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-The Janus-Face of EU Trade Policy-

**A Step towards Free Trade
or towards
Exclusion and Protectionism?**

Prof. San Juan. Madrid, 2006

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The European Union's aim is **free but fair world trade**. In other words, a system where all countries trade freely with one another on **equal terms and without protectionist barriers**. The EU wants a **'level playing field'** for all countries and clear **'rules of the game'** for everyone to follow. The system should be transparent — fully open to public scrutiny.

(EU Commission, 2003, p.5)



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Problem Statement

Are trade patterns in the EU a step towards free trade or towards exclusion and protectionism ?



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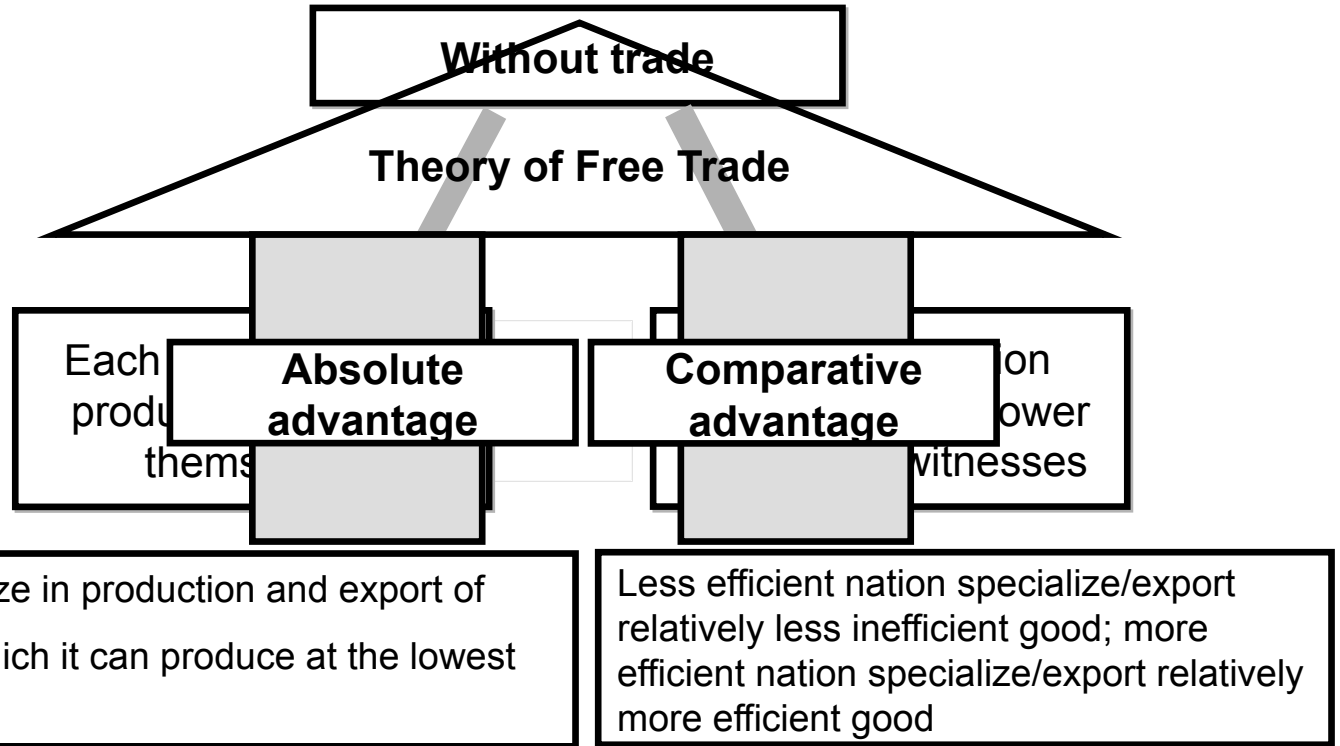
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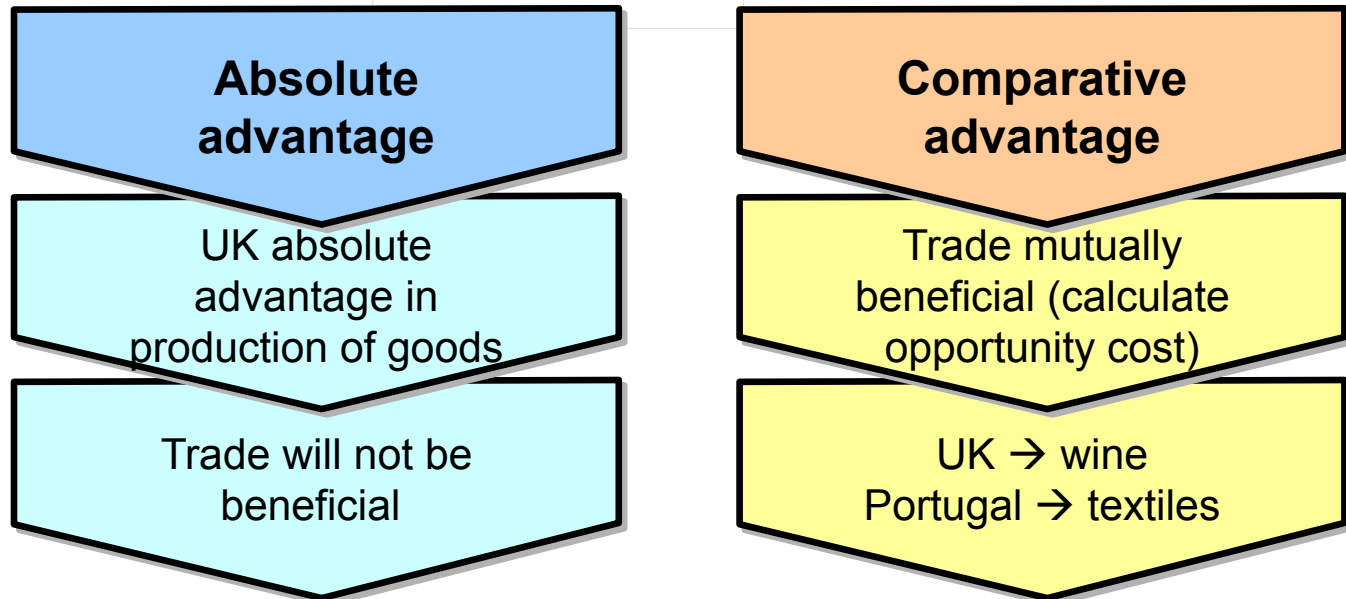
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	UK	Portugal
1 unit of wine	1 labour hour	9 labour hours
1 unit of textiles	3 labour hours	12 labour hours
Wine	$1W = 1/3T$	$1W = 3/4T$
Textiles	$1T = 3W$	$1T = 4/3W$

