IN-DEPTH ANALYSIS

Free trade or geo-economics?

Trends in world trade

Policy Department for External Relations

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ABSTRACT

The European Union (EU) is the biggest integrated economic zone and a guarantor of an open and predictable regulatory system able to determine its own economic destiny. But the behaviour of other global powers is increasingly calling this ability into question. China and the United States, especially, do not separate economic interests from geopolitical interests in the same way the EU does and are increasingly trying to gain geopolitical advantage using their economic might.

The EU is known as a fierce defender of a multilateral rules - based trade system with free but fair trade as its strategic policy objective. The EU will therefore do its utmost to save a 'meaningful multilateralism' by helping to reform the WTO, improve multilateral investment protection and conclude multilateral trade agreements. At the same time, the EU will defend its own interests by negotiating bilateral trade deals and applying trade defence and investment screening where needed. The EU has a strong interest in keeping the use of geo-economic measures manageable and avoid escalation into a trade war.

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Table of contents

1 Key developments

- 1944: The **Bretton Woods Conference** established the Bretton Woods System, which replaced the Gold Standard with the US Dollar and established the International Monetary Fund and World Bank
- 1947: Signing of the **General Agreement on Tariffs and Trade (GATT)** in Geneva
- 1957: The Treaty of Rome established the **European Economic Community**
- 1973: The **Bretton Woods System collapsed**, ending US dollar convertibility to gold
- 1991: Disintegration of the **Soviet Union**, ending bipolarity in the international system
- 1994: Establishment of the **World Trade Organisation (WTO)**
- 2001: Start of the WTO **Doha Development Round** which remains unfinished today
- 2001: **China joined the WTO** leading to expectations that it would become a market economy
- 2003: The **Euro** was awarded the status of **a reserve currency** in the IMF basket
- 2007: Signing of the Treaty of Lisbon, granting the European Parliament **co-legislative powers** in EU trade policy and the **right of consent** to trade agreements
- 2008: The f**inancial crisis** threw the global economy into recession
- 2009-2019: The **EU concluded a variety of trade agreements**, most importantly with Canada, Japan, Mercosur, Singapore, South Korea and Vietnam
- 2012: **Russia joined the WTO** after 19 years of consultations
- 2012**:** Negotiations over the **Regional Comprehensive Economic Partnership (RCEP)** started**,** featuring the 10 member states of ASEAN and six indo-Pacific states, including China
- 2013: China announced the launch of **its Belt and Road Initiative**
- 2014: **China surpassed the US** as the world's largest economy according to GDP[1]
- 2014: The **BRICs Development Bank** was set up, seen by many as an alternative to the World Bank
- 2015: The European Commission published its '**Trade for All Strategy**'
- 2015: The **Eurasian Economic Union** was established, whose members today are Russia, Belarus, Armenia, Kazakhstan and Kyrgyzstan
- 2015: The **Chinese renminbi-yuan** was awarded the status of **a reserve currency** in the IMF basket
- 2016: The **Trans Pacific Partnership Agreement** between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, and the United States was signed
- 2016: The **Asian Infrastructure Investment Bank** took over the role of the BRICs Development Bank
- 2016: Negotiations on a **Transatlantic Trade and Investment Partnership (TTIP)** were put on ice because of fundamental disagreements between the EU and the US
- 2017: **Donald Trump inaugurated** as president of the US, his first act in office was to declare that the US would **leave the Trans Pacific Partnership Agreement (TPP)** before its entry into force
- 2017: The WTO **Trade Facilitation Agreement (TFA) entered into force**
- 2018: The **US imposed tariffs** on China, Canada, Mexico, the EU and other countries
- 2018: The **US left the** Joint Comprehensive Plan of Action (JCPOA) and imposed sanctions against Iran, leading to tensions with the EU which wanted to keep the JCPOA. The EU, in reaction, updated its Blocking Statute to limit the impact on EU operators doing legitimate business in Iran.
- 2018: Conclusion of the **Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP),** between all former TPP states except the US
- 2019: The **EU and US started negotiations** on tariffs on industrial goods and conformity assessment in an attempt to reduce trade tensions and avoid new tariffs
- 2019: on 11 December the **Appellate Body of WTO** might cease to function as the terms of two out of the remaining three panel members of the WTO Appellate body will expire

[1] measured in Purchasing Power Parities and current international US Dollar (World Bank Data)

2 Key EP resolutions

The Treaty of Lisbon granted the European Parliament **co-legislative competences** in the EUs Common Commercial Policy and the **right of consent** to trade agreements, negotiated by the Commission. This made the Parliament an important player in EU trade policy. Some of the key resolutions of Parliament over the past seven years are:

- 2012: EP rejection of the Anti-Counterfeiting Trade Agreement (ACTA): first use of right of consent to reject a trade agreement; since then, the Commission shared more information with Parliament during ongoing trade negotiations and Parliament adopted resolutions before or during negotiations to influence their direction and outcome.
- 2015: EP resolution on the Transatlantic Trade and Investment Partnership (TTIP) negotiations: the EP's requests included a new system for the resolution of investment protection disputes and binding clauses on sustainable development; The replacement of Investor State Dispute Settlement (ISDS) with a an Investment Court System (ICS) was not achieved for TTIP, but was achieved for the Comprehensive Economic and Trade Agreement with Canada (CETA).
- 2016: EP resolution on the setting up of a Multilateral Investment Court: following up on ICS, the EU Commission proposed a Multilateral Investment Court, which was supported by Parliament.
- 2016: EP resolution, supporting the Trade for all strategy of the European Commission and reiterating the importance of transparency, the involvement of civil society and the protection of consumers and the environment.
- 2016: EP agreement with the Council on a regulation that could help to stop the exploitation of minerals from conflict-affected areas.
- 2017: EP consent to the conclusion of the Comprehensive Economic and Trade Agreement (CETA) with Canada, the first comprehensive economic agreement with a highly industrialised Western economy which abolished 98 % of Canadian tariff lines on EU goods; CETA has been applied on a provisional basis since September 2017, except for some parts mainly concerning investment.
- 2017 EP resolution on global value chains (GVCs): the impact of international trade and EU's trade policies on GVC's. It calls for stronger social and environmental standards and for unilateral policies to protect EU businesses from unfair practices.
- 2017: EP resolution on 'Towards a digital strategy' calling for an EU approach on data flows for its trade agreements.
- 2017:-EP legislative resolution on the review of legislation on export controls on dual use goods (which can be used for civilian and military purposes), calling for stronger protection of the right to data privacy and freedom of assembly, by adding criteria to the regulation. The final result will be determined in trilogue negotiations following the Council's adoption of its position.
- 2018: EP resolution on the implementation of the EUs Common Commercial Policy: points to new challenges ahead, including the need to preserve the WTO centred trading system
- 2018: EP resolution on the WTO : expressing Parliament's view on the way forward, reiterating 'its full commitment to the enduring value of multilateralism' and underlining the importance of rulemaking at WTO level.
- 2018: EP consent to the conclusion of the EU - Japan Economic Partnership Agreement (EPA), accompanied by a non-legislative resolution evaluating the result;
- 2019: EP consent to the conclusion of the EU-Singapore Free Trade Agreement, accompanied by a non-legislative resolution evaluating the result. The consent came seven years after the conclusion of the negotiations because the Commission asked the Court of Justice to clarify its exclusive competence.

3 Where the EU is coming from: free and fair trade

3.1 Free trade: the rules based world trade order

The 1947 General Agreement on Tariffs and Trade (GATT) created a global trading system based on non-discrimination and the removal of market barriers. Since the end of the Cold War, the global economy has undergone profound changes to its structure. In 1994, the **World Trade Organisation (WTO) became the core of the multilateral rules-based trading system** and as of 2019, the WTO has 164 members representing 98 % of all trade.

WTO achievements

The WTO's overriding achievement is to help trade flow as freely as possible, as long as there are no undesirable side effects, such as unfair trade practices or protectionist measures. The WTO members take decisions on the basis of consensus. Past experience has shown that the strong and prosperous trading system, created by the GATT and further developed by the WTO, has contributed to global growth, important for economic development. The fact that there is a rules-based trade system means, that individuals, companies and governments know what trade rules apply around the world and they know that these trade rules are transparent and predictable. A further WTO achievement is based on the fact that, unlike GATT and other trade agreements before it, the WTO does not regulate trade in merchandise goods only, but goes a step further by also covering trade in services, intellectual property rights and — on the basis of a plurilateral agreement — government procurement. To guarantee enforceability an independent dispute settlement body (DSB) was established under the WTO, with the same rights for all members, no matter whether big or small trading partners or developed or developing economies. The WTO agreements have always permitted their members to take measures to protect not only the environment but also public health, and animal and plant health — as long as these measures are applied in the same way to both national and foreign businesses and do not result in a form of disguised protectionism.

