GVCs will increasingly need to re-integrate the potential role of such restrictions on trade. This could include the use of quotas and VERs, as well as so called 'Orderly Marketing Agreements (OMAs), which involve bilateral agreements to restrict trade. They also include a very different type of export restriction to the VERs of old, where the home government bans or restricts exports of a given (sensitive) technology to a country considered to be a technical rival. This is what the US has done in restricting the export of certain technologies to China (Bown, 2020; Sullivan, 2022).

These measures were not included in Schema 1, as at the time it was developed (2019) such restrictions in trade in manufactured goods were still quite rare<sup>2</sup>. In the new emerging context, the potential for such restrictions, especially for 'sensitive products', is growing. Going forward, GVC analyses will need to consider whether a given product is subject to any government-imposed trade restrictions and if so, which exporters or importers are covered and for what timescale? We will also need to go back to prior research in order to analyse likely impacts and avoid repeating past mistakes. This includes that on clothing, discussed above, as well as cars, a sector where VERs were widespread in the past (Chu, 2014) and footwear, subject to OMAs in key markets for many years (Dardis and Lin, 1986). The lessons from such past work for the current more interventionist context will be developed more in WP2 and WP6.

## **6.2. The impact of WTO rules on trade and blockage of the Dispute Settlement Body.**

The EU's membership of WTO has had impacts on its trade policy over time, not least because several EU policies have been the subject of disputes in the WTO and the EU has usually changed its policies in response to negative judgements (Young, 2019b). Many of these disputes challenged the EU's regulation of agricultural trade (bananas, sugar, beef...) (op cit) which is not the key focus for this paper. However, trade regimes

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<sup>2</sup> This was of course never entirely true. There have always been some exceptions, most notably in the case of several anti-dumping investigations, where the EU agreed on 'voluntary' export restraints with the supplier under investigation. For example, Chinese solar panel manufacturers agreed in 2013 to install a minimum price and a limit on their market share in order to avoid duties in the EU's ant-dumping investigation (Kolk and Curran, 2017). In agricultural trade, quotas are widely used to provide (minimum) market access.

affecting several manufacturing sectors have been subject to challenge in WTO and the EU has had to adjust its policy in concert. These cases cover a diverse range of issues including anti-dumping procedures (e.g. cases DS405 and DS513 taken by China), failure to accord tariff reductions to certain IT goods (DS375, 376 and 377 taken by the US, Japan and Taiwan respectively), subsidies to civil aircraft (DS316) and the provision of special preferential access to certain developing countries (DS246 taken by India).

The implications of some of these judgements on EU policy will be discussed in the relevant sections below, but more generally, the existence of WTO rules and the capacity of members to challenge policies they consider WTO incompatible has meant that the EU's trade regime has evolved in a context where WTO rules needed to be respected. This restricted key policy choices like how to provide the kind of preferential access which encourages certain GVC structures and under what conditions, as well as how to restrict imports of sensitive goods. As highlighted in Schema 1, such choices impact on GVC structures. WTO rules also restrict the use of trade distorting subsidies, as the long running case on civil aircraft highlights. In a context where many countries are providing extensive support to firms on an effort to reduce dependence and increase resilience, the question of the compatibility with WTO rules will certainly be subject to debate (Curran and Eckhardt, 2023) and this issue will need to be addressed in WP2.

More recently the role of WTO in imposing global trade rules and providing stability to the global trading system has been undermined by the decision of the US to block the nomination of judges to the most important legal body of the DSB – the Appellate Body (AB) – because of perceived legal overreach (Hoekman and Mavroidis, 2019; Wouters and Hegde, 2022). This threat to WTO caused much concern in Europe (Jean et al, 2018). Although the EU was instrumental in negotiating an alternative dispute settlement system, much of the WTO's membership is not party to this system (Wolff, 2022; Wouters and Hegde, 2022). This situation fragilizes the WTO and means that members can avoid implementing rulings that they dislike by appealing to the non-existent AB. It also means that the status of recent important rulings such as that against the US's tariffs on steel and aluminium<sup>3</sup> is unclear.

Thus, in recent years the multilateral context has been one where there has been limited progress on liberalisation and, laterally, legal uncertainty about the capacity of the WTO to impose its existing rules. Seeking to advance (or even defend) market opening through the multilateral system has thus become more difficult as the century has

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<sup>3</sup> [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds556\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds556_e.htm)

advanced. The EU has thus increasingly looked to bilateral agreements to secure market opening. It is to these evolutions which we now turn.

## 7. Bilateral Trade Policy

### 7.1. The rise of FTAs

As it became clear that the WTO Doha Round was not likely to produce significant market opening, the EU has pragmatically shifted its attention to Free Trade Agreements (FTAs) (Wouters and Hegde, 2022). This change in orientation in trade policy has been successively clarified through the Global Europe (2006), Europe 2020 (CEC, 2010) and Trade for All (CEC, 2015) strategy documents. The first policy document, in particular, represented an important shift from the moratorium on launching new FTA negotiations which had been imposed by the previous Commission (Elsig, 2010). The EU has since negotiated several new FTAs and modernized its existing agreements with others. Table 1 below summarizes the key FTAs which have been secured this century and their state of implementation. Several other FTAs are under negotiation, with the Commission optimistic about progress with New Zealand (with whom political agreement has been secured), Australia, and Indonesia (Von der Leyen, 2023).

Table 1 – EU FTAs in force or agreed (2022)	
Country/region	Implementation
South Africa	Agreed 1999. Recently replaced by a regional agreement with SADC
Mexico	In place since 2000, being revised
Chile	In place since 2003, recently revised
Korea	In place since 2011
Singapore	In place since 2019
Ecuador, Peru and Colombia	In place since 2013
Canada	Mostly implemented
Japan	In place since 2019
Vietnam	In place since 2021
UK	In place since 2021
Mercosur	Agreement reached in 2019. Not ratified

*Source – own elaboration on the basis of data on the DG Trade website*

In addition to these FTAs, the EU also has special trading arrangements with its long-time regional partners in the European Economic Area (Norway, Iceland and Lichtenstein) and Switzerland as well as a Customs Union (CU) with Turkey (since 1995) and a series of Association Agreements concluded since the end of last century with the countries of North Africa, the Western Balkans and certain countries in the Middle



East as well as Moldova, Georgia and Ukraine<sup>4</sup>. Although these agreements include a wider range of issues than trade, they also cover market access.

Finally, there are a group of countries known as the African Caribbean Pacific (ACP) countries, mostly former colonies of the EU member states in SSA, or the Caribbean, with whom the EU has long had special preferential trading arrangements. As these were incompatible with WTO rules, they were revised (Curran, Nilsson and Brew, 2008). These arrangements have now mostly been replaced either with bilaterally agreed Economic Partnership Agreements (EPAs), which provide substantial market access, or by the unilateral market access schemes which will be discussed below.

These changes in trade policy mean that over time, an increasing percentage of EU trade has been covered by various types of FTAs. To give an indication of how the importance of these agreements to EU imports evolved over the years up to the COVID crisis, we extracted figures on total EU imports and exports and those in the manufacturing sectors on which TWIN SEEDS will concentrate<sup>5</sup>. Although the current EU27 members were not all members of the EU for the entire period, we include them in the EU grouping to be consistent with our later analysis and because all acceding countries adopt EU trade policy in advance of formal accession as part of their integration of the 'Acquis Communautaire' into domestic law.

In the 2019 figures we differentiated between trade with countries with whom the EU already had FTAs at the beginning of the century (Old FTAs), which are generally more long-term trade partners and that with partners agreed this century (New FTAs). These include a diverse range of countries, not only those in Table 1, but also trade partners with whom FTAs were agreed through the Association Agreements with the Western Balkans and Eastern Partnership, North Africa and the EPAs with certain ACP countries.

As Table 2 shows, in spite of substantial growth in the number of FTAs in recent years, trade with these partners remains a relatively small share of EU trade, both for imports and exports and for all goods as well as manufactures. Although the share is falling, Intra-EU trade remains well over half of trade in both directions and for both types of good. This is consistent with earlier work on the enduring regional orientation of EU trade, which was to some extent reinforced by enlargements this century (Curran and Zignago, 2012). FTAs are not significantly more important for imports than for exports, nor for manufactures versus all goods. While the expansion of FTAs has reduced the

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<sup>4</sup> [https://taxation-customs.ec.europa.eu/customs-4/international-affairs/origin-goods/general-aspects-preferential-origin/arrangements-list\\_en](https://taxation-customs.ec.europa.eu/customs-4/international-affairs/origin-goods/general-aspects-preferential-origin/arrangements-list_en)

<sup>5</sup> The group 'manufactured goods' excludes agricultural trade and trade in energy (also because large changes in the cost of energy over time can distort overall trade flows and this sector is generally MFN duty free, so FTAs have no impact). Trade in arms is also excluded, as this is strongly linked to geopolitical factors and, in addition, it is not a community competence. See annex for details of the exact HS codes included in the grouping.

share the Rest of the World (RoW) in EU trade, these countries remain important trading partners, especially for imports of all goods (which includes energy).

Table 2 – Share of intra-trade and with FTA partners								
	EU Imports				EU Exports			
	Manufactures		All Trade		Manufactures		All Trade	
	2001	2019	2001	2019	2001	2019	2001	2019
EU27	60,4	59,0	57,0	55,7	58,3	57,5	59,3	57,7
RoW	34,0	28,6	36,7	31,5	34,7	28,4	34,1	28,4
Old FTAs	5,6	6,3	6,3	6,3	7,0	7,4	6,7	7,1
New FTAs		6,1		6,4		6,7		6,7

Source – Author’s calculations based on ITC TradeMap

## 7.2. Differential effect of FTAs on trade

While negotiating FTAs mathematically increases the share of trade covered by trade agreements, they do not necessarily increase trade flows. Economic analysis tends to forecast significant increases in trade from FTAs, particularly for smaller economies (e.g. Mendoza, 2021, Planistat, 2002). However, while removing tariffs on imports clearly provides a competitive advantage to FTA partners, this does not always translate into higher trade flows and greater integration of value chains (Baier et al. 2019).

This section will seek to explore how important FTAs have been in stimulating economic integration by analysing the extent to which the EU’s FTAs have had trade effects. Ahipeaud et al. (2021) explored how trade (imports and exports) with North African countries was impacted by FTAs by indexing trade from the year of implementation of the agreement. They find that trade with Egypt expanded far quicker following their EU FTA than other trade partners, while trade with Algeria fell compared to pre-agreement levels in the later years of their analysis.

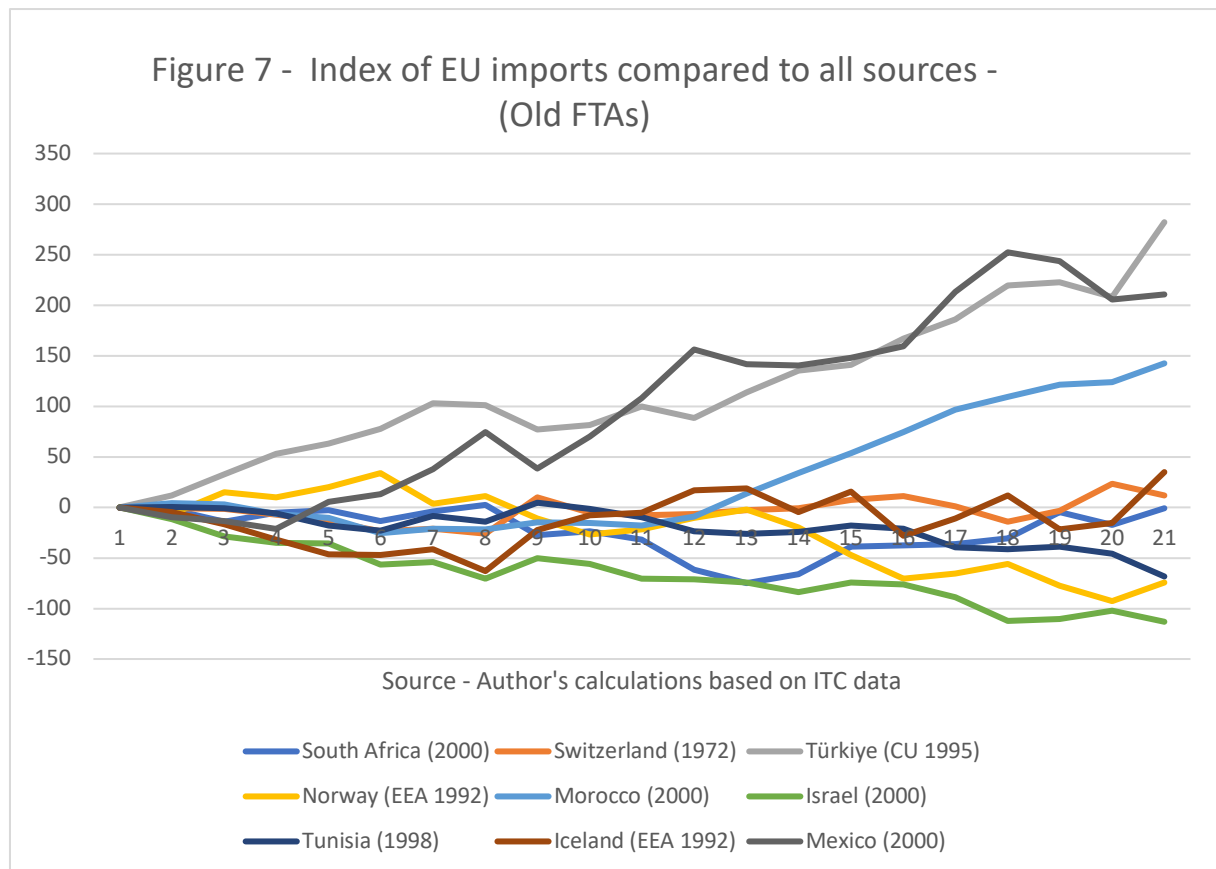
This indexing approach enables us to assess to some extent whether an FTA stimulates trade and facilitates comparisons across countries, but it is also important to put such evolutions into broader context. Trade growth (or contraction) needs to be compared with the general evolution of the market, as changes in trade do not necessarily indicate an impact from an FTA in a context where all trade is expanding (or contracting). As FTAs were implemented at different times this factor is also important for cross FTA comparisons.