Following the principle of





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Trade Theories

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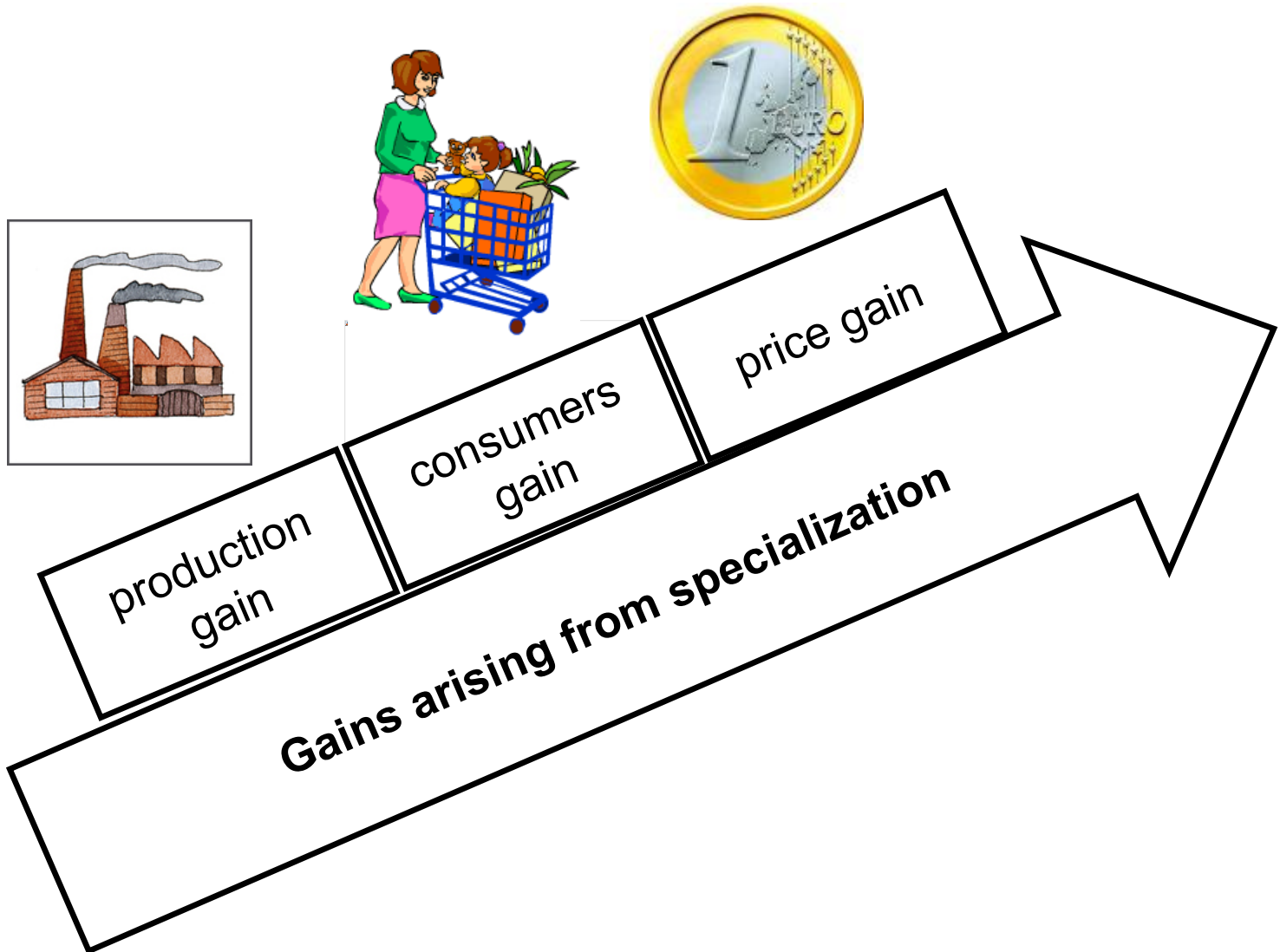