Major achievements of the WTO in recent years include:

- Bali WTO Ministerial Conference (2013): conclusion of the **Trade Facilitation Agreement (TFA)**; WTO members agreed on a series of agriculture and development issues, which were part of the Doha development agenda.
- In 2014: revision of the 1996 **Government Procurement Agreement (GPA)**, a plurilateral agreement within the framework of the WTO, which brings government procurement under internationally agreed trade rules and mutually opens government procurement markets among its parties. At present, the Agreement has 20 parties comprising 48 WTO members (including the EU and its 28 EU member states), 34 WTO members/observers, of which 9 are in the process of acceding to the GPA; so far, GPA parties have opened procurement activities worth an estimated USD 1.7 trillion annually to international competition.
- Nairobi WTO Ministerial Conference (2015): WTO members agreed on the **elimination of export subsidies for agriculture** and the introduction of new rules for similar measures that significantly distort international trade and disrupt local markets.
- Nairobi WTO Ministerial Conference (2015): expansion of the 1996 **Information Technology Agreement (ITA)**, adding more than 200 information and communications technology (ICT) products to the duty free list. This agreement was **initiated by the EU** and is to cover EUR 1.3 trillion in global trade. It is the biggest tariff-cutting deal in the WTO in almost two decades.

Important projects that are not yet concluded:

- Since November 2001, all WTO members have been negotiating the **Doha Round** or Doha Development Agenda (DDA), which seeks to further liberalise trade and help least-developed countries integrate into the multilateral trading system. Although progress has been made in some areas, consensus on an overall agreement is still a long way off.
- Since March 2013, 23 WTO members, including the EU, have been negotiating the **Trade in Services Agreement (TiSA)**. Together, the participating countries make up 70 % of world trade in services. Negotiations were put on hold at the end of 2016.
- Since July 2014, the EU and 16 other WTO members have been negotiating the **Environmental Goods Agreement (EGA).** The aim is to remove barriers to trade in green goods like solar panels and recycling machinery. EGA is important because these products are key for curbing climate change and protecting the environment.

The EU and the WTO

The European Union's economy has been increasingly closely integrated with the rest of the world. The share of extra-EU trade in the EU's GDP was about 15 % in the mid-1980s and had grown to 24 % by 2017. The share of intra-EU trade in total EU-trade remained at around 63% over the same period. The EU is now the world's largest trading block, even if intra-EU trade is excluded, and its economy depends on its trade relationships around the world[2].

The EU has always been a strong supporter of the Doha Round, which it sees it as a way to ensure economic growth and development for all. More generally, the EU remains a staunch supporter of the multilateral trading system and believes that the WTO is essential for ensuring free and fair trade. This support encompasses the active engagement of the European Commission, which is the EU's executive branch for the common EU trade policy, in the work of the WTO. This concerns multilateral rule-making, trade liberalisation and sustainable development on the one hand and an active role in the regular work of the WTO, including tasks linked to WTO accessions by new members and to the administration of WTO agreements and the monitoring of their implementation on the other hand. Proactive involvement in the discussion of trade policy reviews [3] is also a central part of this regular surveillance work, including for the EU.

3.2 Fair trade: responding to criticism of globalisation

First signs of crisis in the WTO and anti-globalisation protests

However, the complexity of consensual decision-making, diverging interests between developing and industrialised countries and perceived imbalances in terms of contribution and the actual and perceived future benefits deriving from multilateralism have led to an **impasse in rule making at the WTO level**. This impasse first became visible in the Doha Development Round, which was launched in 2001 but still has not been completed. Developing countries demand the reduction of agricultural subsidies by developed countries. Industrialised countries, on the other hand, insist on the lowering of tariffs on non-agricultural products by emerging economies. Furthermore, the EU supported the inclusion of the 'Singapore issues' in the negotiations seeking better market access to developing countries' economies on trade related issues like trade and investment, competition policy, transparency in government procurement and trade facilitation.

[2] See: https://bruegel.org/wp-content/uploads/2019/03/PC-05_2019.pdf

[3] The WTO conducts trade policy reviews for all WTO members in surveillance of national trade policies, according to certain principles (Trade Policy Review Mechanism (TPRM). The frequency varies according to the countries' share of world trade.

Moreover, as multinational corporations and global production networks gained importance, tying the world's economies even closer together, trade became an increasingly contested issue, which was expressed as **anti-globalisation protests**, for instance at the WTO summit in Seattle in 2001 and subsequent summits of the WTO, G-7 and G-20. The public increasingly contested large bilateral trade agreements like TTIP and CETA. Critics feared for instance declining labour and environmental standards and the loss of governments' rights to regulate the economy.

First remedies: sustainability in trade and transparency

In response to this criticism of globalisation, the EU started to focus on making trade fairer on the one hand and making trade negotiations more transparent on the other hand. The word 'fair' here refers to fair social and environmental conditions all over the world, emphasizing the altruistic element of fairness, seen from a European perspective. To this end, the EU seeks the **integration of sustainable development goals into trade agreements**. This policy was laid down in European Commission's 2015 strategy 'trade for all'.

Recent free trade agreements (FTAs) negotiated by the EU systematically include provisions on trade and sustainable development (TSD). Their aim is to maximise the leverage provided by increased trade and investment over issues such as decent work, environmental protection and the fight against climate change in order to achieve effective and sustainable policy change. More concretely, the EU and its trade partners should apply international labour and environment standards and agreements; effectively enforce their own environmental and labour laws; commit not to deviate from environmental or labour laws to encourage trade or investment; sustainably trade natural resources, such as timber and fish; combat illegal trade in threatened and endangered species of fauna and flora; encourage trade that supports tackling climate change; and promote practices such as corporate social responsibility. Rules on TSD are currently included in EU trade agreements with Canada, Central America, Colombia, Peru, Ecuador, Georgia, Japan, Mercosur, Mexico, Moldova, Singapore, South Korea, Ukraine and Vietnam.

The European Commission meets its respective partners regularly to discuss implementation of these TSD commitments. When doing so, they also rely on information provided by Domestic Advisory Groups (DAGs) in the EU and the partner country, which bring together representatives of business, trade unions, and environmental or other organisations. To become a member of an EU DAG, an EU organisation needs to be, inter alia, an independent not-for-profit organisation and possess specific expertise or competence on areas covered by the TSD chapter. Under the EU's current standard legal text on TSD, the civil society structures of the FTAs (DAGs of both parties and the joint civil society fora (CSFs)) are competent to discuss and advise on implementation of TSD chapters only. This legal constraint has limited the ability of the groups to provide advice on the sustainability implications of other parts of agreements, such as technical barriers to trade or sanitary and phytosanitary measures (SPS). After recurring requests by civil society participants in DAGs to be allowed to engage in such a broader discussion on sustainability, the European Commission has widened the scope of competence of DAGs' advice to cover the implementation of the whole agreement in future FTAs, starting with the EU-Mexico and the EU-Mercosur FTAs.

Furthermore, the EU, particularly under Trade Commissioner Cecilia Malmström, has made progress in **making the negotiation process more transparent and inclusive for interested stakeholders**. Public access to Council, Commission and European Parliament documents for European citizens is enshrined in regulation EC No 1049/2001 of the European Parliament and of the Council of 30 May 2001. Furthermore, since the TTIP negotiations, Members of the European Parliament and of Member States' national parliaments are able to consult negotiation texts and draft treaty texts. Finally, many text proposals made by the EU are published by the European Commission on the Internet and dialogue with civil society has become more structured and intense, which is beneficial to both sides.

4 Where the world is going to: geo-economics

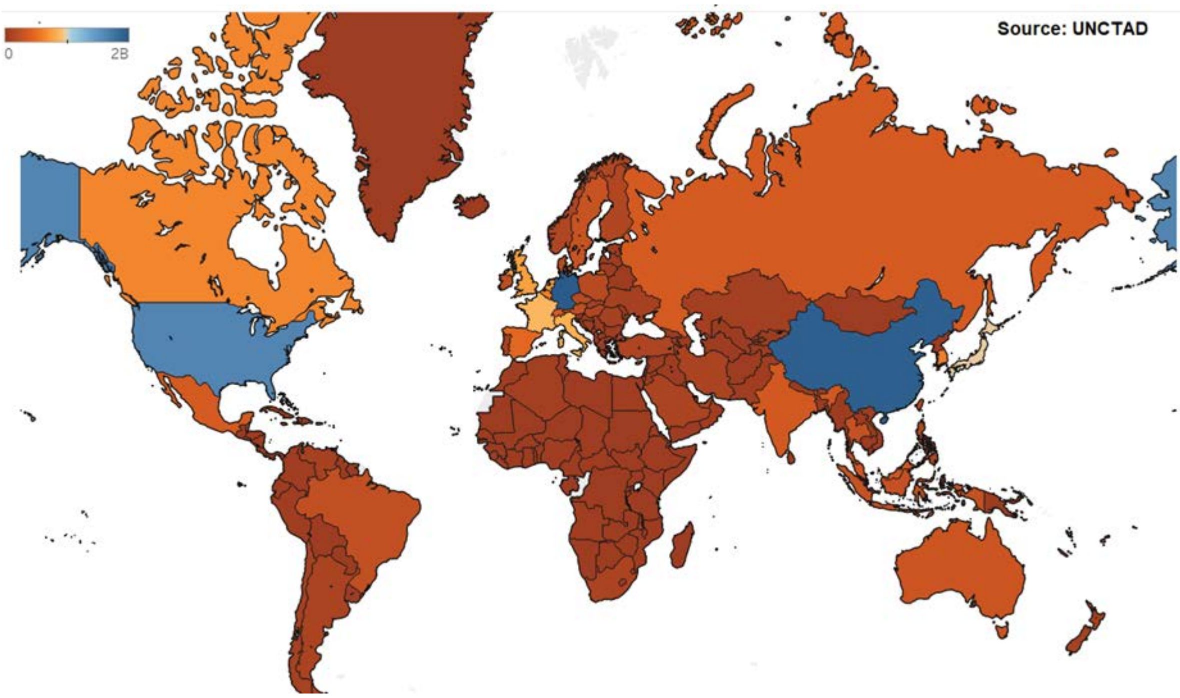
4.1 Four systemic trends

While the global trade community has been trying to accommodate the above mentioned impasse in WTO rule-making and respond to the criticism of globalisation, trade itself has also continued to change. Four systemic trends stand out: the development of global value chains (GVCs), the increase of trade in services including digital trade and e-commerce, the growth of investment and the growing importance of developing countries. Although these developments create new opportunities, they also create new tensions.