This analysis uses a combination of the approach by Ahipeaud et al. (2021) and that of DG Trade (2013) to explore the impact of the EU’s FTAs in recent years. It differentiates between ‘old’ FTAs that were negotiated before 2001 and later FTAs, which, as



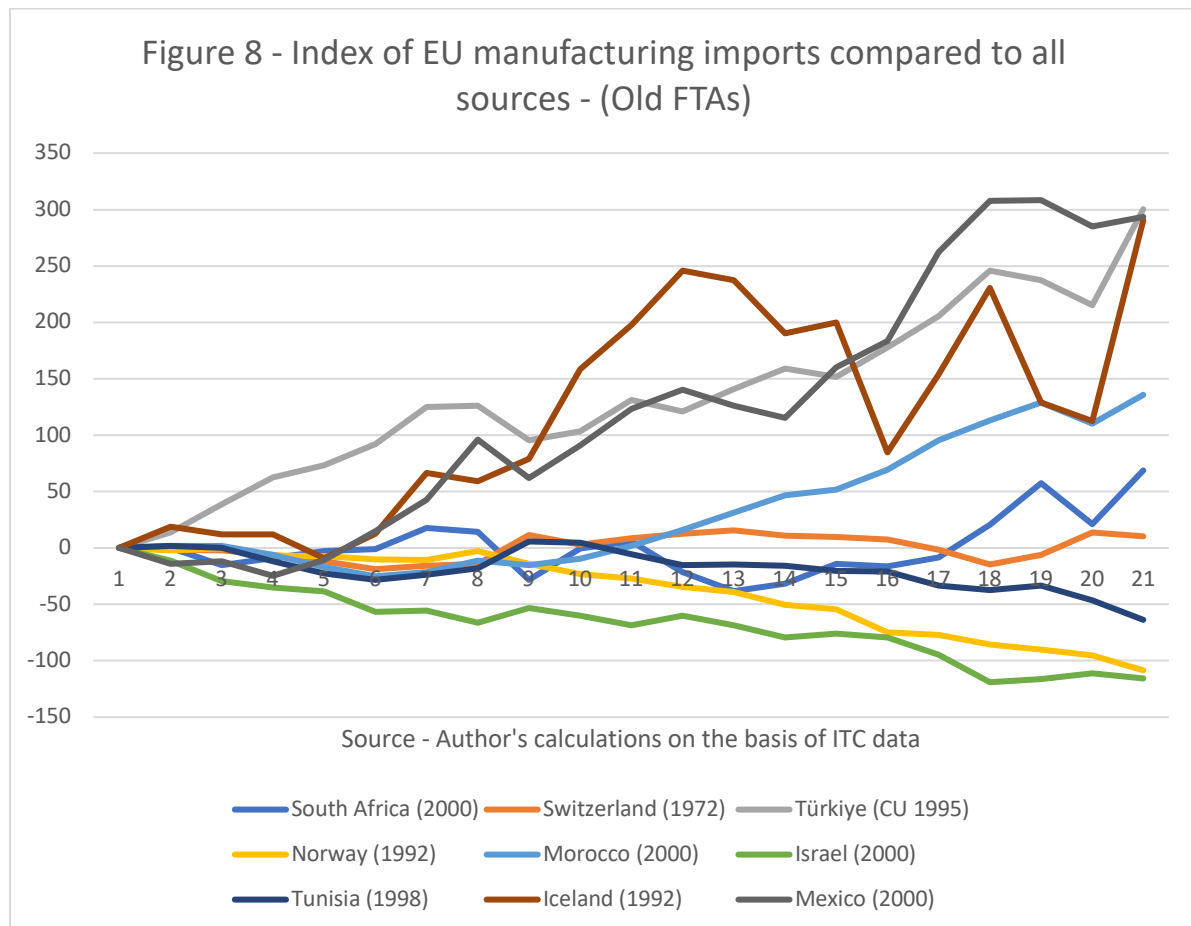
discussed below, were mainly 'next generation' FTAs, which cover a wider range of non-tariff issues. Like DG Trade (2013), I also differentiate between imports and exports, given their different importance for GVCs. For 'old' FTAs, import values (in \$) were indexed over time using 2001 as the reference year. The results of that first stage are reported in figure A1 in the annex. These indices were then compared to the index of EU imports from all sources to get a view of the relative performance of FTA trade partners compared to all trade. Values above zero indicate that trade grew more than all trade, while negative figures indicate the opposite.

If FTAs had a positive impact on trade above and beyond general market trends, then the indices computed here would be positive. However, as we will see below, this was not always the case. The results for the EU's traditional trade partners are shown in Figure 7. The countries whose export performance to the EU were consistently strongest were Turkey and Mexico, with Morocco showing strong growth in more recent years. For other FTA partners, their trade performance has not been significantly better than the average and for several partners – notably Israel and Norway – their exports underperformed compared to other EU suppliers.



As TWIN SEEDS is focused on trade in manufactured goods, we also undertook this analysis for trade in these products. The indices are presented in figure A2 in the annex.

Here we present the difference between these figures and the overall index of EU imports of these goods. The underperformance of several partners is confirmed, although Iceland’s performance is better than for all goods. This is largely because of a large increase in aluminium exports, which represented 60% of the EU’s imports from Iceland in 2021.



For more recent FTAs, we calculated the index by comparing EU imports in the year the agreement was implemented (the reference year) to later years. The number of years available obviously varies depending on when the agreements were ratified. We focus on the most important FTAs in trade terms and, in order to have a reasonably long period, we include mainly those agreements concluded before 2014, although we include Ukraine because of its geopolitical importance. The indices are presented in figure A3 in annex.

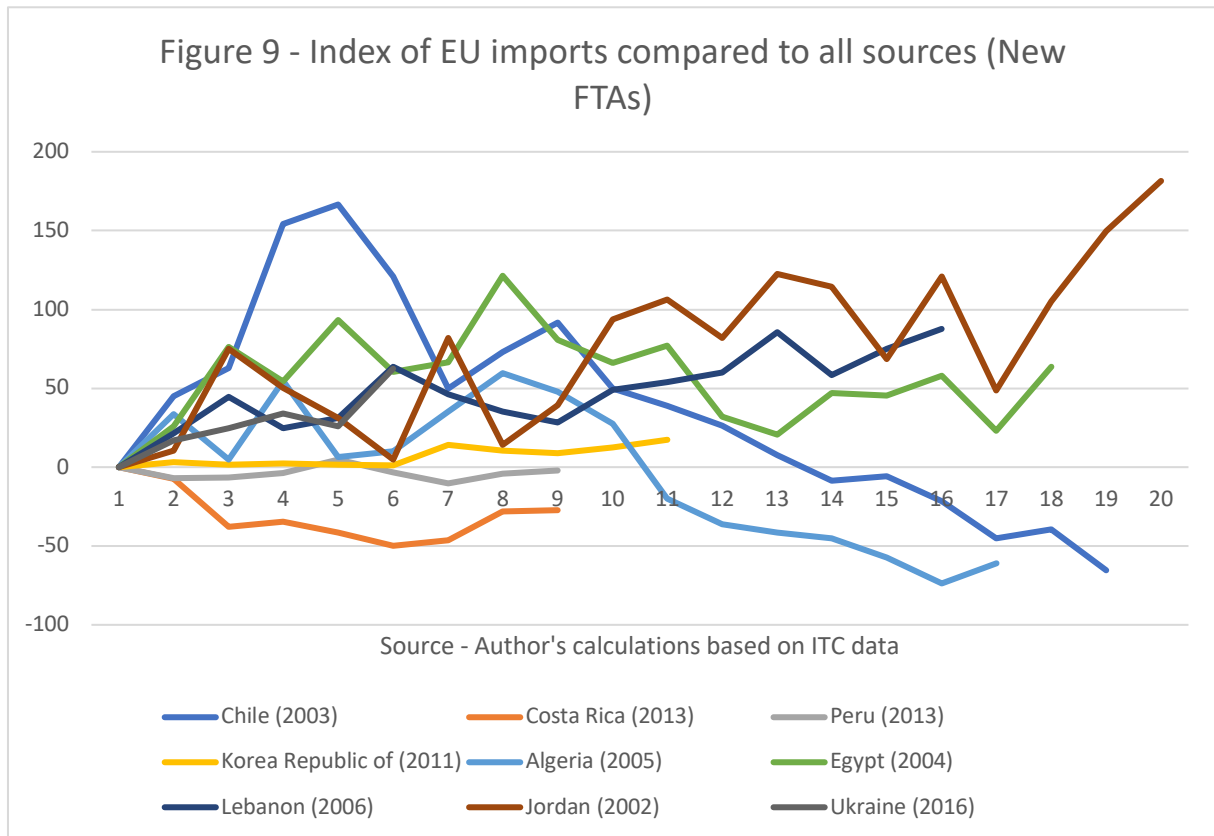
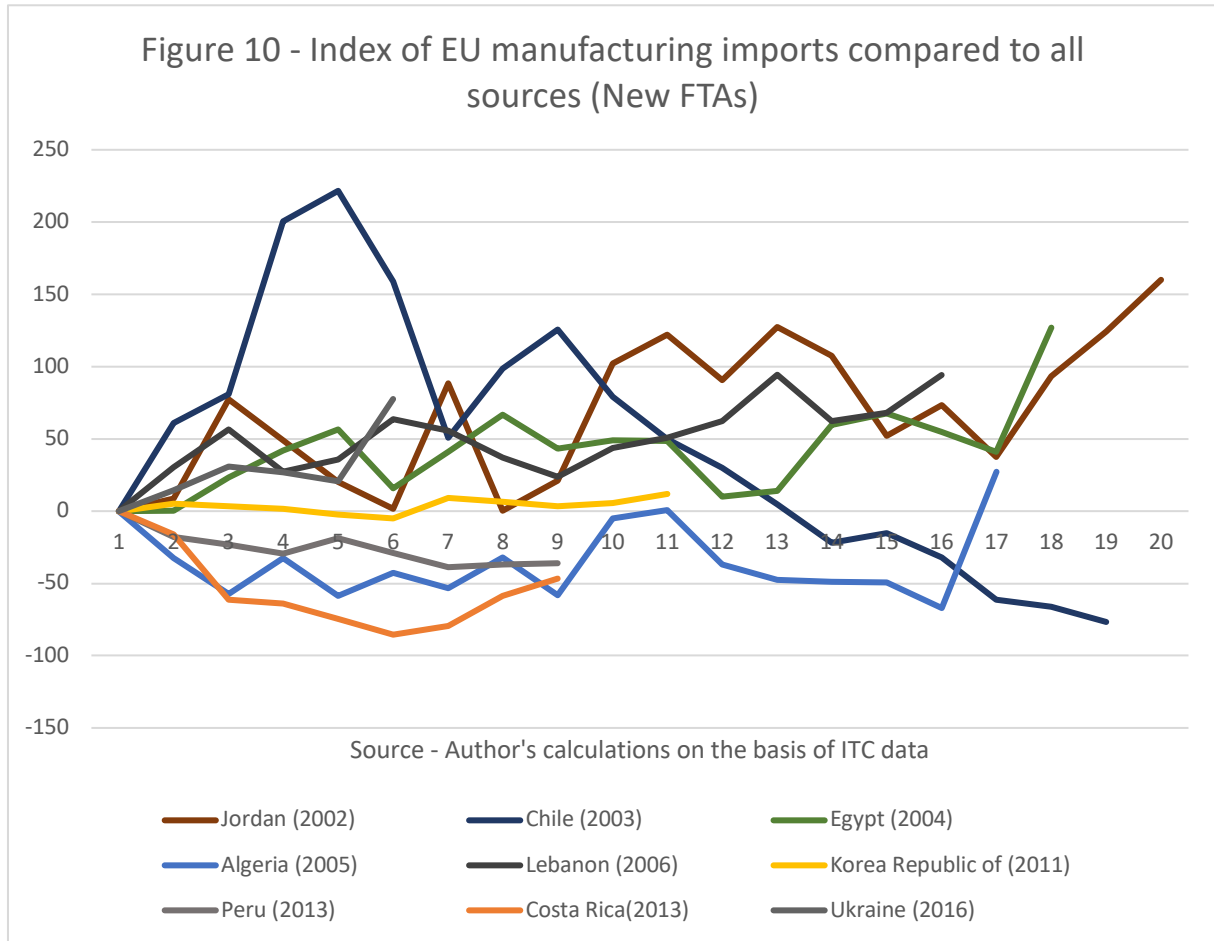
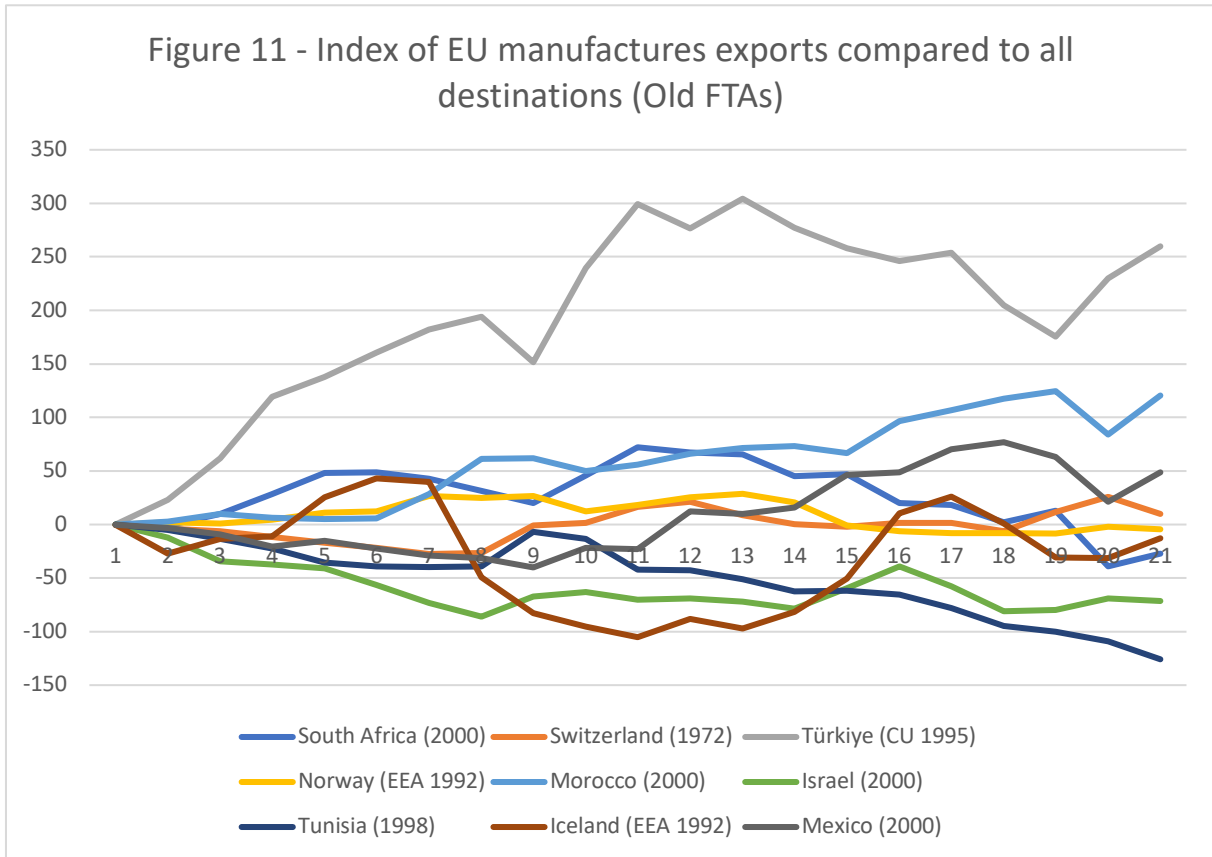