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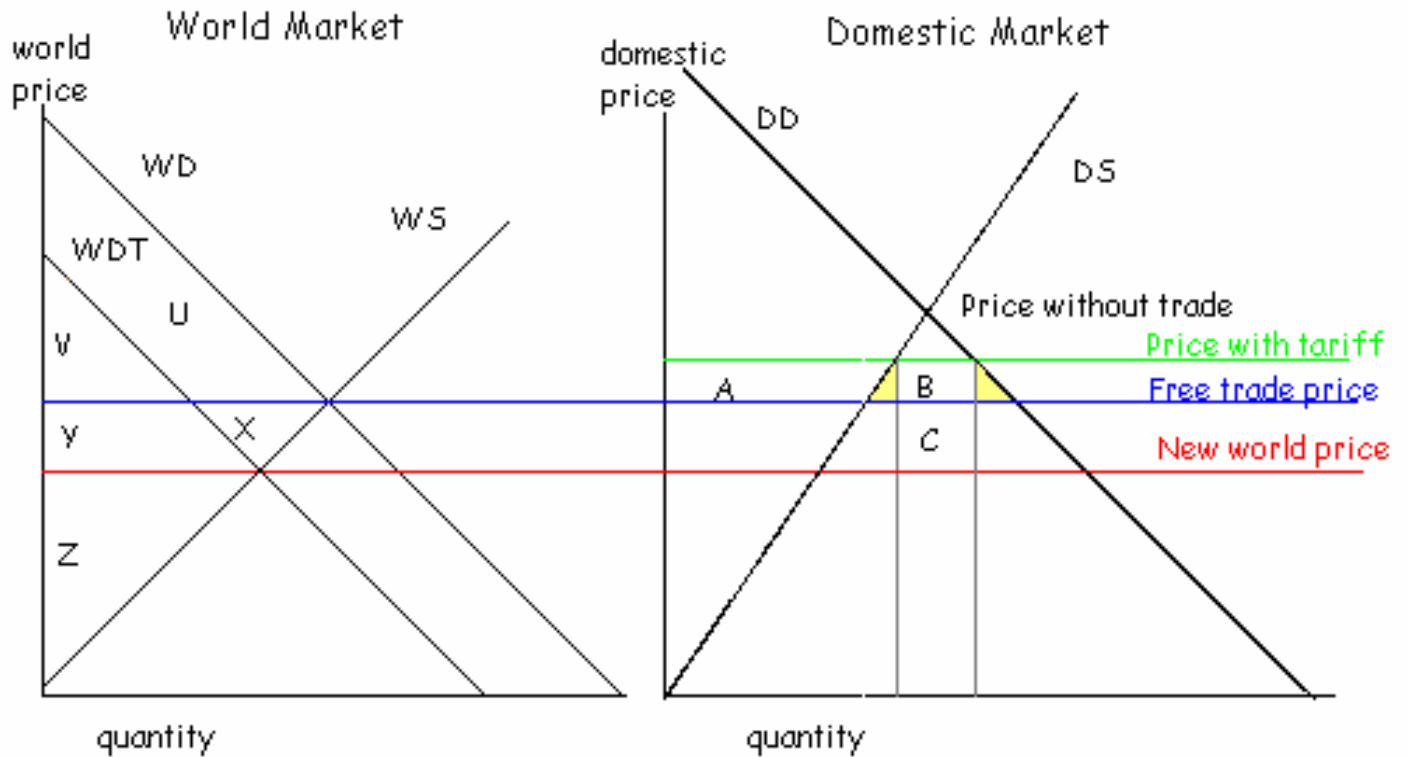
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The use of tariffs (in a large country)