Development of global value chains

The emergence of **global value chains (GVCs)** means that multiple countries add value in the production chain before the final consumption of a good. Thus, most goods exported today are not solely the product of the exporting country, but are a combination of domestic value added (DVA) and foreign value added (FVA) through the import of intermediate goods. The rise of FVA in gross exports since 1990 means that (at least partial) production abroad has become increasingly important. However, GVCs might have reached maturity as most of the efficiency gains seem now to have been realized. The share of FVA in gross exports peaked in 2010 at 31 %, and has since then flattened out and even slightly decreased to 30 % in 2017. While it may be possible that production continues to shift between countries due to differences in prices and wages, this overall trend might only change a little. In looking at the countries where most value added occurs, it becomes quite clear that GVCs are actually highly concentrated among the US, China, Germany (see Figure 1 below in blue) and to a lesser extent Japan, Canada, the UK, France and Italy (in light brown). And while ASEAN states and India were to a certain extent integrated in the global production process in 2018, only very low levels of added value could be observed in the Middle East, South America and on the African continent (in dark red). Changes in prices and wages and other comparative advantages might in future contribute to shifting some production and value chains to these regions, but structural shortcomings in these economies might also prevent this.

Figure 1: Trade in value-added world-wide 2018, in current thousand USD

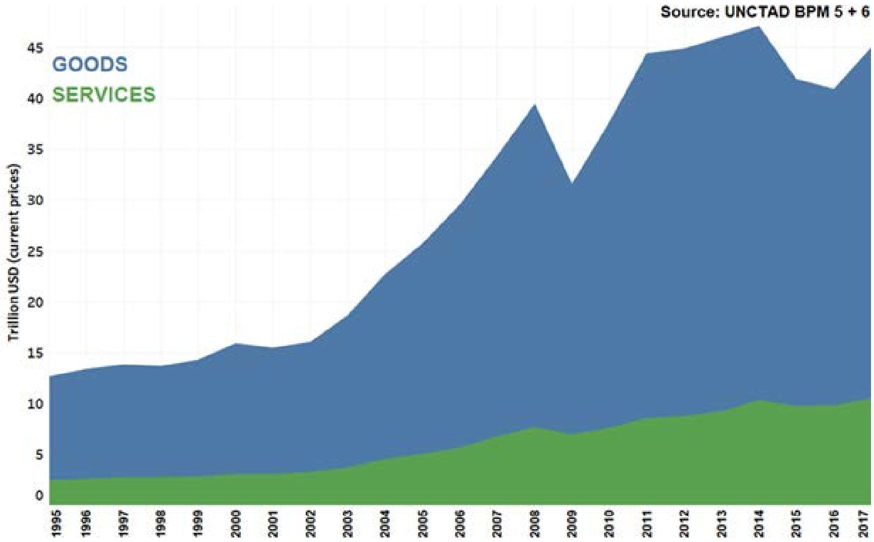


While several EU countries seem to profit from GVCs, their consequences may also harbour dangers for the EU. In its resolution of 12 September 2017 on the impact of international trade and EUs trade policies on global value chains (GVCs), the EP calls for stronger and more binding international social and environmental standards while at the same time prompting the European Commission to adopt unilateral policies to protect EU businesses from unfair practices. While acknowledging the importance of GVCs for the international economy, the resolution emphasizes that integration into GVCs must not be to the detriment of the EU's social and regulatory model and the promotion of sustainable growth.

Increase of trade in services and digital trade

Since the foundation of the WTO, trade in goods has increased by 240 % but only by 25 % between 2007 and 2017. In comparison, **trade in services** has increased by 327 % since 1994 and grew by 55 % between 2007 and 2017. Although trade in services has been the strongest driver of growth in this period, its growth has slowed down and it is unlikely to assume the role that trade in goods has played in driving globalisation.

Figure 2: Sum of imports and exports of goods and services in trillion USD: 1995-2017



The question therefore arises, where could future growth and development potential in trade come from? The growth of **digital flows** could be such a new driving factor, ranging from e-mailing and video streaming to file - sharing and the 'Internet of Things'[4]. Since 2000 the number of internet users worldwide has skyrocketed from 412 million to 3.4 billion in 2016, representing a 727 % increase in only 16 years. However, the share of internet users in North America and Europe is stagnating, while in East and South Asia alone there are about 1.7 billion users and numbers are growing rapidly. The movement of data is already surpassing traditional physical trade. Half of all trade in global services now depends on digital technology in one way or another. Although digital flows mainly link developed countries, emerging countries are catching up quickly. The countries that led the world during the last era of globalisation may not necessarily be the same ones that drive the new (e-commerce) one. Yet, regulating the digital economy is a challenge and lags behind factual developments, as a 2017 European Parliament study[5] showed. And similar to value added, the gains of digital trade are unevenly distributed, leaving much room for improvement, particularly on the African continent. The European Parliament passed a resolution 'Towards a digital strategy' on 12 December 2017 calling for an EU approach on data flows for its trade agreements.

[4] The Internet of things is the extension of Internet connectivity into physical devices and everyday objects. Embedded with electronics, Internet connectivity, and other forms of hardware (such as sensors), these devices can communicate and interact with others over the Internet, and they can be remotely monitored and controlled.
[5] 'Current and Emerging Trends in Disruptive Technologies: Implications for the Present and Future of EU's Trade Policy', 2017

Growth of foreign direct investment

Global **foreign direct investment (FDI)** stocks grew rapidly in the last three decades, surpassing cross border trade in goods and in services. The strongest growth took place between 1990 and 2000, when FDI stocks worldwide increased by 270 % from USD 2.80 trillion to USD 7.4 trillion and more modestly between 2010 and 2017, with an increase of 66 % leading to a total amount of FDI stocks of USD 31.5 trillion.

Several developments indicate that foreign investment has recently been slowing down. In 2017, FDI flows fell by 23 % to USD 1.43 trillion from USD 1.87 trillion in 2016. Even discounting volatile financial flows, large one-off transactions and corporate restructuring operations that inflated FDI numbers in 2015 and 2016, the 2017 decline was sizeable. One of the causes was a significant decline in rates of return on FDI over the past five years[6]. The EU is the main provider of foreign investment in the world. FDI stocks held in the rest of the world by investors resident in the EU amounted to EUR 7 412 billion at the end of 2017. Meanwhile, foreign direct investment stocks held by third country investors in the EU amounted to EUR 6 295 billion at the end of 2017. The 2018 preliminary results indicate a general disengagement of FDI flows — inwards and outwards. The relationship with the US market suffers most from the overall decline in FDI capital exported: preliminary estimates show that US firms withdrew nearly EUR 177 billion of net FDI capital from the EU market. Similarly, EU direct investors withdrew from the US market, with a net disinvestment of EUR 165 billion.

Thus, similar to the adding of value in global value chains we see a flattening of this growth in the past decade and even a decline in investment flows in recent years. North American, European and Asian countries have benefited most from these past growth paths. For other parts of the world, such as South America or Africa the impression remains that fulfilment of the growth and development potentials of GVC, services and FDI has been disappointing.

Growing importance of developing countries

The three trends described above call for a closer look at the role of developing countries. Over three-quarters of WTO members are developing countries and countries in transition to market economies. In general, today, more than half of all international trade in goods involves at least one developing country and trade in goods between developing countries — referred to as South-South trade — grew from 7 % of world trade in 2000 to 18 % in 2016. But not all developing countries are the same. Asia has doubled its share in world trade from 15 % to 35 % between 1990 and 2016. More than half of this trade stays within this continent, a percentage which is only a little smaller than for intra EU Trade. On the other hand, intra-African trade is hardly taking off. Efforts by the EU to boost regional trade through Economic Partnership Agreements have generally not been successful. It remains to be seen how far the African initiative to create a continent-wide integrated regional market for goods and services (African continental free trade agreement) will reverse this trend or whether this is too great of a leap forward.