Figure 9 shows the trends when compared to the index of all EU imports (using the same reference year). The performance of FTA partners varies extensively. Chile's exports were the most affected by the implementation of their FTA (in 2003), although their later performance has been much less impressive. For Korea and Peru, their trade performance was similar to all partners, while for Costa Rica, and recently Algeria and Chile their performance has been substantially worse. Chile is an interesting case, as the FTA initially seemed to stimulate a large increase in trade – the index of their exports was more than 150 points above general EU imports - but in recent years the situation has reversed. The best performing FTA partners were Jordan, Lebanon and Egypt, although all show substantial annual variations in trade, while before the Russian invasion, Ukraine's FTA with the EU seemed to be stimulating exports.

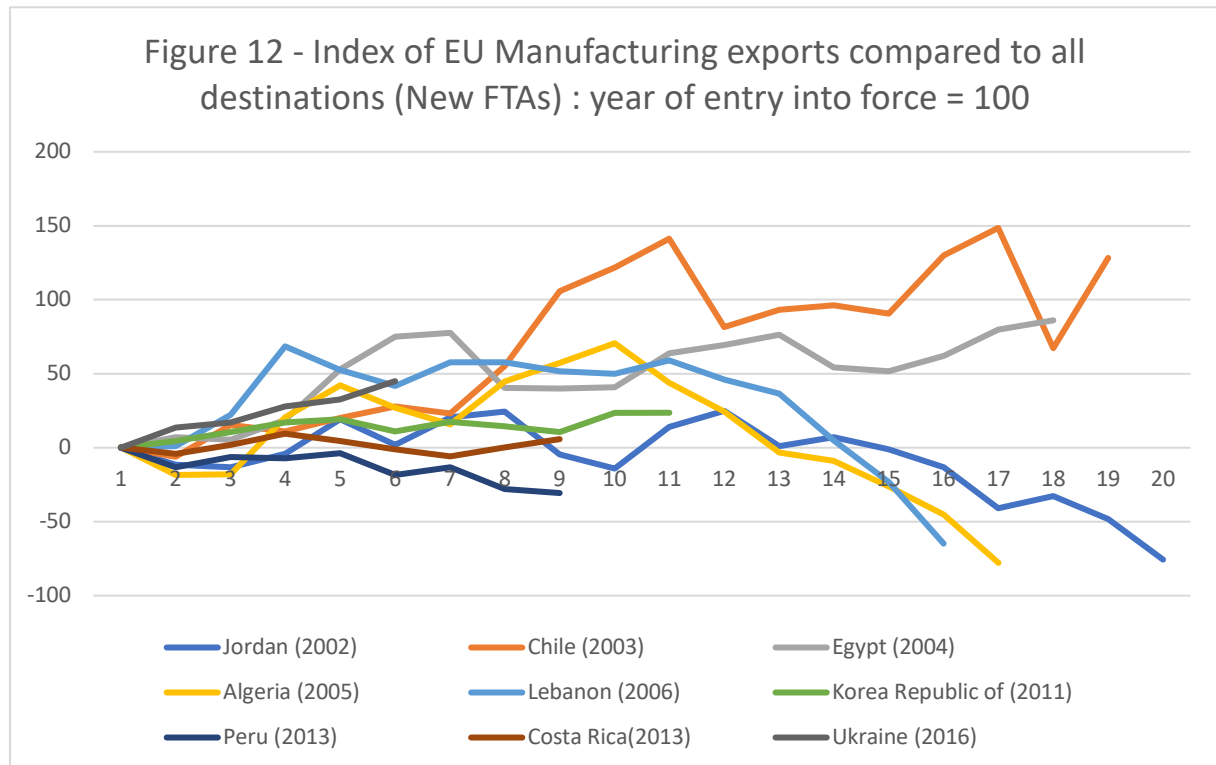
Looking at trade in manufactured goods, overall indices are presented in Figure A4 in the annex, the difference compared to all EU imports is shown in Figure 10. The underperformance of Costa Rica, Peru and Algeria is even more pronounced than for all trade, while Korea's FTA seems to have made very little difference to trade in manufactures. As for all trade, Jordan, Egypt and Lebanon show the best performance.



Although the evolution of exports is perhaps less relevant to the study of EU facing GVCs, given the integrated nature of many industrial GVCs, we also looked at trends in this direction, although here we concentrated only on manufactures. As above, we indexed exports of 'old' FTAs with a base year 2001 and for 'new' FTAs on the basis of the first year of the agreement. The results for 'old' FTAs are shown in Figure A5, while Figure 11 shows the results when compared to the index of all EU exports. The FTA partner in this group where EU exports grew most was Turkey, followed by Morocco. Exports to South Africa performed well in the first years of the century, but in recent years have grown below average. Israel and Tunisia have consistently underperformed compared to all export trade, while Iceland has also generally shown less than average exports.



In terms of 'new' FTAs, export growth to the Chilean market has consistently been greater than the average for EU goods, with Egypt also consistently outperforming all exports. Algeria and Lebanon were both better than average markets for several years before becoming much less attractive in recent years. Peru has consistently underperformed, whereas Costa Rica was not significantly more dynamic than all destinations. Before the Russian invasion, the Ukrainian FTA seemed to be stimulating EU exports.



### 7.3. Why might FTAs not stimulate more trade?

Overall, the figures presented here indicate that the EU's FTAs have had very varied impacts on the integration of trade partners into EU GVCs. In terms of EU imports, certain historic trade partners like Turkey, Mexico and Iceland have performed strongly. As for the more recent FTA partners, geographically close countries that negotiated FTAs earlier in the century (Egypt, Jordan, Lebanon) performed substantially better than more distant sources with more recent FTAs (Costa Rica, Korea).

For EU exports, the most interesting market amongst traditional trading partners has been Turkey, with Morocco also dynamic. Having underperformed for some time, in recent years Mexico has also become a more interesting market. Amongst the more recent FTAs, exports to Chile and Egypt have been most dynamic, while several partners have seen less than average export growth in recent years (Algeria, Jordan, Peru). What is also clear from this analysis is that, in spite of the extensive political efforts which go into negotiating these FTAs, many produce disappointing results in terms of trade flows. Recent FTAs with Peru and Korea seem to have had little impact on trade. We will briefly consider here some of the reasons for the frequently rather limited impacts of EU FTAs.

Firstly, production capacity clearly has an impact, as well as the structure of the economy. If a country has no capacity to provide exports that profit from preferences, trade is unlikely to grow. The products they export also matters. As outlined in Schema 1, preferential access has an impact when other sources pay significant Most Favoured

Nation (MFN) tariffs. The general level at which tariffs are considered to start to have a significant impact on sourcing decisions is about 5%. Many goods enter the EU duty free, or pay minimal tariffs. For a country which mainly exports goods which pay low or minimal tariffs in the EU market, an FTA or preferential access would make little difference to their relative competitiveness. Such goods would include most tropical fruit and vegetables (except bananas), most unprocessed raw materials, electronics and fuels, to name but a few.

The sector where preferential access to the EU market provides the greatest potential advantages is agricultural products, where the EU, like many markets, retains high levels of protection (Bown and Crowley, 2016). Negotiating access to the EU agricultural market can therefore have important impacts on trade. The industrial sectors with high MFN tariffs in the EU market include processed fish, clothing and certain chemicals. Thus, depending on the industrial structure of the partner country and the extent to which they produce goods which are relatively highly protected on the EU market, an FTA will have greater or lesser potential (and actual) impacts on trade.

Secondly, geography is important. It has long been clear that distance impacts on trade flows, such that neighbouring countries usually export more to a given market than those that are more distant, while large markets like the EU attract more trade. This observation has been formalized and tested in the so-called 'gravity model' of trade (Tinbergen, 1962; Linneman, 1966). The effect of gravity is evident in EU trade, including for manufactures. With the exception of Chile and Mexico, most of the FTA partners with whom trade has increased significantly are in the EU's neighbourhood. Yet being close to the EU and having substantial market access, are clearly not sufficient to secure greater integration into EU-focused GVCs, as the poor performance of partners like Algeria, Israel and Norway shows. Of course, other factors like political stability and relative competitiveness also impact on these trends, as do pre-existing trade frictions (Baier, Yotov and Zylkin, 2019).

Thirdly, as the number of FTAs increases, the relative advantage accorded to partners decreases. Economists have noted a 'domino effect' of FTAs (Baldwin and Jaimovich, 2012), where countries negotiate agreements to avoid being disadvantaged on the market after competitors negotiated their own agreements. Both the Mexico and Chile agreements followed FTAs between these countries and the US and there was strong lobbying from EU exporters to seek parity with their US competitors (Dur, 2007). The agreement with Japan was negotiated in parallel with the Transpacific Partnership (TPP), which would have provided Japanese market access to a wide range of countries,

including, initially, the US<sup>6</sup>. In such a case new FTAs don't change the relative competitiveness of the exporters of the relevant countries, unless one has negotiated better market access than the other. The absence of large increases in trade flows following new FTAs in such contexts is unsurprising (Baier et al. 2019).

This does not mean that such FTAs had no impact on trade and GVCs. Rather that, in terms of Schema 1, EU producers would move from a situation of no preferential access to one with preferential access, but together with other key suppliers, such that there would be a level playing field between these competitors and a common advantage over those with no FTA. Similarly for suppliers to the EU market, the increase in the number of FTAs over this century has increased the number of competitors with preferential access to the EU market, such that negotiating an FTA may be as much about levelling the playing field with key competitors, as it is about securing competitive advantage.

It remains to be seen whether the recent large FTAs with Japan and Canada will have greater impacts than other (smaller) recent trade agreements. The first three years of both coincided with the COVID-19 pandemic, so it is difficult to judge whether trade has been affected. Proponents of free trade will be hoping that the liberalisation of tariffs and standards harmonization inherent in FTAs will soon start to show perceptible impacts. Especially given the controversy around the FTA with Canada and the substantial political capital required to assure its ratification (De Bievre, 2018). The extent to which new bilateral agreements will be important in future GVC configurations depends, not only on whether these new agreements can be concluded and ratified, but on whether existing agreements can be seen to deliver improvements in integration across partners' GVCs.

#### **7.4. The changing nature of EU FTAs**

Over time, in reaction to changes in the nature of trade, as well as growing controversy about its potential negative impacts, the issues addressed in FTA agreements have changed markedly. Negotiations are no longer only about trade in goods and traditional tariff bargaining. There has been a general trend towards 'deep' FTAs, covering a wide variety of issues, including some not usually addressed at the multilateral level (Fiorentino, Verdeja and Toqueboeuf, 2007; Dür, Baccini and Elsig, 2014). The EU's FTAs have expanded to include services (including digital services), as well as several 'behind the border' regulatory issues, like competition, non-tariff measures (NTMs), public procurement and e-commerce. For example, the EU's

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<sup>6</sup> Following the election of Trump, the US pulled out of the deal, which was subsequently rebranded the Comprehensive and Progressive Trans Pacific Partnership (CPTPP). It provides substantial market access to the Japanese market to several key exporters in the region including Vietnam, Korea and Canada.



agreement with Korea is made up of fifteen chapters, three protocols and four understandings, together with many annexes and appendixes (Horng, 2012).