WD = World Demand
 WDT = World Demand after Tariff
 WS = World Supply

DD = Domestic Demand
 DS = Domestic Supply



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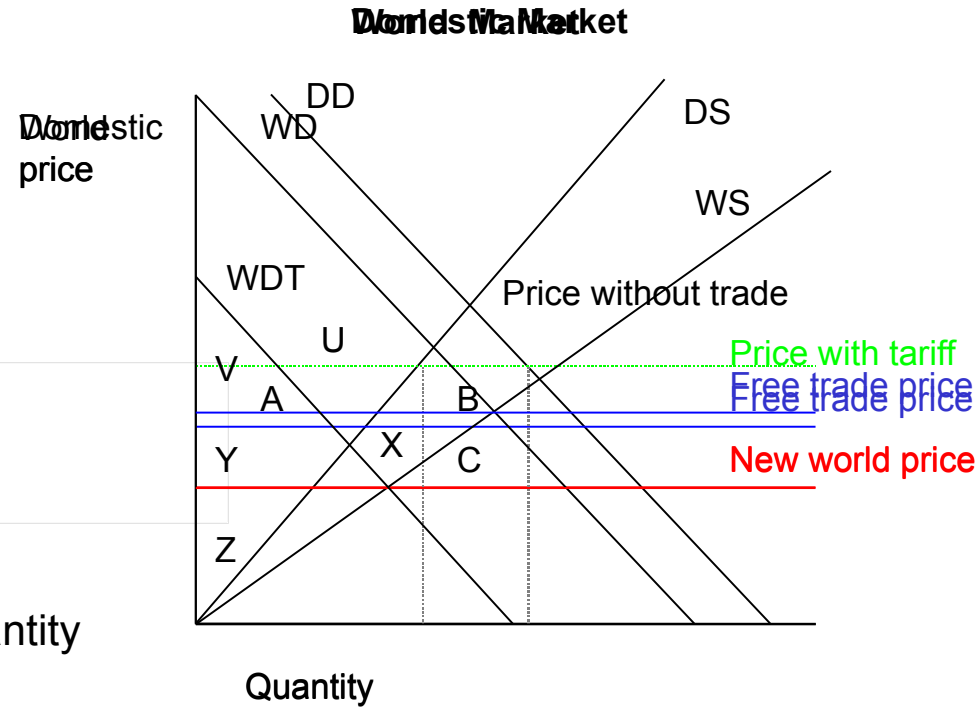
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By imposing tariff on product of which the large country is a *net importer*:

- Prices of this product for consumers in the large country rise
- Domestically demanded quantity decreases and domestically supplied quantity increases



→ Results in reduction of quantity imported by large country and thus shifts world demand curve to the left

→ World-price decreases



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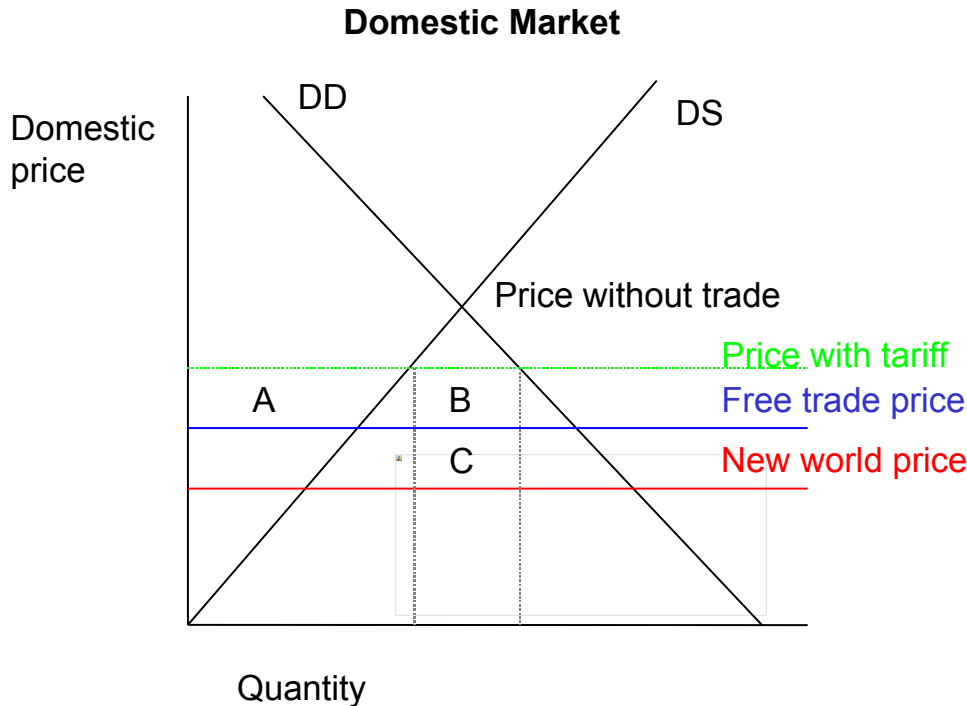
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Thus tariff is beneficial if area C outweighs the triangles

Producer Surplus	Consumer surplus	Government	Total welfare effect
increases by A	decreases A, B + triangles	(B+C)	A+B+C-A-B-triangles
higher Q supplied by domestic producers	(increase in price)	receives extra revenue from tariff	



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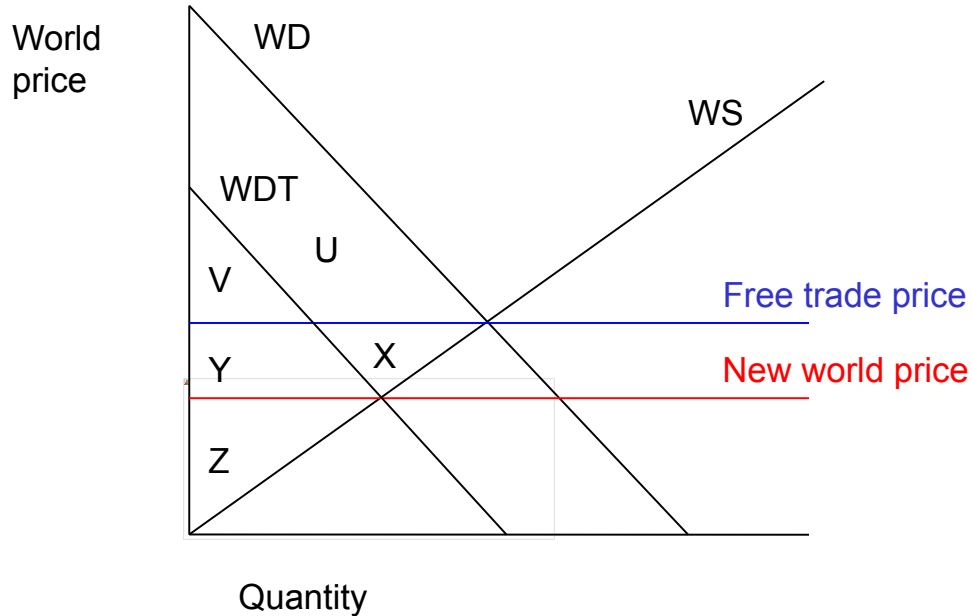
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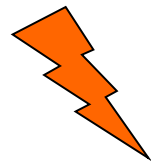
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World Market