The WTO agreements and also the European Partnership Agreements (EPAs) concluded with the EU give developing countries transition periods to adjust to world market conditions and WTO provisions. The engagement of many developing countries has been based on 'special and differential treatment' (SDT). This entails less than full symmetry or reciprocal market access in trade negotiations and acceptance that developing nations should be less constrained in the use of trade policies than high-income countries. This asymmetry in trade agreements is strongly oriented towards the economic development of developing countries[7], reflecting these partners' needs, including protecting their agricultural markets, industrialising, countervailing the reduction of tax revenue and adjusting to EU standards. Developing countries that do

[6] See: https://unctad.org/en/PublicationChapters/wir2018ch1_en.pdf
[7] see also EPRS Briefing: An overview of the EU-ACP countries' economic partnership agreements page 6 f https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625102/EPRS_BRI(2018)625102_EN.pdf

not wish to become part of an FTA with, for instance, the EU, can continue trading under the 'everything but arms' (EBA) regime if they are least developed countries (LDCs). Those countries that have graduated from LDC status can take still advantage of the EU general system of preferences GSP or GSP+ systems, which provide wide preferences, although not fully free access. The EU continuously monitors GSP+ beneficiary countries' effective implementation of the 27 international conventions on human rights, labour rights, environmental protection, and good governance. This monitoring includes exchanges of information, dialogue and visits and involves various stakeholders, including civil society.

But it is the group of emerging economies that lie somewhere on the spectrum between developing country status and regional or global market player that have posed the greatest challenge to the global trade system. Having left a position of dependency on richer, mostly Western countries, they can challenge the economic leadership of those countries, while still benefitting to some extent from their status as developing country. In response, the challenged Western economies demand more WTO conform policies from these countries. Thus, a logical connection starts to emerge between the failure to complete the Doha Round, the rise of emerging economies and discussions on whether the current global system is fit for the future.

4.2 Four criticisms of the global system

Apart from public discontent about globalisation mentioned above, for over a decade there has also been growing criticism by WTO members of the functioning of the global system itself. The WTO was established and its rules designed for trade between transparent and open market economies. Yet, this openness is sometimes lacking, thereby challenging the effectiveness of the WTO and faith in what the organisation can deliver. We focus on four developments: the rise of protectionism in general, the specific problems of state-owned enterprises (SOEs) and intellectual property theft, and the decline of trust in the WTO dispute settlement system.

Trade barriers and protectionism

Various statistics show that protectionist measures are increasing worldwide. Since 2008, according to Global Trade Alert, countries worldwide have implemented more than 14 000 measures that almost certainly discriminate against foreign commercial interests. Such measures can for instance be subsidies, tariffs or investment measures. It should be noted however, that they also include trade defence measures, which may be well justified against dumping practices. The number of hampering measures has been substantially higher than the number of liberalising measures and has been growing strongly since 2017. Since 2008, more than 6 600 protectionist measures have originated in G-20 countries, mainly through tariff increases, import bans and new customs procedures for exports. For trade in services, certain new policies introduced by G-20 countries appeared to be trade-restricting, including localisation requirements, measures affecting communication and network-enabled services and policies pertaining to the review of foreign investment in certain areas considered strategic.

Figure 3: Harmful measures to trade

	2016	2017	2018
US	129	174	238
India	68	94	119
China	55	75	80
Germany	118	89	187
France	59	94	85

Source: Global Trade Alert

Despite the EU's efforts to defuse trade tensions and work towards multilateral and structural solutions, the escalation of unilateral WTO non-compliant measures and the threat of new discriminatory arrangements and managed trade is becoming the new normal in global trade.

The European Commission in its most recent trade and investment barriers report notes that, looking at recorded barriers to EU business in 2018, China has taken over as the country with the highest number of obstacles hindering EU export and investment opportunities (37). Russia came a close second with 34 barriers currently in place, followed by India (25), Indonesia (25) and notably now also the United States with 23 barriers. As the table shows, this is an increase compared to only two years before. The fact that many trade restricting measures come from WTO members that generally plea for an open trade system gives food for thought.

Figure 4: Obstacles hindering EU business

	2016	**2018**
China	23	37
Russia	33	34
India	23	25
Indonesia	17	25
US	16	23

Source: EU Commission

The lack of progress with further liberalisation in the WTO, whether through the Doha Round or otherwise, clearly translates into a more defensive attitude towards national industrial or commercial interests. The fact that WTO members have selective requests for liberalisation, while keeping a protectionist stance in other areas, may have contributed to this. For instance, the conflict between free trade in industrial goods and services but retention of protectionism with farm subsidies for domestic agricultural sectors, which is a position of many developed countries, has been seen as problematic by developing countries. Such impasses have hampered the launching of new multilateral WTO negotiations.

In general, most of the criticism points to the absence of a real level playing field. This results in unequal conditions for trading partners, leading to a discussion about **reciprocal treatment**. Reciprocal treatment is understood here as applying similar rules, thereby guaranteeing a level playing field. This is different from reciprocity in the sense that market shares or trade flows from both partners should be in balance. Such reciprocity is not an aim of trade policy as outlined in the basic international legislation. Nevertheless, reciprocity in the latter sense figured more prominently in recent trade discussions.

State owned enterprises and subsidies

State-owned enterprises (SOEs) and subsidies are other examples of phenomena which hamper a level playing field. The WTO recognises that subsidies can distort international trade and therefore allows its member countries under certain conditions to implement counter vailing duties (CVDs) in such cases. Dealing with SOEs is more complex though. The fact that a business is state owned does not by definition mean that it doesn’t respect international trade rules. When state ownership gives a company such an economic advantage that it can export below normal market prices, the importing country can revert to trade defence measures, such as tariffs, in response.

However, when state-owned enterprises are widespread in a country and become actors of foreign economic policy of that country, trade defence measures may not be sufficient and more fundamental questions come to the fore. This has been the case for China in particular in recent decades. Theoretically, the most convincing justification for the existence of SOEs is to achieve social objectives and/or correct market failures. As such, most SOEs do not need to pursue a profit maximisation objective, and are often strictly regulated and assessed by government. In China, however, SOEs have a much wider scope and are not established on the basis of correcting market failure, but more to carry out government objectives. Since the late-1990s reforms, the Chinese government has pursued a number of initiatives to reform SOEs, but the logic has switched away from privatisation to improving efficiency while maintaining the role of the state in the production of goods and services. The ultimate objective of the ongoing reform has shifted to creating corporate giants that can compete globally. The number of companies included in the Forbes Global 2000 from China is already higher than the sum of the number of firms from major EU countries

(France, Germany, Italy, Spain, Sweden, Netherlands, Ireland and Denmark) together. Chinese SOEs, aided by government industrial policy support schemes, have become major competitors to European firms.

Against this backdrop, the EU is also taking steps to revive its industrial sector but within a very different framework, which aims to preserve competition and avoid distortions. China's rising SOEs and the support they receive are presenting a challenge to the EU's spirit of competition and even its industrial policy. The US has been more explicit in its criticism of Chinese SOEs, as will be explained in Chapter 4.3.

Counterfeit products and Intellectual property theft

Intellectual property rights (IPRs) (such as patents, trademarks, designs, copyrights or geographical indications) enable inventors, creators and businesses to prevent unauthorized exploitation of their creations, and in return to get compensation for their investment. Intellectual property theft is committed when someone manufactures, sells or distributes counterfeit or pirated goods, industrial designs or literary and artistic works, for commercial gain. International trade in counterfeit products represents up to 2.5 % of world trade, or as much as EUR 338 billion, according to 2013 data. Put in perspective, this is the equivalent of Austria's GDP, or the combined GDP of Ireland and the Czech Republic.

Strengthening the link between intellectual property (IP) and trade, also in national policies should be at the centre of interest. Several G20 countries are currently modernising their IP legislation. Many WTO members recognised the need to regulate IP at the international level and started plurilateral negotiations in 2008 on the Anti-Counterfeiting Trade Agreement (ACTA). Eight countries, including the US, Canada, South Korea and Japan signed ACTA in 2011. The EU and only 22 of its Member States signed it in 2012. However, due to rising criticism of, amongst other things, the role of big corporations and the restrictions ACTA could place on the free use of the Internet, the European Parliament rejected ACTA in July 2012 and it never entered into force. It should be noted that countries where most counterfeited good originate, such as China, were not among the ACTA negotiating states. The US has been very vocal in accusing China of intellectual property theft. As a recent CRS briefing states, according to US Customs China and Hong Kong together accounted for 78 % of counterfeit goods seized in 2017. IPR is therefore one of the major trade irritants between the US and China. Another trade irritant, is the requirement that foreign investors in China include certain technologies; this is referred to as forced technology transfer.

Criticism of the WTO dispute settlement system

Besides rulemaking, the **WTO also provides a mechanism for the resolution of trade disputes.** The Dispute Settlement Body (DSB) resolves disputes among members through a dispute settlement procedure laid out in the Dispute Settlement Understanding (DSU). The DSB is widely regarded as a tremendous success with a compliance rate of about 90 %. However, the US and a dozen other WTO members in 2018 have started taking the position that the WTO DSB Appellate Body (AB) had no authority to issue rulings that set a binding precedent. The US argued that the AB overstepped its mandate in the DSU by reversing what was perceived as factual findings of panel reports in its rulings and through this creating new obligations or reinterpreting existing obligations in a matter not previously agreed upon by WTO members. Critics also claimed that those practices have made US trade remedies less effective at addressing unfair dumping and subsidies.