From the point of view of GVC trade, once these 'deep' FTAs are agreed and ratified they provide the opportunity to secure a more level playing field between partners on NTMs, as well as tariff measures, while enabling GVC integration through harmonisation of intermediates and final product standards. The inclusion of standards and regulation in FTAs is not entirely uncontroversial. The insistence of the EU on including these issues is sometimes seen as an exercise of 'Market Power Europe', where the EU seeks to use its market power to impose EU regulations on trade partners, in exchange for market access (Damro, 2012).

Differences in standards can have significant effects on trade. Some studies find NTMs to be even more important in fostering trade (and investment) than tariffs (Adarov and Ghodsi, 2022, 2023). In addition, NTMs can have cumulative effects along GVCs (Ghodsi and Stehrer, 2022). NTMs have become increasingly important to international trade negotiations over time (Grübler and Reiter, 2021a) and were a key issue in several recent EU FTAs. In the case of the EU's FTAs with Singapore and Japan, for example, dealing with divergent regulation was considered to be a more important objective than tariff reduction (DG Trade, 2013; DG Trade, 2016), although ex-post analysis of the EU-Korea FTA indicate that it did not result in significant reductions in the costs associated with NTMs, with most of the impacts of the FTA explained by traditional tariff cutting (Grübler and Reiter, 2021b).

Nevertheless, agreements on NTMs within FTAs clearly have the potential to encourage greater production sharing across the member countries. This issue is analysed in more detail in deliverable 1.4. We will therefore not consider it further here, beyond noting that in later WPs TWIN SEEDS analysis will need to also integrate the potential impact of NTMs (and their removal) on trade. With this in mind, we propose to include this issue in the revised framework for analysis for the project.

At the same time the inclusion of sustainable development objectives within EU FTAs has increasingly become politically indispensable, not least because the European Parliament insists on undertakings in this area and as discussed above, the EP now has veto powers in trade policy. The EP's consent to FTAs with Colombia and Peru was conditional on the establishment of 'Road Maps' on human, environmental and labour rights by both countries (EP, 2012), while they have consistently underlined that any agreement with India would only be ratified if it included strong commitments on sustainable development (Curran et al. 2021).

The trade and sustainable development (TSD) chapters of the EU's FTAs have been contested, with civil society considering that they are not effective enough (Harrison et

al, 2018) and many (especially emerging country) trade partners strongly resisting the inclusion, of such 'non-trade issues' (Stephen and Parízek, 2019; Curran et al. 2021). This resistance has further complicated FTA negotiations (Curran et al. 2021).

The controversy about TSD has also rendered the ratification of FTAs which are agreed more complex, most notably the EU-Mercosur FTA, which was concluded in 2019, but has not been ratified. This blockage is largely because of civil society concerns about the potential negative impacts of trade liberalisation on climate change and human rights, due to perceived weaknesses in environmental and social protection in Mercosur countries (Fritz, 2020). A report for the French government by a group of influential economists underlined the potential negative effects on climate change and concluded that the agreement was a missed opportunity to leverage EU market access to secure greater commitments (Ambec et al., 2020).

France has publicly indicated that they will not ratify the agreement<sup>7</sup>. Meanwhile the EP has expressed concerns and several member States have voted against the deal (Grieger, 2020). The election of Lula and president of Brazil has rekindled hope that the deal can be passed. A recent opinion piece by three cross-party MEPs argues for such an outcome (Warborn, Moreno Sanchez and Canas, 2023). However, in the post-Covid context, a combination of increasing demands from the EU for broad and deep FTA coverage and a generally rising scepticism about the merit of FTAs seem likely to dampen enthusiasm for future trade deals.

## 7.5. Brexit

The trade policy shift which was arguably the most significant this century was one which was unilaterally imposed on the EU by one of its member states. The UK's 2016 vote to leave the European Union was the beginning of a long and complex series of negotiations which are still incomplete. In trade terms Brexit involved the opposite of an FTA negotiation. It was a negotiation to re-install barriers to trade. In as much as it was the mirror image of an FTA, the potential impacts of Brexit on trade could be forecast using similar economic models to those used to forecast FTA impacts. Before and after the vote many studies were published which sought to forecast impacts, including on EU and UK GVCs (e.g. PWC, 2016; Emerson, 2017).

We will not consider all these studies here, as they have been extensively discussed elsewhere. Emerson et al. (2017:54) list the key studies prior to the vote, while Gasiorek, Serwicka and Smith (2019) includes studies undertaken immediately after. Although analysis generally finds the impact on the UK to be far more significant than on the EU, certain member states (Ireland, Belgium and the Netherlands in goods, Malta, Cyprus and Luxembourg in services) were very dependent on trade with the UK (Emerson et

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<sup>7</sup> <https://www.vie-publique.fr/en-bref/276259-la-france-opposee-au-projet-daccord-ue-mercotur>

al, 2017). In addition, some GVCs (transport, chemicals, wood, textiles...) were forecast to experience greater disruption, with negative impacts on prices and trade (Gasiorek et al. 2019).

These analyses were often based on the idea that new bilateral tariffs would be imposed, especially in the case of a hard Brexit, where the UK would have reverted to MFN tariffs. In the event, the two parties agreed an FTA for merchandise trade, such that tariffs are not a key barrier to the continuance of pre-Brexit GVCs in goods. However, the exit of the UK has resulted in barriers to services trade, as well as new NTMs for goods, which will only increase over time, as the UK diverges from EU standards. In this sense this real-life experiment which has been imposed on the EU, could yield interesting insights into the effect of deviation in industrial standards on GVCs. This should increase our understanding of the positive impacts of standardization, which are being forgone in this case.

The actual impacts of Brexit on trade will be monitored as the TWIN SEEDS project develops. Initial analysis of the first year of the new trading arrangements indicate that, post Brexit, UK import increased by more than exports and the UK trade deficit therefore grew, both with the world and with the EU27.<sup>8</sup> The sector that saw the largest increase in trade in the latter months of 2022 was machinery and transport equipment. This was primarily due to increases in imports of ships from the EU and power machinery exports in the other direction. The new EU-UK trading arrangements are likely still being integrated into company strategies, so these short-term effects may change with time. As the impact of Brexit evolves, the TWIN SEEDs project will be well placed to assess its longer-term effects on EU GVCs.

## **7.6. Bilateral relations with key countries without an FTA**

Much of the EU's external trade still takes place outside of FTAs. For the EU27 as a whole, only 28.5% of all extra-EU goods imports in 2019 were covered by FTAs. The two biggest suppliers without EU trade agreements were China (19% of imports) and the US (12%). As it is unlikely that this situation will change in the near future, it is worth briefly recalling the policy context in relation to these two important trade partners.

The EU's relations with China have inevitably been impacted by the deterioration of the latter's relations with the US. The prevailing narrative in the US is conflictual, with China perceived as a revisionist state, seeking to undermine the world order (Johnston, 2019; Overhaus, Rudolf and van Daniels, 2020). Europe has sought to pursue a more engaged strategy with China, although finding the right balance has been difficult. The two have found common ground in relation to key issues of trade policy like the reform of WTO (Liao and Mavroidus, 2021), but have clashed on other core questions like the extent

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<sup>8</sup> <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/december2022>

to which China can be treated as a market economy within the EU's trade policy machinery (Curran and Maiza, 2016).

Since China joined WTO, its trade with the EU has expanded dramatically, rather inevitably this caused some trade conflicts. In recent years China is the country which has been most often targeted by the EU's trade defence machinery. The most recent report from the EU Commission found that nearly 70% of the EU's anti-dumping actions in place in 2021 targeted China (sometimes together with other countries) (CEC, 2022a). From conflicts over clothing and footwear exports after liberalization of trade in 2005 (Curran, 2009; Eckhardt, 2011), to solar panels in 2012-3 (Kolk and Curran, 2017) to steel, where there were 25 investigations between 2017-21 (CEC, 2022a), China's expanding exports have caused friction and led to intense debates about the most appropriate response.

The policy debate often pitted EU domestic producers against importers and/or retailers dependent on low-cost Chinese imports (so called import-dependent firms (Eckhardt, 2011)). Unrelated sectors sometimes suffered collateral damage from these conflicts. As China's market has become increasingly important to EU exporters, the country has not hesitated to retaliate against EU trade defence actions. In the solar panel case retaliation targeted EU goods as diverse as silicon, cars and wine (Kolk and Curran, 2017).

In this conflictual context, an FTA with China has never really been a realistic prospect. However, a bilateral agreement on investment (the Comprehensive Agreement on Investment (the CAI)) was successfully negotiated in 2020. Given the expanding bilateral investment relationship, such an agreement could be desirable (Meunier, 2014). At the time, the agreement was seen as ground-breaking and has been praised for its strong commitments on sustainable development (Chaisse, 2022). It was also considered a stark contrast to the US's lack of engagement (Famigli, 2020). However, the road to ratification for this agreement will not be smooth. The process has been suspended in view of a series of concerns, including the fact that several MEPs have been sanctioned, following their criticisms of China's human rights record (Burnay and Raube, 2022).

In terms of relations with the US, as mentioned above, efforts to secure the TTIP agreement with the US ran into strong resistance from civil society (Bauer, 2016; Young, 2016; De Ville and Siles-Brügge, 2017; Meunier and Czesana, 2019), even before the 2016 US election of President Trump led to the negotiations being put on hold. There is little prospect of FTA negotiations being relaunched, although relations have been less conflictual under President Biden and a bilateral dialogue on trade and technology – the Trade and Technology Council (TTC) - has been seen as an opportunity to rebuild cooperation on several key global issues (Van der Loo, Vandebussche and

Aktoudouanakis, 2021). However, the huge subsidies which the US extended to its industry through the Inflation Reduction Act (IRA) in 2022 and the conditionality which is applied to the funding has created renewed tensions (Wright, 2022). The difficulties emerging in the transatlantic trading relationship will be further analysed in later WPs.

In terms of other trade partners, at time of writing (early 2023) the EU had agreed an additional FTA with New Zealand (in June 2022) and was still in negotiations with Australia, India, Indonesia and the Philippines. In trade terms, by far the most important of these negotiations are those with India (2% of extra EU27 trade in 2019) although they have been fraught with difficulties (Curran, Nadvi and Khorana, 2021). As these different trade relationships evolve, we shall address the implications in future WPs of the TWIN SEEDS project.

## **8. Unilateral policy measures**

In addition to trade policy shifts and constraints at multilateral level and bilateral agreements with partners, there are another set of trade policy tools which can have important impacts on the relative competitiveness of GVC partners. These are the unilateral policy tools which the EU can use in certain circumstances to render certain goods more expensive and make others relatively cheaper. The key unilateral instruments the EU applies are trade defence tools and preferential access schemes. We will look at their operation and implications for GVCs in turn.

### **8.1. Trade defence - Anti-dumping and anti-subsidy**

The underlying idea behind trade defence is that certain countries (or companies) seek to increase their market share by dumping their goods at a low price in order to illuminate local competition or by providing subsidies to their industry in order to render them more competitive one international markets. Trade defence enables countries to redress the balance by applying additional duties on these goods to counteract their 'predatory' behaviour. Economists have long been sceptical about the justification for trade defence. Much of the research on these measures have focused on anti-dumping (AD) measures, rather than anti-subsidy (AS, or countervailing measures as they are called in the US). This is unsurprising given that WTO figures indicate that less than 8% of trade defence measures taken between 1995-2020 were AS (NBTS, 2021) and AS duties tend to be lower than those in AD cases. In the cases explored in NBTS (2021), AS duties averaged 4% and were well below the AD duties imposed. For example, in the solar panel case in 2013, AS duties varied from 0-11.5%, while ADs ranged from 27.3-64.9%. Given the increase in subsidization following COVID and the political controversy surrounding it (Rankin, 2023), it seems likely that AS measures may become more widespread in future, stimulating further research into their effects.

Research on AD measures indicate that they are as much, if not more, an institutionalised strategic tool to support competitiveness, as a measure to prevent unfair trading practices. There is evidence that AD filings are strongly motivated by strategic concerns (Prusa and Skeath, 2001), as well as macroeconomic factors like exchange rates and industrial production levels (Jallab et al, 2006), as well as GDP growth (Knetter and Prusa, 2002).

The fundamental issue of whether these filings are actually related to dumping, as economically defined, remains questionable, with quite a lot of evidence that other factors are at play (NBTS, 2021). The economic basis of many AD investigations has been found by researchers to be dubious. The OECD found that 90% of practices ruled as unfair in key OECD countries would not have been questioned under domestic anti-trust laws (OECD, 1996). Jallab and Kobak (2006) found that over 68% of the AD investigations launched in the EU between 1998 and 2001 had a questionable economic basis. The equivalent figure for the US was 76%. Other studies suggest that at least some investigations are launched in retaliation, such that the imposition of AD duties by a given country often results in new investigations against their own industries by the targeted trade partner (Feinberg and Reynolds, 2006, Prusa and Skeath, 2001).

Early research on the actual impacts of AD on markets tended to focus on firm level effects. Studies found that AD protection impacts on domestic firms' productivity (Konings and Vandenbussche, 2008), as well as the profit margins of both affected exporters, who lose out (Vandenbussche and Zarnic, 2008) and protected domestic firms, which experience significant gains (Marsh, 1998). More recently there has been greater interest in the impacts on trade flows, with strong support for the trade destruction and trade deflection effect of these tools in the EU (Baran, 2015; Brenton, 2001; Curran, 2009; NBTS, 2021). In other words, when the EU instigates AD measures exports from the targeted country fall (trade destruction), but exports from other similar suppliers increase (trade deflection), such that the overall level of EU imports does not necessarily fall as a result of the measures, although prices tend to rise and GVC structures often seem to shift.