	Before imposing tariff	After imposing tariff
Producer surplus	areas X, Y and Z	area Z
Consumer surplus	areas U and V	areas V and Y



Total welfare decreases by U and X





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Trade creation

Trade diversion

shift *from a high cost source to a low cost source*, a shift that would imply an overall **increase in productive efficiency** in the world

shift of a *low cost producer to a high cost producer* in response to the formation of a **CU**, which would imply an overall **decrease in productive efficiency** in the world.



Trade Theories -An Example-

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	A	B	C
Production costs:	50	25	35
Tariff:	-	100 %	100 %
Price in A before CU:	50	50	70
Price in A after CU with B:	50	25	70
Price in A after CU with C:	50	50	35

Country B is the most efficient producer in the world

Country A is the least-efficient producer

Before CU= country A will import the good from country B

After CU with B → trade creation

After CU with C → trade diversion



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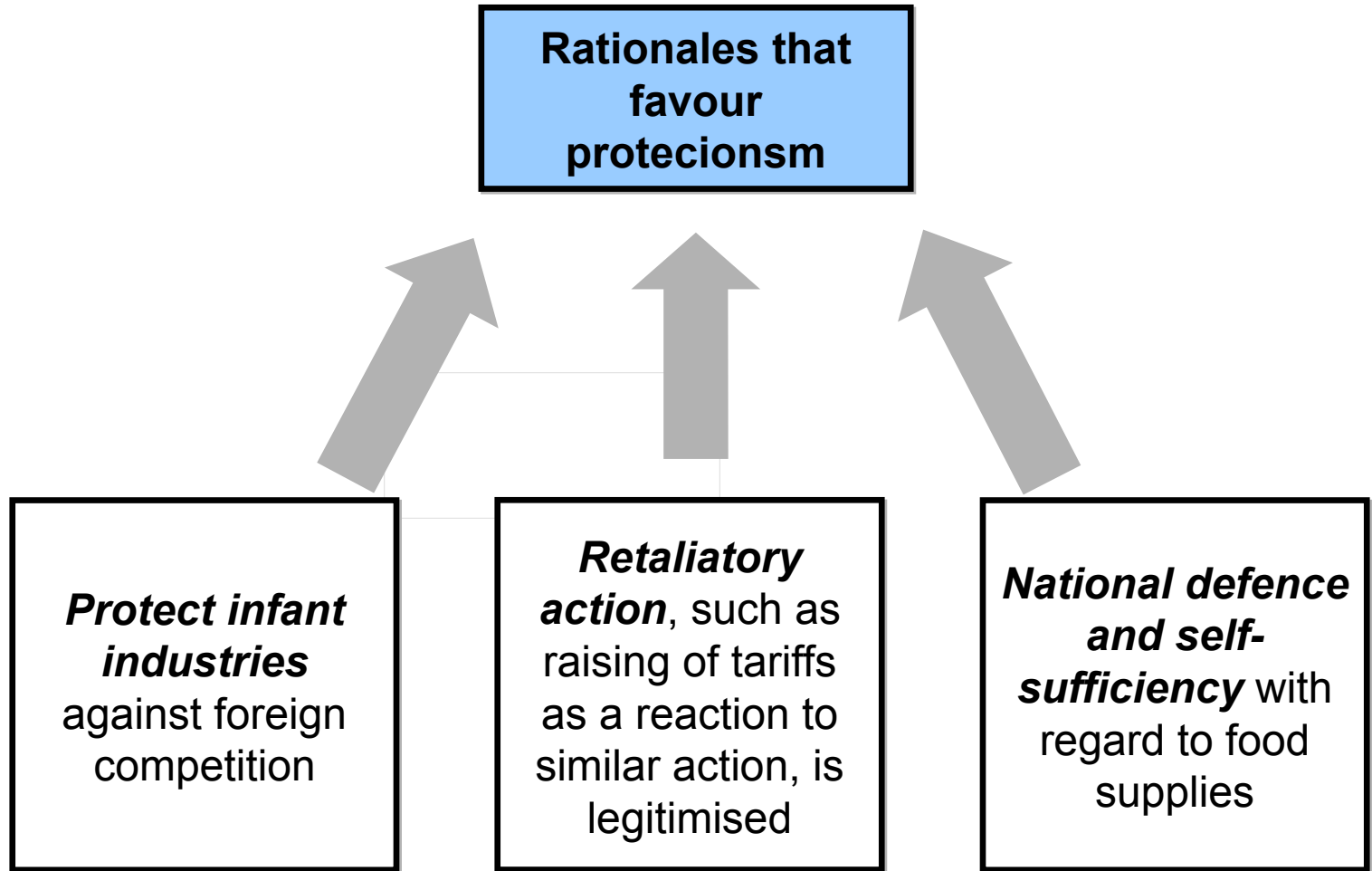
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- **Treaty of Rome**