Seven panel members are needed for the AB to function but the US Administration is blocking new appointments of outgoing members. The AB currently functions with only three members out of seven. The terms of two members will expire on 11 December 2019, at which date the AB will cease to function. While a horizontal approach to recreate a shadow AB would be politically viable, this would push the US outside the system and possibly undermine any future resolution of the Appellate Body crisis. Therefore, the EU has been focussing on an 'interim solution' based on Article 25 DSU.

4.3 Geo-economics crystallising around US - China tensions

China and the US play an important role in most of the above mentioned criticisms. The US is top of the 2018 list of countries taking measures harmful to trade and China is in third place, whereas from an EU perspective China is creating the most obstacles for EU business. As regards state-owned enterprises and intellectual property theft, China has to face a lot of criticism, mostly voiced by the US. When it comes to the functioning of dispute settlement in the WTO, it seems that both China and the US are not engaging ambitiously in reforming the WTO, but are rather focusing on negotiating their issues bilaterally. It therefore seems justified to have a closer look at the economic relationship between these two countries.

US-China tensions

Since the 1990s and its accession to the WTO in 2001, China has undergone a remarkable economic development, making it a leading global powerhouse. However, China still profits from its self-declared status as a developing country despite its enormous economic influence and increasingly global ambitions, which are for instance visible in its Belt and Road Initiative. WTO accession allowed China to adopt an export led growth strategy. However, because this strategy, as indicated above, included trade barriers, the use of industrial subsidies, non-respect of intellectual property rights and investment in strategic sectors of other countries, it was criticised as pursuing a 'mercantilist' approach to trade. Such criticism was voiced most strongly by the United States and ultimately sparked a trade conflict between the US and China which dampens global growth and risks fragmenting the global economy. The unprecedented rise of China has also sparked fears that its economic might will translate into military power and result in an attempt to achieve regional and/or global hegemony, thereby threatening the national security of other countries, including the US. Thus, a convergence between economic and security thinking occurred.

The US grievances against China go back a long way and are not limited to the administration of President Trump or the Republican Party in the US. In the framework of its policy of 'Pivot to Asia', announced by Secretary of State Hillary Clinton in 2013, the Obama administration had already tried to use the negotiations for a potential Trans-Pacific-Partnership Agreement (TPP) as a means to induce China to liberalize its economy, for instance by agreeing standards on the treatment of state-owned enterprises. At the same time, the Report on China's WTO Compliance which the United States Trade Representative (USTR) has to submit annually to Congress has undergone a subtle but clear change in tone and has become more negative year by year.

As explained in a European Parliament study[8] (pages 31-37) on US trade policy, President Trump added a new element of criticism, focussing on the bilateral trade deficit between the US and China, and escalated the tensions that had been building up. Following his inauguration, on 23 January 2017, he signed a Presidential Memorandum withdrawing the US from the TPP negotiations. Not surprisingly in this overall context, the 2018 USTR Report to Congress on China's WTO Compliance bluntly stated: that 'The United States' approach to China is more aggressive than in the past. Out of necessity, the United States is now using all available tools....to respond to the unique and very serious challenges presented by China.'

One frequent complaint over the years has been that while China made some desired legal and economic reforms in the years immediately following its accession to the WTO in 2001, followed by a period generally characterised as stagnation, it has backtracked on liberal reforms ever since. The US has at times been very open about the fact that many of the practices it considers to be market-distorting 'are not directly disciplined by WTO rules or the additional commitments China made in its Protocol of Accession.' (2017 USTR report, page 2) The report refers instead to the Marrakesh Declaration of 15 April 1994 where WTO members declared their determination that their economies would participate in the international trading

[8] 'Consequences of US trade policy on EU-US trade relations and the global trading system', November 2018

system based on both 'open market-oriented policies and the commitments set out in the Uruguay Round Agreements and Decisions' (2017, page 5). Against this background, it is not surprising that the US administration frequently accuses China of having breached its good faith[9].

The US claims that it has been trying for years to solve some of these irritants through bilateral dialogue(s), which have 'largely been unsuccessful'. (2017, page 2). The 2018 report is also very critical of China's claim to developing country status, stating bluntly that 'China's claim of developing country status is disingenuous and inconsistent with the terms of its Protocol of Accession to the WTO'. The report insists in particular that already in 2001 — when China acceded to the WTO — existing members did not accept it as a developing country and 'expressly denied China's right to self-elect developing country status'.

One important issue contributing to the rising aggressiveness of US policy towards China is the 'Made in China 2025' initiative launched by the country in 2015. As shown by the CRS, this initiative has a clearly mercantilist aspect as it seeks not only to promote domestically the industries of the future but also to reduce reliance on foreign technologies by 'stating a goal of achieving 40 % of domestically manufactured basic component and basic material by 2020 and 70 % by 2025' (CRS, page 40). The US side is particularly outraged by the fact that these aims are to be achieved by methods which the US is not alone in considering unfair (such as 'large subsidies; protection of domestic industries, directed policies to purchase technology, increased pressure on foreign firms to transfer technology').

The problems surrounding the 'Made in China 2025' initiative have become symptomatic of a tendency on each side to consider the other as a technological rival, contributing to the already growing sentiment of a more general rivalry between the US and China this century, expected to mark the 21st century in much the same way that rivalry between the US and the Soviet Union marked the larger part of the second half of the 20th century. The discussion about the geopolitical implications of China's rise has been framed in particular by an article published by G. Allison in 2015, in which Professor Allison discusses whether the US and China are likely to escape the Thucydides Trap, defined as the 'attendant dangers when a rising power rivals a ruling power — as Athens challenged Sparta in ancient Greece'. He underlines in particular the 'inexorable, structural stress caused by a rapid shift in the balance of power between two rivals' while even emphasizing in another place that 'never before in history has a nation risen so far, so fast, on so many dimensions of power (as China)'.

It is this geopolitically motivated structural stress that has recently been harming trade relations: President Trump has been imposing relatively high tariffs on a considerable amount of US imports from China and China has retaliated accordingly. Furthermore, President Trump has publicly established a link between the arrest of Huawei's chief financial officer Mrs Meng, daughter of the founder of Huawei, and the discussions on whether to ban Huawei from Western markets, and the ongoing US-China trade negotiations.

Global effects: the rise of geo-economics

Some observers assume that based on historical trends, a **bifurcation — a division into two parts — of the global economy might now become unavoidable between a China centred and a US centred system**, also referred to as G-2 world. Actually, China has itself through its own actions contributed to a global bifurcation: since its 2009 decision to ban Facebook domestically. It has closed down not only many other Western social media (such as Twitter, WhatsApp and Instagram) but also many more traditional media (such as The New York Times, Wall Street Journal, Reuters, South China Morning Post and Strait Times), while the respective Chinese media are easily available in the West. Bifurcation would imply that smaller state actors are put before a political choice between the US and China, which would also determine their economic and technological options, leading to the decoupling of the global economy.

[9] This insistence on good faith in trade relations looks like a reference to the 1796 Farewell Address by G. Washington, point 36: '...So far as we have already formed (commercial) engagements, let them be fulfilled with perfect good faith'.

This, however, was more the line of the Obama administration's Pivot to Asia and the ensuing proposal for a TPP, which would have put China before the choice of either being contained or adhering to the TPP with all the necessary economic and political changes this would entail inside China. In this scenario, major entities like the EU and Japan would very probably have had no choice other than joining the US side.

However, ever since President Trump took the US out of the TPP, a general confusion has reigned as to how his 'America First' strategy translates into commercial affairs. Such a strategy could also open up the possibility for other parties to **focus on their own region and/or to try to unite most of these third parties through free trade agreements**. This view is confirmed by the push for a TPP agreement without the US by Japan and New Zealand, in particular, and by the intensified and successfully concluded negotiations on an EU-Japan FTA. Some see or hope for a multipolar world on the horizon with the US, China, the EU, India, Russia, Brazil and others as distinct centres of power.

This discussion shows that the current state of global political and trade relations is to a large degree the result of a **confusion over which model** — bifurcation, regional blocs and/or third-party-cooperation or something else — is going to prevail. Looking at the bigger picture, with the end of the Cold War, a geopolitical period of bipolarity ended and for a short period, which some called a 'unipolar moment', the US led West saw the 'end of history' arriving, characterised by the universal application of capitalism and liberal democracy. However, the global financial crisis in 2008, the backlash against globalisation in developed markets as well as the drastic changes in relative economic power through the rise of emerging economies, most importantly China, reshuffled the international system and ended what many called the 'Pax Americana'. Instead, something like a G-0 world emerged in which no single country or bloc of countries has the political and economic leverage — or the will — to drive a truly international agenda. This G-0 world is resulting in the dysfunction of existing multilateral institutions, one of which is the WTO.

As recently underlined by the IMF, the confused state of world economic affairs has caused considerable **damage to existing global value chains** and is one of the main reasons for the recent deceleration in global fixed investment and thereby in global growth[10]. The sad conclusion of this is, that due to the growing escalation of trade conflicts, the multilateral rules based economic order is under severe stress and risks falling apart. The fact that the US as the former vanguard of this liberal economic order has shifted its position and is now challenging the system it once helped to create, means that all other actors in the global economy have to position themselves, as each of these strategies would not only feed back into the political sphere, but would also have significant technological, regulatory and business implications.