A recent in-depth study by the Swedish National Board of Trade (which has long been sceptical about the merits of trade defence) looked at the trade and price effects of EU trade defence measures from 2008-15 (NBTS, 2021). Overall, they find an average reduction in imports from the targeted country of 28%, an increase of 13% in imports from non-targeted countries, a fall in overall imports of only 1% and an increase in prices of 4%, although there is extensive heterogeneity in the effects across cases (NBTS, 2021). These findings underline, not only that AD has important impacts on



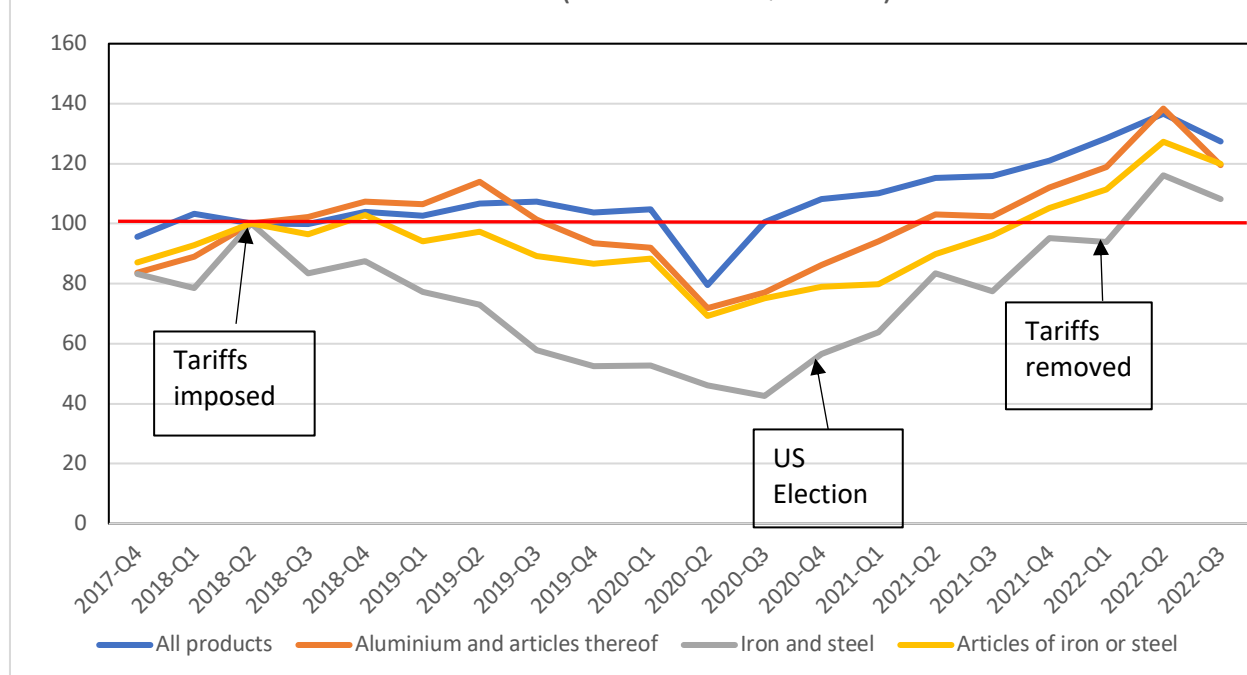
trade flows, but also that the reaction of specific actors within GVCs to the new measures varies quite extensively across and even within industries.

The type of good is also an important consideration in terms of the impact of AD and AS on GVCs. 80% of the EU's trade defence actions were against intermediate goods, with likely direct effects on the structure of EU-facing GVCs (NBTS, 2021). In addition, goods related to climate protection and the energy transition (like biodiesel and solar panels) are often targeted, with potentially negative impacts on the EU's wider sustainable development targets (Kampel, 2017; Kolk and Curran, 2017; NBTS, 2021).

The above discussion has mainly focused on imports, but trade defence has an impact on EU trade in both directions. EU exports have often been targeted by trade partners, with sometimes dramatic impacts. The most far-reaching recent example in the pre-COVID context was probably the US imposition of tariffs on steel (25%) and aluminium (10%) shortly after Trump acceded to the White House. These were not imposed under AD legislation, but under a special unilateral regulation related to threats to national security (Section 232). The use of this instrument allowed the US to target a much wider range of countries than would usually be covered by AD, as it was not related to unfair trading practices, but to supposed security risks. Although the WTO has ruled that the measure is incompatible with US commitments, it remains in place (Deaux, 2022). Following the change of administration, the EU negotiated an exclusion from the duties in exchange for accepting a tariff rate quota (TRQ) for EU suppliers. This means that EU exports are exempted, provided they do not go above a certain level (Dadush, 2021).

Section 232 duties had significant impacts on EU exports in the affected sectors. Figure 13 provides an overview of trends in trade in these sectors and for all trade over recent years, taking the last quarter without tariffs as the basis. It is clear that the 25% tariff had a strong impact on iron and steel exports, which had almost halved by the time the COVID pandemic further disrupted trade in early 2020. It took some time to negotiate the removal of the tariffs with the Biden administration, although, interestingly, trade started to return to previous levels even before the new arrangements entered into place. Nevertheless, according to the most recent figures, the index of exports of all affected products except aluminium were still below that for all trade, indicating a persistent impact from the supply disruption.

Figure 13 - EU exports of Steel and Aluminum to the US under Section 232 (Index 2018 Q2 = 100)



In response to the Section 232 tariffs the EU, along with several other targeted countries, imposed its own retaliatory tariffs<sup>9</sup> on the US from June 2018. These persisted until the announcement of an agreement with the US in late October 2021. They consisted of a 25% tariff on certain metals, but also on unrelated finished goods including such diverse goods as jeans and boats. Figure 14 gives an indication of the impact of these tariffs. It shows quarterly trends (indexed from 2018 Q2, the last quarter before the imposition of new tariffs) for all EU imports from the US, together with those for all products affected by the retaliation and two important iconic US products targeted - motorbikes and whiskey<sup>10</sup>. It is clear that EU imports of the targeted products fell compared to all US imports, which were fairly flat until the pandemic disrupted trade in 2020Q2. Although trends in whiskey and motorbikes vary and tended to perform slightly better than the entire group of targeted products, the index of imports of both were below trends in all products. This remained the case, even after the tariffs were lifted.

What these analyses confirm is that trade conflicts have real and enduring impacts on trade of affected products and that such conflicts can affect GVCs well beyond those initially targeted. The decision of the US to impose new duties on EU steel and aluminium imports had direct effects on US exporters of a diverse range of goods

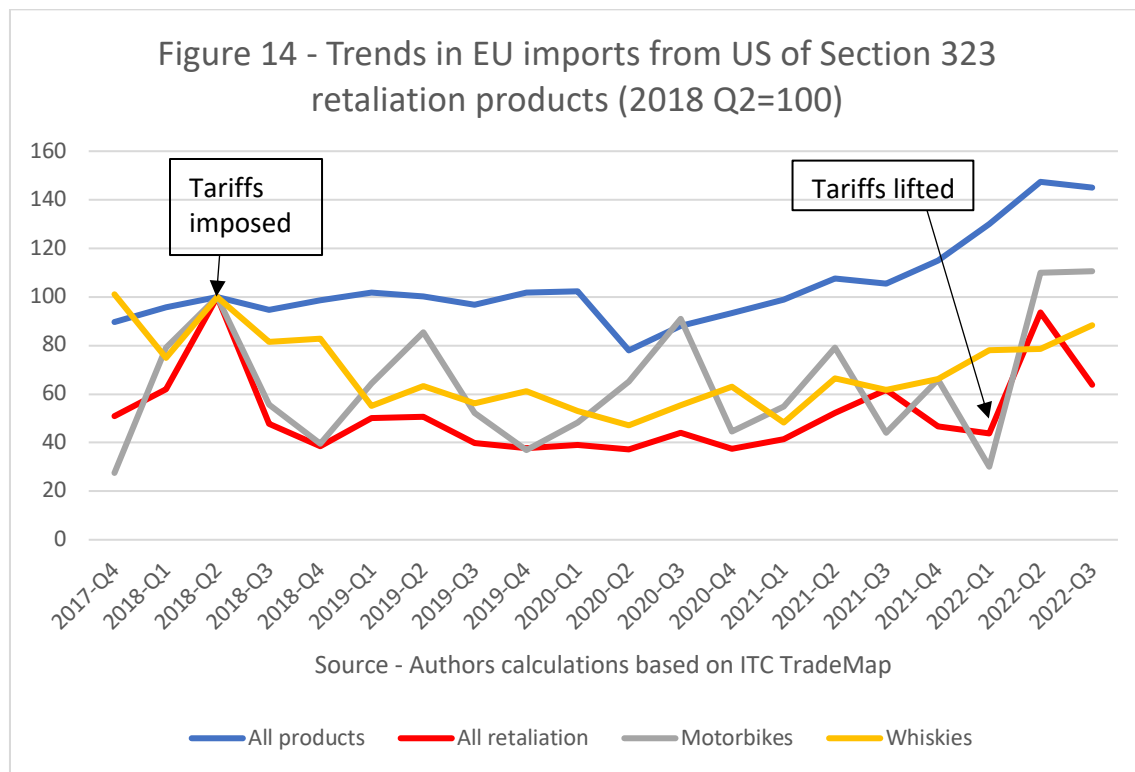
<sup>9</sup> See <https://www.trade.gov/feature-article/foreign-retaliations-timeline> for a comprehensive list.

<sup>10</sup> Together these made up 45% of US exports to the EU in the non-metal goods targeted in the quarter prior to the imposition of retaliation



including whiskey and motorbikes. Such conflicts also have impacts on investment. It was reported that iconic motorbike brand Harley Davidson planned to move production out of the US as a result of the joint impacts of higher metals prices (due to Section 232 tariffs) and new EU import taxes on their exports (Rappeport, 2018).

The trade conflicts between the EU and the US were relatively limited compared to the parallel conflict with China, which has been characterized as a 'Trade War'. As Chad Bown has highlighted, the result of this conflict was a series of new tariffs, exemptions and managed trade of such extreme complexity such that: *'Measuring that change and identifying its causes and effects will keep researchers busy for years.'* (Bown, 2021: 806). As research emerges on these extensive, and often novel, policy interventions, they will certainly prove useful to the TWIN SEEDS project.



Precisely because of its negative effects of trade and investment, even the threat of unilateral AD or AS action can also have impacts on trade flows, as companies voluntarily minimize exports to reduce the risk of negative outcomes (Krupp and Pollard, 1996; NBTs, 2021). Threatened actions also impact on trade policy. For example, the threat from China to impose AD measures against EU silicon and wine exporters impacted the debate on solar panel AD duties (Kolk and Curran, 2015), while the US threat to impose duties on EU car exporters during the Trump Presidency led to great nervousness in EU industry about the wisdom of retaliation (Curran and Eckhardt, 2022).

As indicated above, most research on trade defence has looked at AD. The impact of subsidies and reactions to them (AS duties) has been much less widely analysed. However, interest in the impact of subsidies on trade has increased in recent years. This was partly because of the widespread deployment of government support to industry during the Global Financial Crisis (GFC) (Evenett and Jenny, 2009), but also because of the widespread use of subsidies in large emerging markets, especially, but not only, China (Ambaw and Thangavelu, 2022). These latter subsidies have been blamed for global overcapacity and tumbling prices, especially in renewable energy sectors (Zhang et al. 2016) and steel (Wuttke, 2017), which in turn spilled over into the trade conflicts referenced above. Recently, academic interest in the impact of subsidies on trade has increased (Ambaw and Thangavelu, 2022; Kaploutpsidi, 2018), although since the GFC Evenett and his co-authors have been arguing that trade policy has increasingly been manifested through non-tariff measures including industrial policy in what they term 'murky protectionism' (Aggarwal and Evenett, 2013).

As we emerge from the Covid-19 pandemic, it is difficult to predict which sectors will be vulnerable to unilateral action by trade partners (or by the EU). As pointed out in Curran (2015), and incorporated into Schema 1, industrial sectors which are important for employment and/or strategic objectives are particularly vulnerable to ad-hoc trade defence measures and subsequent impacts on GVCs. Given that the conception of strategic industries has recently expanded globally, both as a result of the COVID pandemic (Curran and Eckhardt, 2021) and the war in Ukraine, ad-hoc trade policy interventions seem likely to increase in the future. The TWIN SEEDS project will certainly need to assess such actions as they develop.

## **8.2. Unilateral measures to address Sustainable Development Concerns**

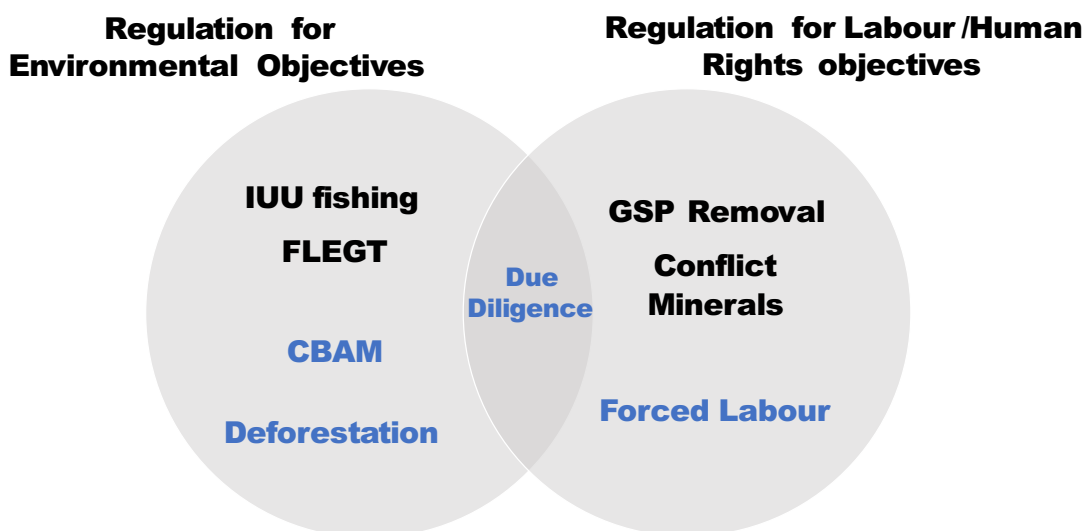
In recent years, the EU has become increasingly concerned about the impact of trade on sustainable development. As discussed above, this has led to stronger efforts to integrate TSD into FTAs, but it had also led to an increasing number of unilateral measures aimed at ensuring that goods which are imported into the EU respect minimum environmental and social norms. This is another manifestation of 'Market Power Europe' (Damro, 2012). The landscape of such measures has recently expanded considerably. Schema 2 (updated from Curran, 2022) provides an overview of the measures, differentiating between existing regulations (in black) and those that are proposed (in blue).