“the community shall be based upon a customs union”

→ Liberalizing trade on an intra – European scale and adopting a common customs (external) tariffs for trade with 3rd countries

- **Common Commercial Policy (CCP)**

launched to contribute to progressive liberalization of global trade



The EU's Trade Policies

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How does the EU pursue free trade?

Multilateral level

Bilateral / Regional level

Are these approaches a step towards free trade or towards exclusion and protectionism?



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- In 1947 the General Agreement on Tariffs and Trade (**GATT**), a voluntary pact, was concluded
- Several updates with major overhaul of the World Trade System after the Uruguay Round 1994
 - ***WTO replaced the GATT*** by agreement of more than 125 countries.



The EU's Trade Policies -WTO main Principles-

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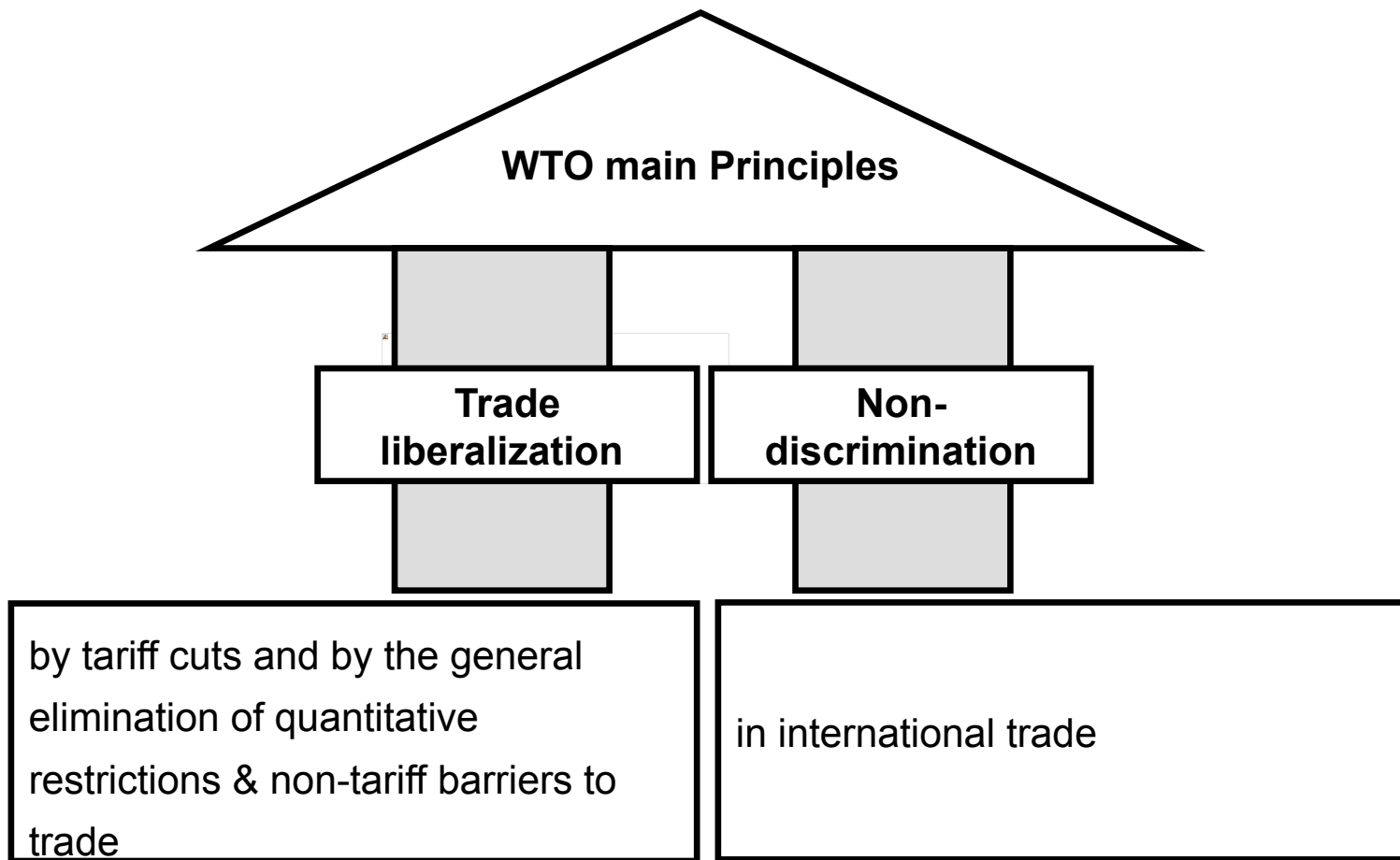
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The EU's Trade Policies -GATT vs. WTO-