From this relatively leaderless world a new international order may arise and whether it will be bipolar (bifurcation) or multipolar is currently the subject of academic and political debate. As long as it is not clear where we are heading, great power competition is back. But unlike the period of the Cold War, when the two competing blocks barely had any economic linkages between them, nowadays global markets and supply chains link the most important actors together. So competition takes place in the context of globalisation, where free trade and increasing interconnectedness are no longer seen as a win-win situation, producing absolute gains for all by enlarging the pie. The globalised market has become a battle field on which some gain more than others and relative gains became important again. This more **competitive approach based on national interest can be characterised as geo-economics**, defined as use of economic instruments to promote and defend national interests and to produce beneficial geopolitical results. Several recent developments can be seen as an expression of geo-economics. A report of the World Economic Forum signalled this trend already in 2015. Growing tensions between the US and China have contributed to the further rise of geo-economics as a principle and as a practice.

[10] The Economist (13-7-2019, special report p.4): 'before politicians started taking a hammer to the trading system', 'supply chains were already undergoing the most rapid change in decades in response to deeper trends in business, technology and society'.

4.4 Four characteristics of geo-economics

Geo-economics can be expressed in several ways. We look at four characteristics: linking economy and national security, using infrastructure to project national power, using financial policy for geo-political purposes and using economic sanctions to achieve political goals.

Linking economy and national security

President Trump started using the argument of national security on a wide scale in trade policy. The new US import tariffs on steel and aluminium, imposed in 2018, were based on Section 232 of the US Trade Expansion Act of 1962, allowing **import restrictions on grounds of national security**. In principle the WTO agreement provides for the possibility for its members to use national security as grounds for restrictive trade measure, but this is usually understood to relate to serious and exceptional cases of threat. The Trump administration also threatened to impose tariffs on the import of cars and automotive parts on the basis of national security, a measure that would mainly hit the EU car industry. In April 2019, a WTO panel ruled for the first time on the use of national security in relation to trade in a case between Russia and Ukraine. The panel ruled in favour of Russia's suspension of commitments justified on the basis of national security concerns, but used as a crucial argument that military violence was actually ongoing. This is not the case for the US tariffs on steel or cars. However, the US does not recognise the jurisdiction of the WTO on matters of national security, thereby further undermining the status of the WTO.

The EU and other countries that have filed complaints at the WTO against the US measures have chosen to treat them as trade measures of a protectionist nature, denying any real security interest of the US. They argue that the US measures are in fact 'safeguard measures in disguise'. On the basis of this reasoning, the EU has imposed counter-balancing measures, referring to the WTO safeguard rules, which are part of the WTO trade defence instruments. The fact that the US has been willing to drop these tariffs in return for trade concessions in the case of South Korea, resulting in a modification of the trade agreement in favour of the US, reinforces the argument that they are in fact '**economic safeguards in disguise**'. This case shows how difficult it is to fight economic measures when they are presented as security measures.

Some authors have tried to explain why security aspects are on the rise in economic and trade policies. They point to the fact that **during the Cold War and in the 1990s trade adversaries and security adversaries were usually not the same**, at least not for the US. During the Cold War, the Soviet Union and its allies were security adversaries, but had no relevance for trade, whereas an economic competitor like Japan was no security threat. After the Cold War, US security concerns focussed on the fight against terrorism, whose proponents again were no economic competitors. In this reasoning, the rise of China as both an economic and a security competitor was one of the main reasons for the convergence between security and economic policy thinking in the US, even before the Trump administration. One could add to this that the US after the failed TTIP negotiations with the EU, may have started to see the EU more as an economic competitor as well. Although the EU is not a security adversary, an extension of the trade policy toolbox to security arguments has become acceptable in US trade policy.

Using infrastructure as projection of national power

International connectivity has been promoted mainly as a means to an open economic order and ultimately a more peaceful world. Interdependence works positively, as long as there is enough trust between the interconnected. But in a geo-economic world, great powers may increasingly seek to shield off their strategic and economic interests and aim at establishing asymmetrical relationships with others. They may t**ry to master connections by developing their own infrastructure networks**, possibly in a joint effort with other countries or large enterprises. Once established, such controlled physical, digital or energy infrastructure networks will protect them better against geo-economic attacks by others. The European

Council on Foreign Relations (ECFR) even coined the term 'Connectivity Wars' for this behaviour. According to the ECFR, the new battleground for geopolitical and geo-economic aspirations will be the 'interconnected infrastructure of the global economy: disrupting trade and investment, international law, the internet, transport links, and the movement of people'. This leads countries on the other hand to try to decouple from an asymmetric relationship and to reduce vulnerability and interdependence.

Today's world provides many examples. Command over **energy infrastructure** is high on the agenda in Eastern Europe. **Russia** uses its abundance of energy and its asymmetric supply relationship with former Soviet Republics as a foreign policy tool. The choice of pipelines and the countries they cross has become part of an ongoing geo-economic power struggle in the region. Ukraine has cut many ties with Russia but wants to keep the transit fees from the gas pipeline from Russia to Europe running through its country. Russia tries to circumvent this via for instance the Black Sea or the Baltic Sea. On a different level, as the New York Times reported, Russia hacked into the US power grid installing malware possibly capable of shutting down energy supply, sparking retaliation by the US a few years later in the same way. The **US,** for its part, has to a great extent achieved energy independence through its shale gas and oil revolution, reducing its energy dependency on Saudi Arabia and other OPEC states. While it tries to sell this gas in Asia and Europe, it opposes the Nordstream 2 gas pipeline from Russia to Germany, which it sees as a competitor. However, the US states that national security of European states who should become less dependent on Russian gas is the main reason for its opposition, as outlined by Atlantic Council. The controversy may lead to increased tensions with Germany. **China**'s Belt and Road projects are also partly intended to secure access to energy resources in Eurasia in order to satisfy its increasing demand and to lessen its dependency on oil and liquid natural gas (LNG) imports through the South China Sea and the Strait of Malacca, where the US Navy is still predominant. Iran holds massive reserves of oil and natural gas and has long been a focal point of geo-economic and geo-political struggles, often at odds with the US and a possible strategic partner for China.

Nevertheless, the main part of China's Belt and Road (BRI) project is about **transport infrastructure**. The BRI is one of the most ambitious infrastructure plans of the last decade in the world and fits well the narrative of geo-economics. China is using its enormous economic power to build physical and institutional infrastructure across Eurasia. In doing so, it makes use of the Asian Infrastructure Investment Bank (AIIB). China is also active in setting up global **cyber infrastructure**, for instance by being the first to roll out 5G digital infrastructure across the world, sparking security fears over espionage and dependency in other countries. Russia at the same time uses its cyber and propaganda capabilities to undermine Western democracies and their social cohesion and trust in institutions. Furthermore, President Putin announced that Russia must prepare for possible Western attempts to deny it access to the global internet and therefore create its own self-sufficient segments of the web, in order to decouple from a perceived asymmetric dependency. Even **space infrastructure** has become part of geo-economics and satellites could gain importance. Satellites and the Global Positioning System (GPS) are the backbone of our telecommunication and navigation infrastructure as billions of data flows and financial transactions depend on it. So far, there is no system that could **replace the US GPS**, even though China (BSD), India (GAGAN), Russia (GLONASS) and the EU (Galileo) are working on their own alternatives to be less dependent on US infrastructure and satellites.

Using financial policy for geo-political purposes

Apart from physical or cyber infrastructure, financial networks are also used as a tool of geo-economics. Regarding the monetary and financial sphere, the use by the US of the international financial infrastructure and the central role of its currency in enforcing sanctions were very visible in the recent case of sanctions against Iran (see below), as observed by the Brussels think tank Bruegel. As the global financial architecture and the centrality of the US and its currency within it were built on the assumption that the US would act as a guarantor of basic global public goods, the US' growing unwillingness to fulfil this role much longer also leads to growing doubts about the sustainability of US dominance of the global financial architecture and thereby the central role of the US dollar. At the same time, China tries to decouple from perceived vulnerabilities by shifting towards a domestic consumption driven economy, diversifying its foreign holdings away from the US dollar and developing with its China International Payment System an alternative to the western SWIFT payment system. Many interpret this as the building of a China led financial, trading, and with the Shanghai Cooperation Organisation (SCO) on top, also security system, directly challenging the Bretton Woods Institutions.

The European Central Bank (ECB) is primarily focused on maintaining the stability of the euro and the euro area. However, it is forced to position itself in the developments described above. Clearly, the euro is an important international currency and recognised as an IMF reserve currency. As far as central bank reserves are concerned, the euro's share in 2017 was 20 % compared to 63 % for the US dollar, 5 % for the UK pound sterling and the Japanese yen, and 1 % for the Chinese renminbi. The question arises whether increasing the use of the euro by non-residents should be actively encouraged, including the promotion of its use for international agreements and transactions in for instance the energy and food sectors. However, even bearing in mind the strong regional reach and strong role in invoicing of euro-area trade flows, it seems to be clear that such considerations would be very far from challenging the dominance of the US dollar. On the other hand, occasional strategic decisions for example through interest rates cuts by the ECB seem to politically impact on the other side of the Atlantic very quickly and to correlate with at least some Federal Reserve's considerations.