Existing SD measures tend to address sector-specific concerns. The key measures are the Regulation to address illegal unreported, and unregulated (IUU) fishing, which came into force in 2010 (Jaremba, 2020); the 2013 Forest Law Enforcement, Governance, and Trade (FLEGT) initiative, aimed at combatting illegal timber trade

(Zeitlin and Overdevest, 2021); and the 2021 Conflict Minerals Regulation, which aims to ensure that conflict minerals don't enter the EU's supply chains (Jaremba, 2020).

These measures seek to address sustainability concerns in particular sectors, through a combination of cooperation and coercion at bilateral and global levels. As indicated in the schema, the first two address environmental concerns while the latter is focused on protecting human rights. Given their focus on key sectors vulnerable to negative SD impacts, their impact on trade has been relatively limited. The final existing mechanism to address SD concerns is the potential removal of trade preferences under the Generalized System of Preferences (GSP). This will be discussed below in the section on preferential access.

**Schema 2 – EU unilateral measures to address SD concerns: Existing (black) and proposed (blue)**



*Source - Adapted and updated from Curran (2022).*

In terms of proposed unilateral actions, there are several new measures under discussion which will affect a far wider range of sectors and export partners than existing tools and, as such, they are much more controversial, both in the EU and with their trade partners. On the environmental front, the Carbon Border Adjustment mechanism (CBAM) is a proposed measure to avoid 'carbon leakage' by levelling the playing field between EU producers of energy intensive goods, who increasingly have to pay the costs of the carbon embedded in their production (as part of the EU's efforts to move to carbon neutrality) and imports that do not (CEC, 2021a). The proposal has

stimulated a lot of debate with even the industries which it is supposed to protect lobbying against certain aspects (AEGIS, 2021).

The proposed regulation on products linked to deforestation aims to reduce the negative impacts of EU consumption on forest cover by seeking to assure that products which have been produced on deforested land are not placed on the EU market. It proposes that importers of covered products (cattle, cocoa, coffee, oil palm, soya and wood – and their direct derivative products) submit a due diligence statement, including the precise geographic coordinates where the goods were produced and would make them subject to legal liability in case of non-respect or fraudulent declarations (CEC, 2021b). The regulation on forced labour similarly proposes to require importers to undertake adequate due diligence and enables member states to block imports of goods suspected of profiting from slavery within their supply chain (CEC, 2022b). Finally, the proposed Directive on Supply Chain Due Diligence, seeks to impose greater due diligence requirements on all large EU companies to ensure that they make efforts to avoid negative impacts on either human rights or the environment along their supply chains (CEC, 2022c).

These new regulations are far-reaching and highly controversial with the EU's trading partners. Several overseas interests provided detailed input to the consultation on CBAM, including Russian, Ukrainian and Brazilian exporters as well as the central Canadian government together with representatives of 3 local regions<sup>11</sup>. Brazil has strongly objected to the deforestation proposal, including in the WTO (Assis Moreira, 2022). This is unsurprising given that it is the biggest non-EU source of the goods covered (Curran, 2022).

Although unlike similar US legislation, the forced labour proposal does not single out goods from China or Xinjiang, it is likely to affect Chinese trade in particular and intensify geopolitical tensions with Beijing (MERICS, 2022). Public debate has also been intense. The Commission's open consultation on the due diligence proposal attracted 473,461 inputs, the vast majority of which were linked to NGO campaigns in favour of the legislation (CEC, 2021c). However, EU industry remains sceptical and is lobbying to restrict the coverage and operation of the instrument (Business Europe, 2022).

These policy proposals have the potential to impact in the future orientation of EU GVCs by increasing the costs and risks associated with overseas sourcing. Some will affect only certain sectors (CBAM and deforestation), while others are far more generic (forced labour and, especially, due diligence) and will impact across GVCs. As these debates move forward into concrete policy orientations, subsequent work packages of

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<sup>11</sup> All feedback is available at: <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-EU-Green-Deal-carbon-border-adjustment-mechanism- en>

the TWIN SEEDS project will be well placed to monitor the debates and assess the likely impacts of these proposals across key affected GVCs.

### 8.3. The Generalised System of Preferences (GSP)

The GSP is a long-standing trade regime which provides preferential access to developing countries. Such special access is validated in the WTO through the 'Enabling Clause'<sup>12</sup>, such that the EU (and other WTO members) can provide preferential market access to developing countries, as long as they treat similar countries in the same way (the principle of non-discrimination). Least Developed Countries (LDCs) have been given almost completely free access to the EU market under the Everything But Arms (EBA) initiative since 2001. This scheme has helped to increase the exports of these countries, especially those of Bangladesh, the key trader in the group (Curran and Nadvi, 2015). Early EU efforts to differentiate between other developing countries by providing special access to those who were actively involved in the fight against illegal drugs had to be revised following a WTO challenge by India<sup>13</sup>. The panel judged that, although the EU could provide more generous market access to certain developing countries, they had to do so in a way which was non-discriminatory i.e. transparent, objective and open to all.

As a result of this judgement, the EU revised its special access arrangements, increasing preferences for countries which respect certain minimum labour, environmental and human rights commitments. The result was the 'Special Incentive Arrangement for Sustainable Development and Good Governance' (the GSP+ regime), which provides very generous market access (most industrial goods pay zero tariffs) to those beneficiary countries that ratify and comply with a list of international conventions. The most recent evaluation of the GSP regimes indicated that the GSP+ scheme had positive impacts on both exports and the ratification of conventions, although it recommended that monitoring be improved (Development Solutions, 2018).

At the same time, the EU has increasingly restricted the number of countries with access to the GSP regime, most notably in the 2014 reform of the system which removed preferences from all high and upper-middle income countries and 'graduated' many key products exported from emerging nations (Siles-Brügge, 2014). The declared idea behind this reform was that it would favour the poorest exporters, by giving them greater preferential access, although some have argued that the objective was to improve the EU's leverage with core partners with whom they were seeking to negotiate FTAs (op cit.).

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<sup>12</sup> [https://www.wto.org/english/docs\\_e/legal\\_e/enabling1979\\_e.htm](https://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm)

<sup>13</sup> [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds246\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds246_e.htm)

Access to the standard GSP programme is also subject to ratification of a shorter list of labour and human rights conventions, such that access can be removed from countries where there are clear abuses of human or labour rights (e.g. Belarus) (Zhou and Cuyvers, 2011). This mechanism is part of the broader EU efforts to leverage unilateral trade policy instruments to foster sustainable development presented in Schema 2.

The effect of such conditionality on sustainable development on the ground in developing countries has been subject to a lot of debate. While the evaluation noted that GSP+ has improved the uptake of international conventions, labour and human rights abuses have continued in EBA countries, especially Bangladesh, Cambodia and Myanmar (Development Solutions, 2018). The EU has also been criticized for uneven application of human rights commitments across GSP beneficiaries (Velluti, 2016).

The European Parliament (EP) has been very active in monitoring the situation and calling for action in cases where commitments were not seen to be respected. In an analysis of the 2014-18 period, Pakistan was the country where the most concerns were expressed (EPRS, 2018). More recently, the EU withdrew some market access preferences from Cambodia, an LDC,<sup>14</sup> following pressure from several actors, including the European Parliament, about human rights abuses there (EP, 2017). Although some have questioned the impact of such withdrawals on trade (Zhou and Cuyvers, 2011), most studies find that greater market access increases exports (Curran and Nadvi, 2015; Development Solutions, 2018) and thus preferential access can constitute a lever to impact on government policy.

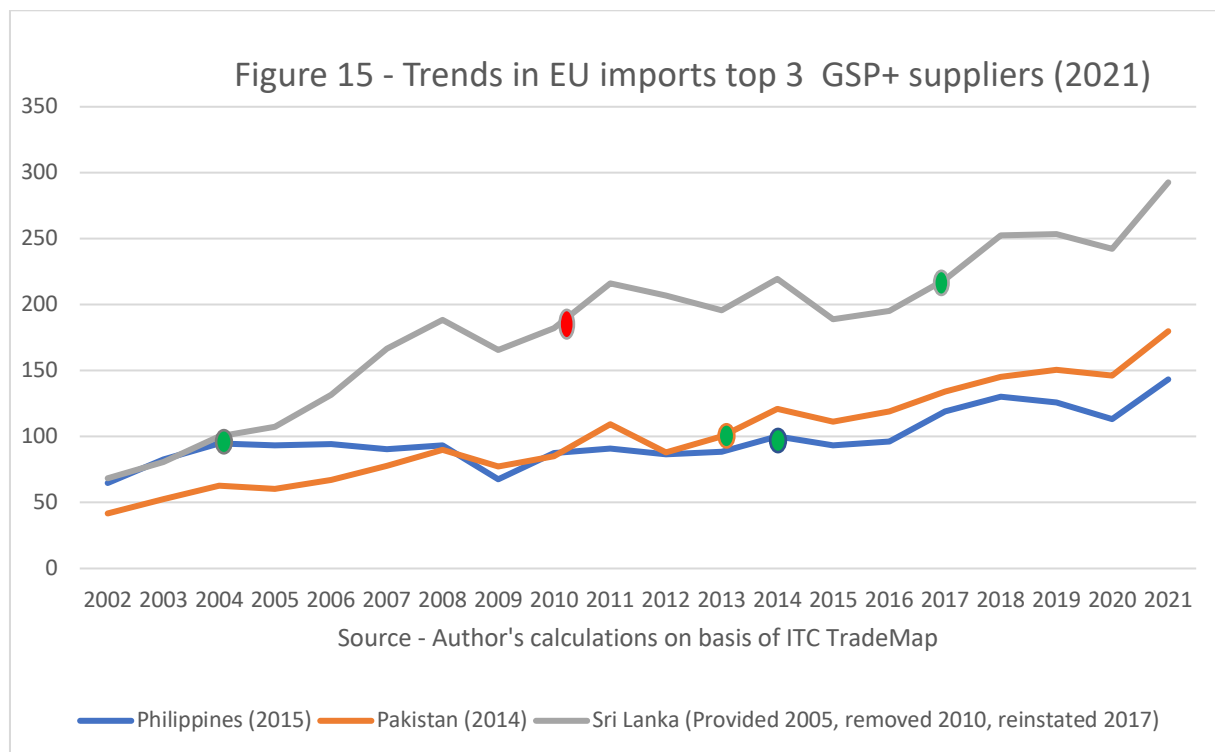
To provide a clearer indication of the impact of market access on trade, we looked at trends in imports from the three biggest EU suppliers under the current GSP+ programme, which provides generous market access, including in sensitive sectors like textiles and fish, where the standard GSP provides little advantage. These are the Philippines (subject to GSP+ since 2015); Pakistan (since 2014) and Sri Lanka (which was subject to GSP+ since its inception, but had it removed for 7 years due to human rights concerns). As their access has varied over the years, this represents something of a natural experiment on the impact of GSP+. Figure 15 shows the indexed trends in EU imports. The base year for each country is the first year they were subject to preferences - indicated by the green dot. The red dot indicates the year that preferences were removed from Sri Lanka.

The graph indicates that in the initial years of the GSP+ scheme Pakistan and, especially, the Philippines saw slower growth in exports to the EU than Sri Lanka, whose exports were subject to GSP+. Following their integration into the scheme, exports increased for both Pakistan and the Philippines, especially the former. However, Sri Lanka's

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<sup>14</sup> <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2113>

exports stagnated in the years when they were suspended (although interestingly they did not fall), before increasing again when preferences were reinstated. These trends indicate that the provision of such market access does impact on trade, although the extent of these impacts obviously varies depending on the context. As discussed above in relation to FTAs, the capacity to benefit from preferences in a given market depends on the presence of a competitive industry capable of exploiting their tariff advantages.



The European Commission recently proposed a revised GSP Regulation for the ten-year period from 2024 (CEC, 2021d) which strengthens both the 'carrots' and the 'sticks' applied to market access. It would extend the eligibility requirements to qualify for GSP+, by adding the adoption of several further international conventions, including the Paris Agreement. In addition, it is proposed to enable more rapid removal of market access in cases of grave violations of commitments. This latter provision is certainly a reaction to criticisms by the EP and civil society more broadly of the long delays between negative shifts in local governance and removal of preferential access, most recently in the case of Myanmar<sup>15</sup>. The potential impacts of these shifts in GSP access in the medium and long term will be considered in WP2 and WP6.

#### 8.4. Rules of Origin

The final area of trade regimes which needs to be considered, especially in terms of potential impacts on access to the EU market, relates to the rules of origin. These rules, which are built into all trade agreements and preferential access schemes, are critical

<sup>15</sup> <https://cleanclothes.org/news/2021/call-for-the-eu-to-suspend-preferential-eba-trade-tariffs-from-myanmar>



to determining their impacts on trade and GVCs (Conconi et al. 2018). Preferential trade agreements (whether bilateral or unilateral) can provide trade partners with substantial tariff advantages. In sectors where tariffs are high (which in the EU include clothing, fish and horticulture), such preferences can generate significant advantages over suppliers who are not offered the same access (Curran et al. 2019). These gains, however, depend on how market access rules are defined.