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GATT

WTO

Reduce and to regulate trade intervention at the border

International agreement covering trade in goods only

Greater role in monitoring & management

Mission to accelerate trade liberalization

Settle trade disputes on multilateral rather than bilateral/regional basis

International organization that covers trade in services & FDI



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- In addition to its participation in the multilateral WTO System, the EU has another quite distinct approach to free trade
- EU divides the world in groups of countries and concludes agreements with each group separately
- Can be illustrated by the EU's Pyramid of Preferences
→ Sensible to categorize it into three layers



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The EU's Trade Policies -Pyramid of Preferences-

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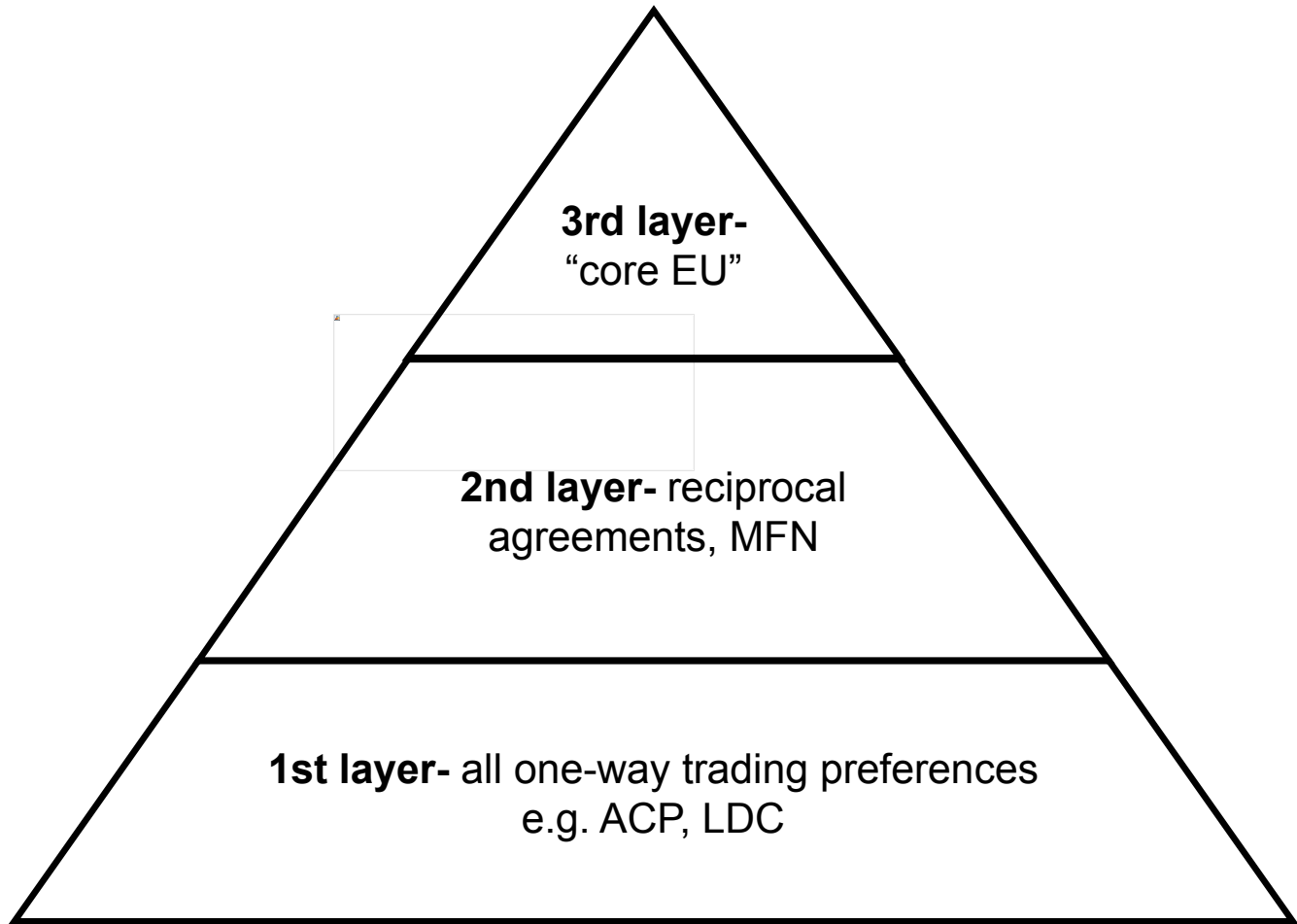
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- Economic regional integration permitted with by the WTO with the restrains:
 - Common external tariffs of a customs union (**CU**) not be higher than the general incidence of duties and regulations of commerce applicable
 - The CU or Free Trade Area (**FTA**) must be completed within a reasonable [=short] length of time
- Two third of world exports and global GDP generate by EU and NAFTA



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The EU's Trade Policies -Anti – Dumping Code-

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- Signed 1967
- Allowed countries to defend themselves when dumping causes or threatens material injury to an established industry
- However, rules on anti-dumping and countervailing duties were rather fuzzy, and made their misuse tempting for protectionist purposes