Using economic sanctions to achieve political goals

Economic sanctions are a classic tool of geo-economics. When sanctions are applied over time, they can not only re-direct trade flows, but also affect the technological development of a country, impoverish the population, lead to possible uprisings or even regime change. How far sanctions also hurt the domestic economy of a sanctioning state depends on market size and trade flows. Recent examples of the use of sanctions by emerging economies are **Russia**'s sanctions against Ukraine, Georgia and Moldova to prevent their Westward shift, or **China**'s sanctions against the Philippines and Japan over tensions in their shared maritime zone. The **US** imposed sanctions against Iran in 2017, which were aimed at forcing Iran to reduce (or shut down) its nuclear programme, although Iran had committed to use the programme only for peaceful purposes, as laid down in the Joint Comprehensive Plan of Action (JCPOA) concluded in 2015 by the permanent UN Security Council members China, France, Germany, Russia, the UK, the US plus the EU (represented by the High Representative) and Iran. These sanctions strongly affect the EU as the largest market in the world. The EU has not found a way to circumvent the US sanctions against Iran despite attempting doing so through the Instrument in Support of Trade Exchanges (INSTEX). However, the EU updated its Blocking Statute to limit the impact on EU operators doing legitimate business in Iran. In general, the **EU** tries to avoid the use of economic sanctions for political purposes, but it has sometimes used them too, for instance against Russia or Myanmar.

The important difference between the US sanctions against Cuba, Libya or Iran and European sanctions is that the US sanctions also apply to companies from third countries, which have financial interests in the US. This is called the extraterritorial effect of sanctions, punishing companies of third countries if they do not comply with sanctions imposed by the US, which can use this instrument effectively, because of its dominance of the international financial system (see above). Third countries' firms involved in trade would lose access to the US financial system and can be prevented from trading using the US dollar. Examples of US extraterritorial sanctions are Cuba, Iran, and North Korea, or the threat of sanctions against European companies involved in the Nord Stream 2 pipeline project. Even a big power like China is not exempt from being hit by such measures, as shown by a stark decline in Iranian oil production and in Chinese imports, although Chinese firms seem to circumvent US sanctions.

5 Options for the EU to move forward

5.1 Defending a meaningful multilateralism

Most of these options defined as geo-economics are only a second best compared to the multilateral system established after the end of the second world war. As previously mentioned, the GATT and the WTO-led rules - based trade order has been a major source of global prosperity. This is especially the case for the open economy of the EU. Its **market size makes the EU more apt to be a regulatory power**, as foreign companies depend on access to its markets and thus have to adhere to its regulations. The EU actively exports its legislation to affiliated countries and is the centre of a 'euro-sphere' of about 80 countries that depend on it for trade and investment, and even align themselves with its currency[11]. When global arrangements fail or are missing, this EU regulatory sphere of influence can nevertheless clash with those of other powers, for example with Russia's integration initiatives for the Eurasian Economic Union. And the EU is vulnerable to divide and rule tactics by other powers, when it is split internally on strategic policies, for instance in having different approaches to China's Belt and Road or Huawei's 5G initiatives, or as regards energy diversification.

Therefore, apart from exporting its own rules based system, **the best option for the EU is to support a larger rules based world order**. The EU Global Strategy of 2016 and the Trade for all strategy of 2015 clearly identified the need to preserve '*an open and rules-based economic system with a true level playing field'* in order to ensure the EUs prosperity and competitiveness. This implies saving the WTO by reforming it where necessary, concluding multilateral agreements where possible and working on a rules based international order for investment. Others will be watching carefully to see how the EU manages the pressures that the WTO system is under[12]. Success in preserving the multilateral trading system will ultimately depend on a reform of the WTO backed by a critical mass of member states, including the US and China.

Plans to save the WTO

The WTO with its growing membership and 23 observer governments and with a decision-making system normally based on consensus, has been and is facing considerable challenges in its daily work: Firstly, the Doha Development Round came to an impasse because of disputes between developed and developing countries. This impasse has made it impossible to launch new WTO negotiations since. Secondly, emerging countries, in particular China, do not play by WTO rules and only seem to be more willing to do so if put under pressure — as in the case of China and US. These countries should have an interest in the preservation of the WTO and in contributing to a more level playing field in international trade under the WTO umbrella. Thirdly, contrary to the spirit of the WTO too many trade barriers are being erected which should be dealt with under WTO auspices and not by falling into the geo-economics trap. Fourthly, new economic sectors like e-commerce are not or are not sufficiently covered by the WTO and there is an urgent need to address and negotiate this in the WTO and thereby restore the system so that it operates as originally intended. Fifthly, the DSB is criticised or even under attack and a reform seems inevitable if there is sufficient will to do so. The crisis with the Appellate Body is the most debated, but not the only aspect of the WTO which is disputed.

[11] European Council on Foreign Relations (2017), 'Connectivity Wars: Why Migration, Finance and Trade are the Geoeconomic Battlegrounds of the Future', p.25.
[12] Consequences of US trade policy on EU-US trade relations and the global trading system

In response to problems in the WTO system, the EU is committed to upholding and reforming it, while respecting the basic principles of free and fair competition in trade. For its part, Canada is leading a small, representative group of WTO members known as the Ottawa Group[13], in order to address specific challenges that are putting the multilateral trading system under stress. The objective of this bottom-up process is to find ways to achieve meaningful, realistic and pragmatic reforms of the WTO. So far, discussions have focused on safeguarding and strengthening the dispute-settlement mechanism and reinvigorating the negotiating function, including how the development dimension can best be pursued in rule-making efforts[14]. In this context, the Commission published a concept paper on WTO reform on 18 September 2018, seeking the support of a broader membership within the WTO. Without prejudice to the EU's final position, these ideas relate to three key areas:

- updating the rule book on international trade to capture today's global economy
- strengthening the monitoring role of the WTO
- overcoming deadlock on the WTO dispute settlement system

The European Parliament in its resolution of 28 November 2018 welcomed this concept paper recognising that 'a rules-based multilateralism remains the key part of the WTO's structure', but also noting that 'there are possibilities for deeper and more flexible plurilateral cooperation among interested states in areas where consensus has proven difficult to achieve'. Such efforts should also strive to enhance a level playing field on horizontal issues like subsidies among WTO members, rules based solutions for new topics such as e-commerce, investment facilitation and transparency for state-owned enterprises (SOEs).

While the EU and Canada continue to work on WTO reform, the **US and China have not been meaningfully engaging in the WTO reform process**. The combination of disruption and paralysis has begun to erode respect for rules-based trade and the institutions that govern it. The focus of US trade policy has moved from multilateral or plurilateral deals to bilateral negotiations. It even appears at times as if the US is working towards ensuring a lack of concrete results in WTO reform, rejecting solutions put forward while not presenting alternative proposals. The current lack of commitment on the part of the US to the WTO is depriving the EU of a strong ally and forcing a re-alignment of positions. This creates a new situation for the EU and for the other like-minded countries.

New multilateral agreements for new trade

If the US sticks to its position and it turns out that no global consensus on WTO reform can be found, countries that do want to preserve an international order will have to find new ways to achieve this. One of the possible options is to shift rulemaking on future topics to plurilateral agreements formed by a subset of WTO members. Currently, some initiatives of this kind are already under way:

- The EU and 77 other WTO members agreed to launch talks on e-Commerce in spring 2019
- The EU and other WTO members are engaged in negotiations on domestic regulation in services
- The EU and 86 other WTO members started discussions on Investment facilitation in 2018

Creating global rules for investment

Another area where the EU is active in reforming international trade practices is the settlement of investment protection disputes. This activity intensified following criticism of investment chapters and the Investor State Dispute Settlement (ISDS) provisions, which were perceived by some to favour multinational corporations to the detriment of environmental standards and the right of governments to regulate.

As a first step, the EU adopted a regulation in 2012 creating a set of rules for Bilateral Investment Treaties (BITs) between individual EU Members States and non-EU countries, so as to make sure that they are

[13] Australia, Brazil, Canada, Chile, EU, Japan, Kenya, South Korea, Mexico, New Zealand, Norway, Singapore and Switzerland
[14] Multilateralism in international trade - reforming the WTO

consistent with EU law and with the EU's investment policy — including with those EU agreements containing provisions on investment protection and investment court system (ICS) where the EU has partly exclusive and partly shared competence. Those conditions stipulate that the agreement must not be in conflict with EU law and must be consistent with the EU's principles and objectives for external action. Furthermore, the Commission must not have submitted or decided to submit a recommendation to open negotiations with the non-EU country concerned and the agreement must not create a serious obstacle to the EU negotiating or concluding bilateral investment agreements with non-EU countries.

As a next step, in September 2017, the European Commission published a Recommendation for a Council Decision for negotiations on a convention **establishing a multilateral court for the settlement of investment disputes (Multilateral Investment Court (MIC))**. Talks to work on multilateral reform of ISDS and on the possible creation of a MIC started in late 2017 under the auspices of the United Nations Commission on International Trade Law (UNCITRAL). On 20 March 2018, the Council adopted and published the negotiating directives for the European Commission on a convention establishing a MIC. The Council's mandate includes: EU accession to the convention, composition of the court (a tribunal of first instance and an appeal tribunal), procedural safeguards (including against frivolous claims), independence, transparency of proceedings, effectiveness (costs and length of procedures), involvement of developing and least developed countries, and access of small and medium-sized enterprises and natural persons. The Commission aims to address criticisms of ISDS which also became clear in a 2014 Commission public consultation, by setting up a MIC that is permanent, independent, consistent in its case-law, and allows for an appeal of decisions. The initiative will only deal with procedural issues, as substantive matters will be based on the underlying investment agreements to be applied by the MIC.