As discussed briefly above, when a country provides preferential market access to a trade partner, this is conditional on the product being 'made in' the latter country. How this is defined can vary. The so-called 'Rules of Origin' (RoO) provide the specific definition for each trade agreement or preferential regime. They are highly technical and vary widely by product and country, with sometimes major implications for the geography of production (Kniahin and de Melo, 2022). For example, in the clothing sector, RoOs often specify that preferential market access is conditional upon either the sourcing of inputs (such as textiles, or even yarn) from the country, or region, offering the trade preference, or from the preference receiving country itself. These requirements, like most RoOs, are aimed at avoiding a situation where most of the value of preferences are captured by third countries. However, they also provide an incentive to use the outputs of the textile industry of the country of assembly or the preference provider, impacting directly on GVC structures.

Such rules of origin can act as barriers to the use of preference because developing countries in particular may not have local production capacity. Indeed, the garment sector has seen historically low utilisation rates of preferences (Curran et. al., 2007; Pickles, 2012). As a result, RoOs imposed by importing countries have been widely criticized by development agencies and economists (Brenton and Manchin, 2003; Oxfam, 2004; Rahman, 2011; Frederick and Staritz, 2012). As Cadot et al (2008:105) concluded: *'Forcing backward integration in the host country by imposing rules requiring substantial transformation of goods amounts to preventing the division of labour, i.e. organising and codifying inefficiency.'*

In a recent paper by Curran et al (2019), the impact of RoO on EU facing GVCs was explored in detail. Focusing on textiles and clothing, fish and fish products and horticulture, they show how RoO and variations in these rules across trade regimes can be seen to have important impacts on the way in which GVCs are structured, especially in the former two sectors where rules are complex and variations particularly extensive. The RoO for fish, which include ownership and flag requirements for fishing boats, are particularly cumbersome (Campling, 2016). As a consequence, derogations from these rules have been key to the development of fish processing in several small island developing countries (Ponte et al., 2007; Havice and Campling, 2013). The liberalization of these rules to allow the introduction of a wider range of inputs has also been shown

to have important impacts on trade in other sectors (Curran and Nadvi, 2015; Andersson, 2016).

Although most research on RoO has been undertaken in the context of developing country market access to the US or EU, especially under preferential access schemes, from the point of view of EU MNEs, RoO can sometimes be cumbersome and impact on their trade and investment decisions. The US has long used RoO to seek to craft GVCs supplying their market, not only in the sectors discussed above, but also in the automobile sector, which is an important one for the EU. The recent renegotiation of NAFTA (now called the USCMA) included the revision of the RoO for the auto sector. The new rules are 48 pages long. For cars, they specify local content levels which start at 66% for the first year, going up to 75% by 2023. Although local content requirements are standard practice in RoO, these levels are uncommonly high. Furthermore, they also stipulated how they should be achieved – including through a minimum local steel and aluminium content of 70%. By definition, these rules reduced trade opportunities for non-members of USCMA, including the EU (Gonzalez and Vernon, 2019).

The most unusual requirement of these new RoO is that a given percentage of the car's value - 30%, increasing to 40% by 2023 - should be assured by workers whose wages are above a fixed minimum hourly rate of \$16/hr. (USCMA, Chapter 4 Appendix p. 26). As pointed out in a recent analysis of the proposals, this represents an unprecedented use of RoO to define how a given value chain should operate, where value adding activities should take place and under what conditions (Johnson, 2018). EU auto MNEs in the US market are concerned that they are disadvantaged by these rules, which are easier for local producers to fulfil (Curran and Eckhardt, 2023).

Another recent US innovation, integrating concepts of RoO into US consumer subsidies, is further complicating the context for EU auto exporters. Under the 2022 IRA, subsidies for electric vehicles are subject to requirements that the critical minerals and batteries must come from the US, or a country with which it has an FTA (which is not the case for the EU), while the vehicle must also be assembled in the US.<sup>16</sup> The EU has been pressing for more flexibility for EU auto producers, but so far has only managed to secure access for commercial vehicles (CEC, 2022d). Although the scheme is trade distorting and clearly WTO incompatible, the EU is under pressure not to challenge the measures, including from environmental NGOs who favour massive investment in clean transport systems (Palmer, 2023). EU industry also favours an equivalent massive subsidization of electrification in the EU over conflict with the US (ACEA, 2023). The linking of RoO and subsidies raises new questions about where trade policy stops, and industrial (and environmental) policy begins. This complicates the

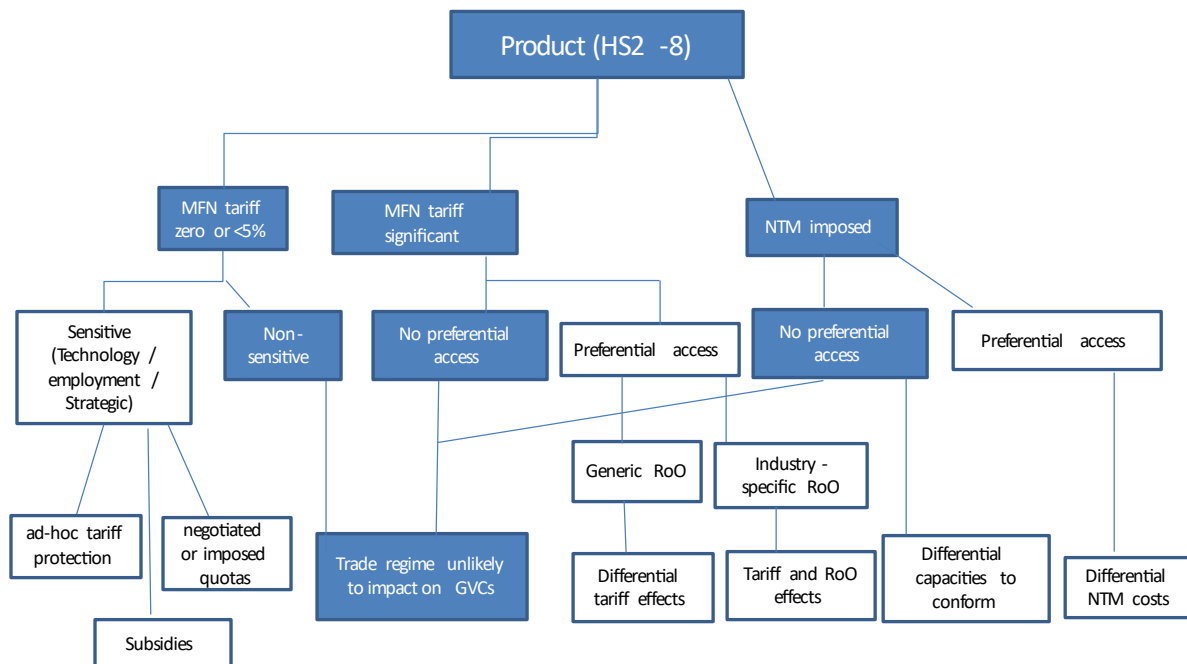
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<sup>16</sup> <https://www.whitehouse.gov/cleanenergy/clean-energy-tax-provisions/>

post COVID context for companies seeking to optimize their GVCs. These issues will be further considered in the later TWIN SEEDS WPs.

### 9. A framework to integrate trade policy shifts into the TWIN SEEDS project

On the basis of the discussion above, it is clear that trade policy and variations in market access have important impacts on the GVCs which are integrated into the EU market. At multilateral, bilateral and unilateral levels, choices about the structure and operations of trade regimes, and trade policy more widely, create incentives to source in certain countries above others. At the same time, in an increasingly conflictual context, where scepticism about global integration has been heightened by the pandemic and the war in Ukraine, the EU and its trade partners have developed new innovative policies which will impact on GVCs going forward. Based on the insights from the above analysis, Schema 3 adapts and expands the framework proposed by Curran et al (2019) presented in Schema 1, to provide a robust basis for the trade policy analysis within the TWIN SEEDS project. It highlights those aspects of the trade regime (and other measures with an impact on trade) that are most likely to require analysis, as the policy context evolves.



Schema 3 – A revised framework for assessing the impact of trade regimes on GVCs

The key issues highlighted in the figure relate to the following issues:

- *Risk of intervention in industries considered sensitive* – while past sensitivities were often related to employment (which motivated the quotas in clothing and footwear), more recently technological sovereignty and capacities in leading edge technology (including digital and green technologies) have become very politically sensitive. The result has been increasing ad-hoc protection. On the import side this included EU and US AD actions on solar panels (Kolk and Curran, 2017). On the export side, there have been increasing restrictions on trade in leading edge electronics, especially in the US.  
There is extensive existing work on the impact of trade defence, discussed above which helps us to understand the potential economic effects of measures like AD and AS. However, limitations on exports are far rarer and we know less about how they affect GVCs. During the COVID pandemic there was a sudden explosion in export restrictions and work has begun to explore these measures (Curran et al, 2021; Evenett et al. 2022) and their effects (Gereffi, Pananond and Pedersen, 2022), which we can draw on in later WPs. In relation to quotas and other quantitative restrictions, as mentioned above, we can learn from research on past experiences, as ad-hoc quotas were common in trade until outlawed by the WTO (Bown and Crowley, 2016).
- *Preferential market access* – as discussed above, the provision of market access through FTAs and unilateral schemes has a direct impact on relative competitiveness. The extent of this effect depends on the MFN tariff, but it also depends on the RoO applied to the imports. As mentioned above, there are not many significant new EU FTA negotiations. The key potential change in market access in the period of TWIN SEEDS project would be the ratification of the agreement with Mercosur. Yet, there are substantial barriers to the ratification, even if the return of Lula has fostered hopes of a breakthrough (Warborn et al. 2023). In terms of unilateral market access schemes, the key shifts will be related to the reform of the GSP. This process, and its potential impact on GVCs will be monitored within WP2 and WP6.
- *Non-Tariff Measures (NTMs)* – There is a large variety of NTMs that can impact on trade and GVCs, such that seeking to define how they impact on trade and GVCs is very difficult (Bown and Crowley, 2016). Although they vary over time and across sectors, common characteristics include potential discrimination against certain foreign producers, together with preferential treatment for others. NTMs may in theory impact on all suppliers, however certain producers may be exempted, for example through mutual recognition agreements while the capacity of certain suppliers to conform to the requirements of the NTM may vary widely. The EU is developing several NTMs in the post-COVID context, which will require analysis in terms of their impacts in GVCs. These include the

CBAM, the Due Diligence Directive and the Regulation on goods made by forced labour.

## 10. Conclusions

This paper has sought to highlight the key interactions between trade policy and GVCs and set the groundwork for future work within the TWIN SEEDS project. The objective is to draw on prior research and novel data analysis to secure a clear understanding of the impacts on GVCs of key policy areas likely to require attention during the project. The paper starts with a brief introduction to the global context in which EU trade policy has evolved this century, it notes that the growth of global integration, fostered in particular by the dynamism of emerging markets, plateaued after the GFC and even started to fall according to some measures. Thus, even before the COVID pandemic, globalization was moving to a new stage of consolidation, rather than growth. At the same time, the EU trade policy landscape was shifting, with a more complex institutional decision-making structure and an increasing need to incorporate non-trade concerns, especially sustainable development, into policy proposals.

I then turn to the analysis of EU policy at multilateral, bilateral and unilateral levels and explore how changes over this century impacted on GVCs, noting that ML liberalization has been limited. The key shifts were the implementation of the UR and the accession of China to WTO, both of which undoubtedly had impacts on EU GVCs. In addition, ML rules have continued to frame policy making, despite the recent fragilization of the institution following US failure to engage.

The lack of progress at WTO led to an increased dynamism in the EU's bilateral relationships, with several new FTAs negotiated this century. However, our analysis indicates that these agreements only seem to have had important impacts on trade with a limited number of trading partners, mostly those in the EU neighbourhood. We note the increasing difficulty in negotiating and ratifying these agreements, not least because of the extension of FTA negotiations to a wider range of issues, including sustainable development and NTMs. It seems unlikely that many new FTAs will emerge soon, thus the exploration of existing agreements and the effects of Brexit are likely to be the key issues over the period of TWIN SEEDS.

Finally, I explore how unilateral policies have impacted on the EU's trade flows and GVCs, both by increasing trade costs (AD and AS) and by reducing them (preferential access). In both cases prior research and my own analysis indicate that the effects of these policies can be significant. In addition, recent increases in both the complexity of trade defence measures and the provision of government support to industry, have the potential to distort trade. It seems likely that both trends will continue and create conflicts in the coming years which the TWIN SEEDS project will be well placed to

explore. Finally, growing concern about the need to secure coherence between trade policy and sustainable development has led to a series of unilateral EU policy proposals, including a revision of the GSP and several new regulations. These could be considered NTMs and seem likely to have differential impacts across suppliers and sectors, such that GVCs may be restructured in the light of these effects.

These analyses provide us with a comprehensive overview of how the EU's different trade policies and regimes have impacted on GVCs in the years preceding the pandemic, as well as signposting several potential new issues for analysis. Changes in policy inevitably produce winners and losers. Post-pandemic policies will be no different. It is hoped that by providing an overview of what we know about the impacts of prior policy shifts, this paper can help us to better frame our analysis of new proposals going forward and thus provide a firm grounding for the trade policy aspects of the TWIN SEEDS project.