The EU's Trade Policies -Fortress Europe-

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- Criticism faced from advocates of a more liberal economic order about its assorted tariff preferences
- Particularly in the trade of agricultural commodities

**Inward looking, highly protected,
and a self-sufficient economic bloc ?**



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The EU as a Building Bloc for Global Trade

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Worlds biggest trader

- Relative openness in trade
- Highest share in FDI
- EU tariffs on industrial products are among the lowest in the world
- Most EU imports are duty free
- EU is an active participant in the WTO



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1. One-way trade preferences

- “Everything but arms” initiative
- EU opened its markets to Low developed countries, LDCs
- Imports of unlimited quantities of all products from 49 LDCs
- “Preferential trade arrangements” PTA
- Also positive effect on reforms of LDCs



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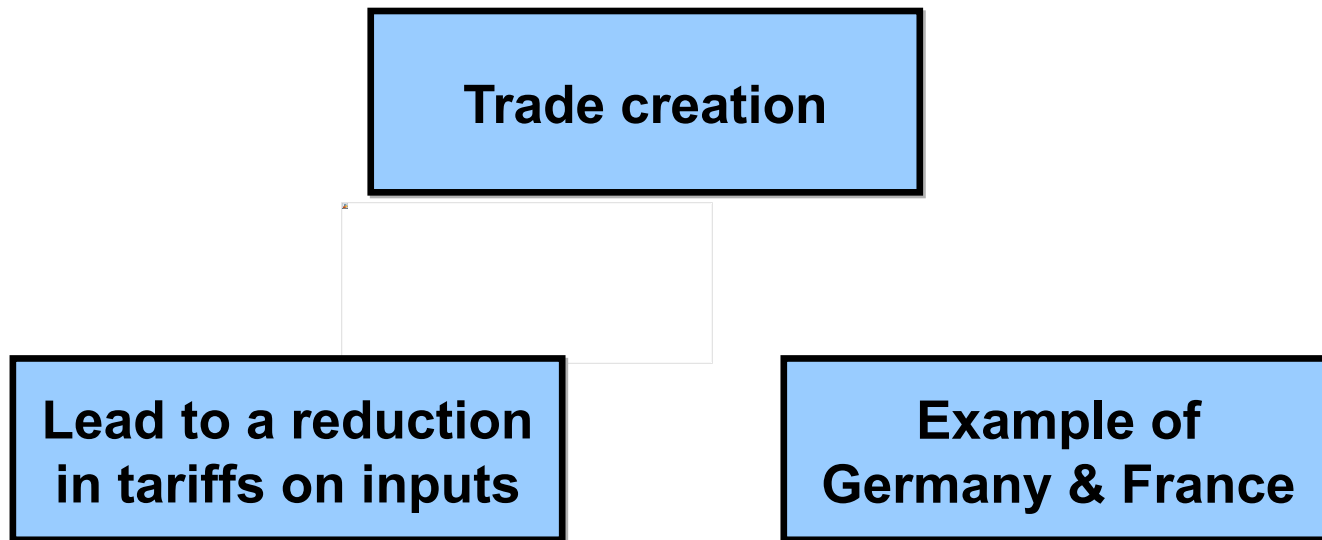
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2. Free trade arrangements FTAs





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3. EU's single market

- Trade creation for a union member's less efficient industry
- Movement of goods, services, labour and capital facilitate deeper economic integration



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1. Failure of one-way trade preferences

- PTAs stand on shaky grounds
- Agreements are offered as privileges and can be withdrawn any time
- Too many restrictions
- Protectionist measures of EU are very high against developing countries with comparative advantage
- Low tariffs just on industrial products



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1. Failure of one-way trade preferences ctd

- EU uses tariff escalation in textiles
- Higher tariffs on finished goods than on raw materials
- Beneficiary country has to satisfy certain rules
- This favors big and rich countries, since less developed countries do not have necessary capacities for production

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1. Failure of one-way trade preferences ctd

- EU often used its preferences as an argument to resist pressures from the WTO
- EU wants to have a certain control of products in which developing countries have a comparative advantage



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2. Failure of free trade arrangements

- Exclusion of sensitive products
- Tariff escalation
- Certain member countries of FTAs will have an incentive to block further entry
- Possibility of raising the tariff on finished goods & reducing tariffs of inputs



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2. Failure of free trade arrangements ctd

- Accession to a free trade area hinges on a country's potential to offer trade preferences

- The Common External Tariff is a very complex and not transparent system

- Each free trade area has its own rules of origin



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3. Single Market and CCP of the EU

- Common Agricultural Policy CAP very trade diverting
- Negative impact on free trade
- High import duties, export subsidies, price and buying guarantees



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3. Single Market and CCP of the EU ctd

- CAP is anti-competitive
- Can be seen as a step towards protectionism rather than a move towards free trade



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EU promotes free trade internally- that is within the EU market- but hinders progressive liberalisation of world trade with 3rd countries by protecting its sensitive sectors from foreign, more efficient competition.

Are trade patterns in the EU a step towards free trade or towards exclusion?

→ The Janus-Face of the EU



onism ?

Recent development: More multilateral approach to trade liberalisation as it is less discriminatory and protectionist



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