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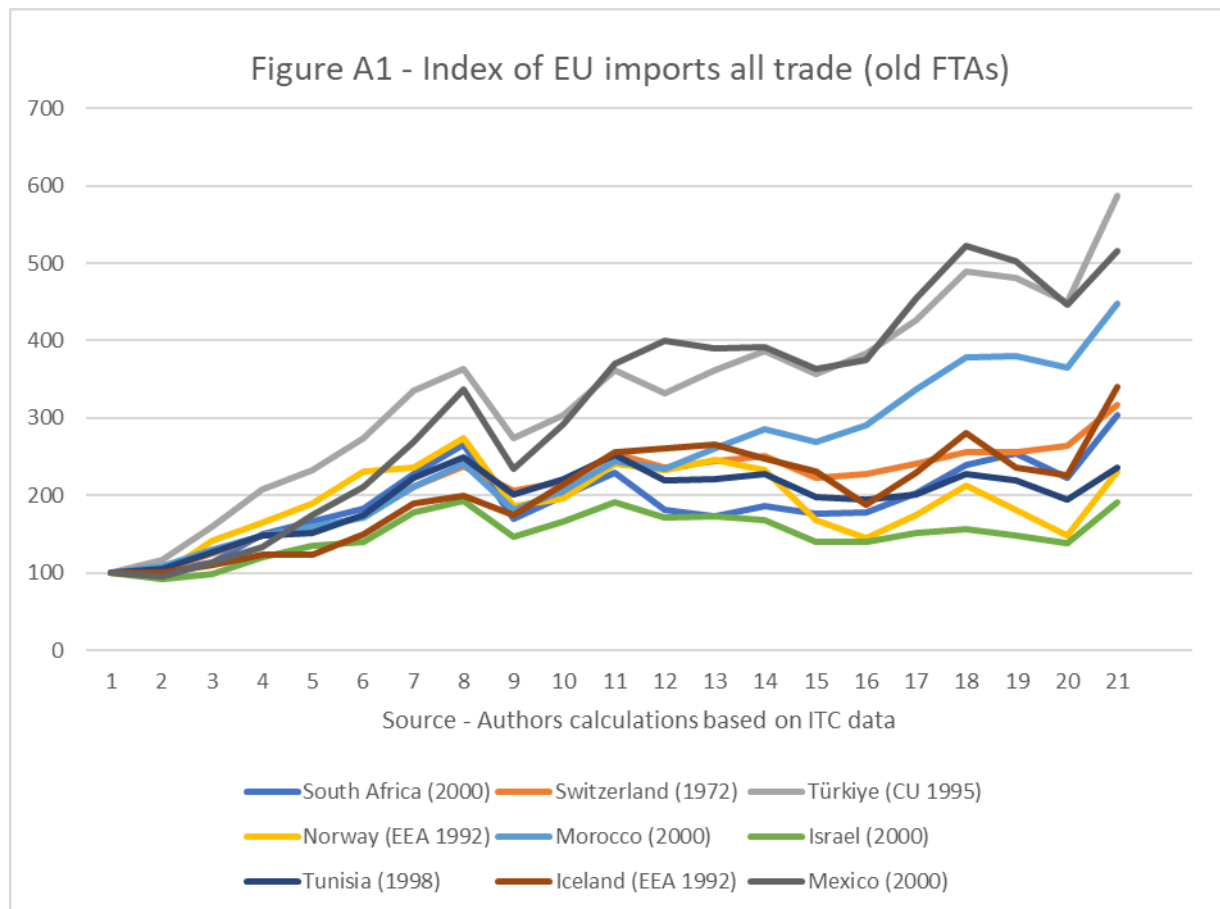
Annex

Table 2 – Share of FTA trade

*Manufacturing goods* – HS 16; 19-22; 25-26; 28-92; 94-96.

*EU FTAs in 2001* – Andorra; Faroe Islands; Iceland; Israel; Mexico; Norway; Palestine; South Africa; Switzerland; Syria; Tunisia; Turkey

*EU FTAs in 2019* – Albania; Algeria; Andorra; Antigua and Barbuda; Bahamas; Barbados; Belize; Bosnia and Herzegovina; Cameroon; Canada; Chile; Colombia; Comoros; Costa Rica; Cote d'Ivoire; Dominica; Dominican Republic; Ecuador; Egypt; El Salvador; Eswatini; Faroe Islands; Fiji; Georgia; Ghana; Grenada; Guatemala; Guyana; Honduras; Iceland; Israel; Jamaica; Japan; Jordan; Kenya; Korea; Lebanon; Lesotho; Macedonia; Madagascar; Mauritius; Mexico; Moldova; Montenegro; Morocco; Mozambique; Namibia; Nicaragua; Norway; Palestine; Panama; Papua New Guinea; Peru; Saint Kitts and Nevis; Saint Vincent and the Grenadines; Samoa; Serbia; Seychelles; Singapore; Solomon Islands; South Africa; Suriname; Switzerland; Syria; Trinidad and Tobago; Tunisia; Turkey; Ukraine; Zimbabwe.



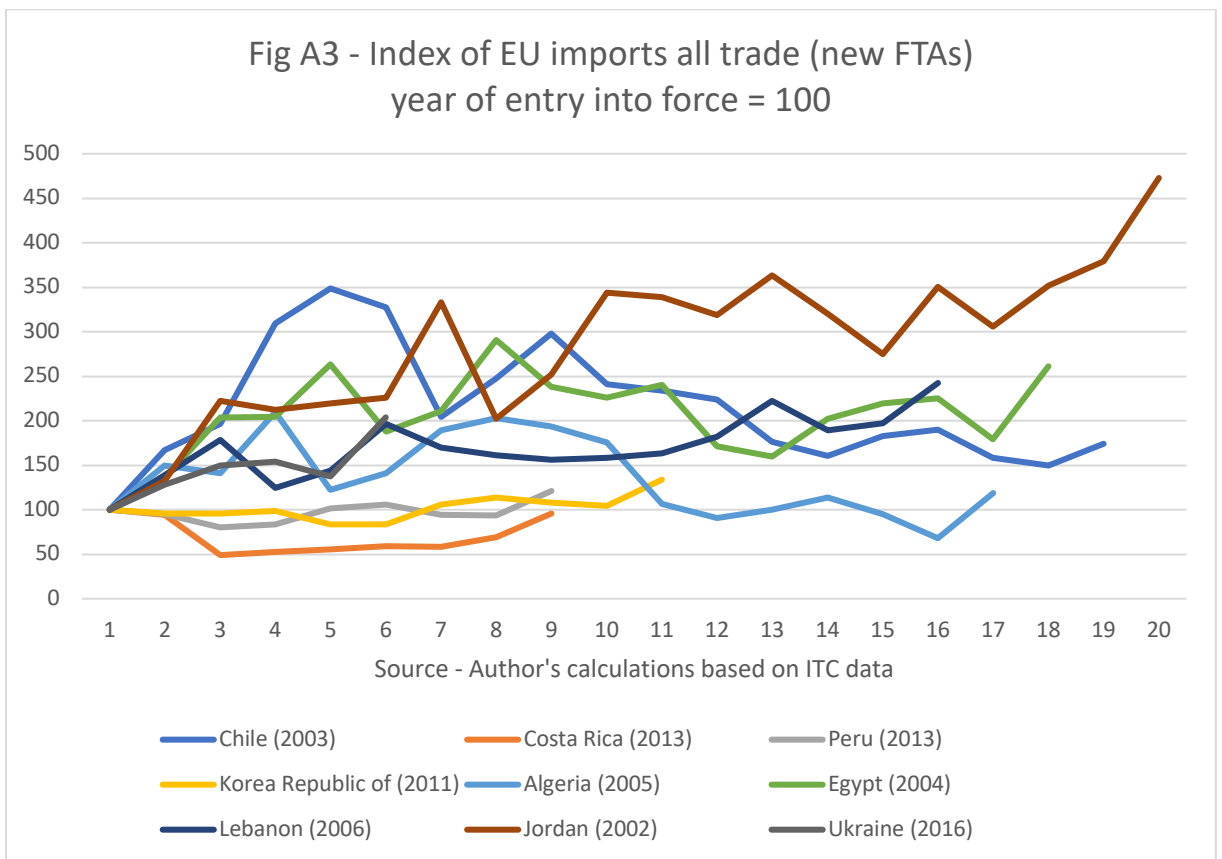
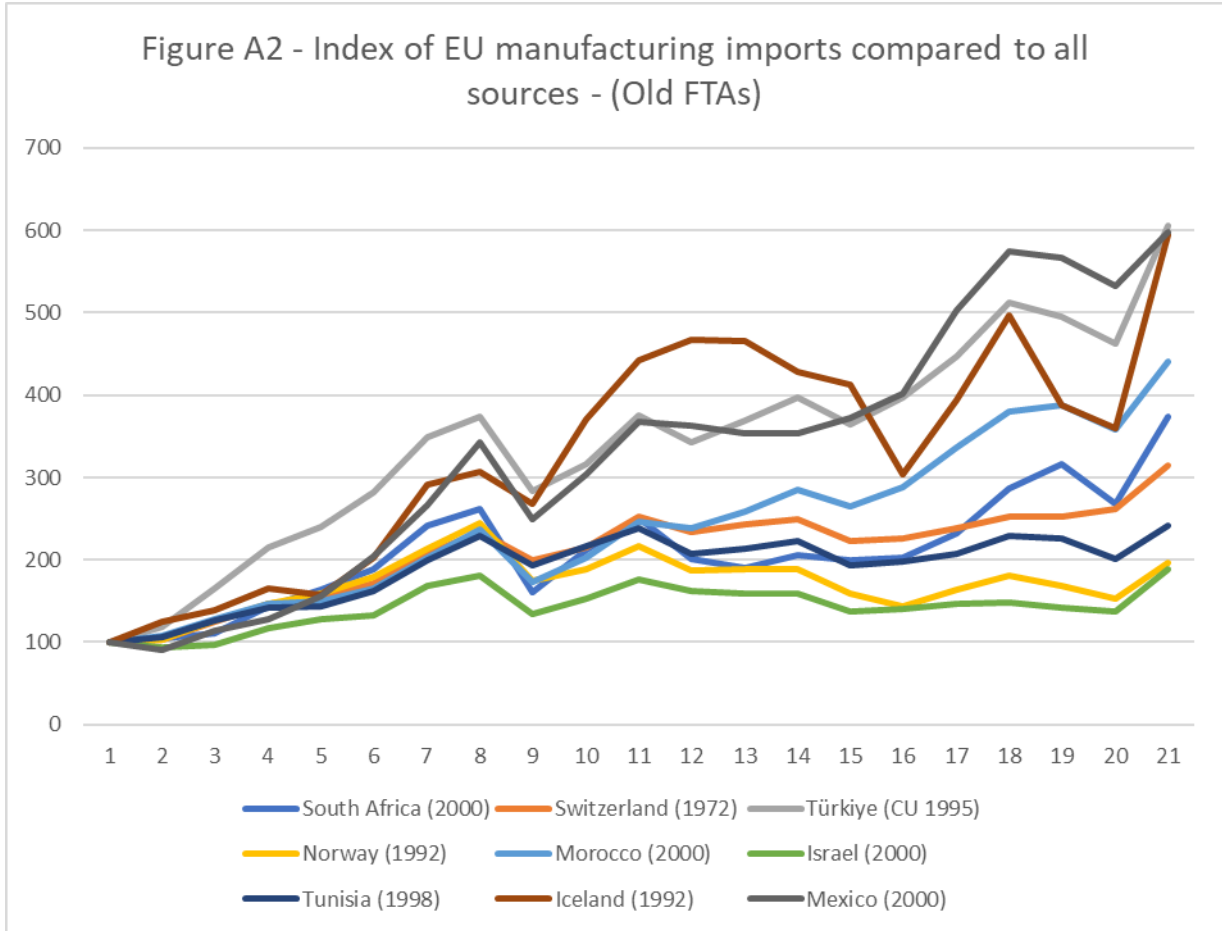


Figure A4 - Index of EU Manufacturing imports compared to all sources (New FTAs)  
year of entry into force = 100

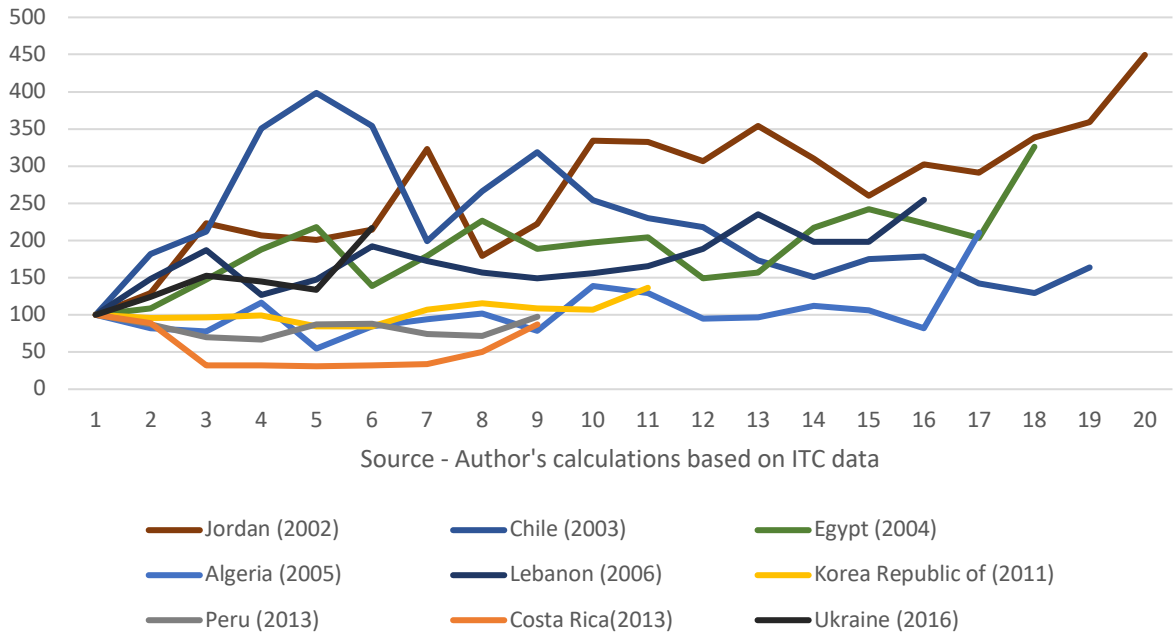


Figure A5 - Index of EU manufactures exports (old FTAs)