The mandate of UNCITRAL's Working Group III divides the present multilateral talks into three phases: Phase 1 focuses on identifying concerns regarding the current system of ISDS, Phase 2 on considering the desirability of reforms, and Phase 3 on negotiating such reforms. The European Commission expects the talks to move to the final Phase 3 during autumn 2019. The European Parliament supports the proposal to work towards a multilateral solution in its resolution of 8 July 2015 on a future strategy for trade and investment. Parliament considers the inclusion of the new bilateral ICS in CETA and the EU-Vietnam Free Trade Agreement (FTA) as a stepping-stone towards achieving that goal and is expected to elaborate its position on the negotiations establishing a MIC in the near future.

5.2 Defending our interests

While the EU will keep working on the defence of the WTO or at least of 'meaningful multilateralism', it will also have to defend its own interests in a world that focusses more on national interest. As EU trade policy is an exclusive EU competence, the 'national interest' becomes the interest of the EU and its Member States as a whole. In this case, the EU is pursuing fair trade not so much in an altruistic way, but is pointing to fairness for its own states, businesses, workers, environment and citizens. The EU has always done this by negotiating favourable trade agreements, but it has recently also revised its trade defence instruments and established mechanisms at EU level for the screening of incoming investment.

Negotiating and enforcing EU trade agreements

The negotiation of offensive bilateral trade agreements is the first step in defending the EU's economic interests. The European Union's trade and investment policy has been doing well so far in this respect and also as far as regional coverage of EU trade agreements is concerned. While FTAs in force covered less than a quarter of EU trade 10 years ago, they now account for more than a third of EU trade. This could reach two thirds if all the ongoing negotiations are concluded. This is by far the most ambitious trade agenda in the world today. So far, the EU has notified 41 trade agreements with 72 countries to the WTO (including plurilateral agreements) and thereby leads the way compared to other large economies like Japan (17), China (15), the US (14), Canada (14) and Australia (13).

The most important EU trade agreements recently concluded are:

- **EU–South Korea FTA** (KOREU FTA): a prime example of the kind of new generation agreement the EU is negotiating and of the concrete results these negotiations produce. It is a very ambitious trade agreement, eliminating almost 99 % of duties on both sides within five years and dealing with non-tariff barriers (NTBs). It goes beyond the US-Korea FTA. In the four years since its entry into force, EU exports of goods have increased by 55 %, automotive exports have more than tripled and the long-standing EU trade deficit has now turned into a surplus. The EU's share of South Korea's imports has increased from 9 % to 13 %, while the US's share has remained stable and Japan's share (before the conclusion of the FTA with the EU) lost 2 %.
- **Comprehensive Economic and Trade Agreement (CETA) with Canada**: CETA is a ground-breaking agreement because it provides for the ambitious liberalisation of both trade and investment. It includes unprecedented commitments by Canada to public procurement and geographical indications, and promotes EU standards. It is therefore likely to create significant economic opportunities for European companies and consumers.
- **The EU-Japan Economic Partnership Agreement** entered into force on 1 February 2019. Its conclusion should lead not only to increased bilateral trade and investment, but also to greater economic integration, closer cooperation between EU and Japanese firms, and closer cooperation between the EU and Japan in international regulatory and standardisation bodies. This could even lead to the forging of a new partnership between the EU and the CPTPP countries which will play a considerable role in restoring balance and trust to the multilateral trading system.
- In south-east Asia, the agreements with **Singapore** and **Vietnam** set examples for engaging with other smaller Asian partners.
- Also, the EU and **Latin America and the Caribbean** are longstanding trade and investment partners. Preferential trade agreements have been concluded with 26 out of the 33 Latin American and Caribbean countries. EU companies are the largest investors in Latin America with a portfolio that surpasses EU investment in other regions.
- The Economic Partnership Agreement with the Caribbean and FTAs with **Peru, Colombia, Ecuador** and **Central America** are creating new dynamics for trade and investment and for promoting a shared agenda on sustainable development and regional integration. The EU - **Mexico** Global Agreement could help to reap all the untapped benefits for our economies. The EU - **Mercosur** FTA concluded on 19 July 2019 reconfirms the EU's commitment to take into account the economic realities in the region, aiming at eliminating barriers and boosting trade.

Important ongoing EU trade negotiations are:

- In Asia, investment negotiations are ongoing with **China** and **Myanmar**. The EU remains committed to resuming negotiations with **Malaysia and Indonesia** and with **Thailand** when the conditions are right to do so. The EU can open FTA negotiations, when appropriate, with the **Philippines**. At regional level, the EU and **ASEAN countries** could ensure the rule of law in trade policy in a region, where the US - China trade dispute is adversely affecting the investment climate on a regular basis.
- **Australia** and **New Zealand** are Europe's close partners, share Europe's values and views on many issues, and play an important role in the Asia-Pacific region and in multilateral settings. Stronger economic ties with these countries will also provide a solid platform for deeper integration with wider Asia-Pacific value chains. Strengthening these relationships should continue to be a priority.
- Negotiations with the **US** on the transatlantic trade and investment partnership (TTIP) ended without conclusion in 2016 and the Council stated on 15 April 2019 that the negotiating directives

for TTIP were obsolete and no longer relevant. Currently, the European Commission is in discussion with the US on negotiating a deal on two sets of rules: a trade agreement strictly focused on the removal of tariffs on industrial goods, excluding agricultural products and an agreement on conformity assessment, that would help address the goal of removing non-tariff barriers. The reasons for the failure of TTIP were manifold but negative perceptions in large parts of civil society were one of the reasons as well as differences between the US' and the EU's approach to conducting international economic policy. What the EU negotiates with the US should also take into account what the US has negotiated with its neighbours Canada and Mexico in the new US-Mexico-Canada (USMCA) trade agreement.

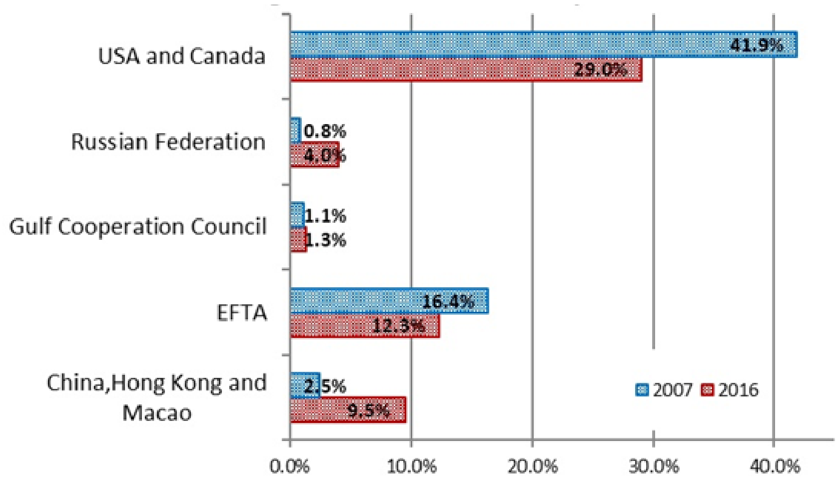
- **Africa** has been the fastest growing continent over the past decade. However, the key challenge is to make growth sustainable, through an effective agenda for economic transformation and industrialisation, including trade and investment. Africa still suffers from highly fragmented markets with high barriers between countries. There is a strong case for fostering regional integration and creating hubs that would benefit a whole region. The African initiative to create a continent-wide integrated regional market for goods and services (African continental free trade agreement) could set the legal framework for this integration and also the European Partnership Agreements (EPAs) concluded with the EU so far gave developing countries better market access and transition periods to adjust to world market conditions and WTO provisions. The EU has a strong interest in a long-term, sustainable alliances with Africa beyond migration, as this is a consequence of broader challenges, demographic developments, climate change and socio-economic issues.

Establishing investment screening

The EU has one of the world's most open investment regimes, as acknowledged by the OECD in its investment restrictiveness index. The EU is the main destination for foreign direct investment (FDI) in the world: foreign direct investment stocks held by third country investors in the EU amounted to EUR 6 295 billion at the end of 2017. However, in exceptional cases, foreign investments may represent a risk for security or public order in Member States or in the whole Union. This could be the case for example when a foreign investor seeks to acquire control of European businesses whose activities affect critical technologies, infrastructure or sensitive information. In some cases, the risk may be exacerbated by the fact that investors are owned or controlled by the state of a third country. Currently 14 member states have national screening mechanisms in place. Although they differ in their design and scope, they share the same goal of preserving security and public order at national level. The EU has introduced a screening mechanism which was agreed in ordinary legislative procedure (OLP) with EP and Council in March 2019 and will enter into force in October 2020. **The mechanism enables the EU member states and the Commission to screen foreign direct investment on the grounds of security or public order**. The EU screening framework will be transparent, non-discriminatory and predictable.

In 2016, as shown in Figure 5, a European Commission study on foreign direct investment in the EU accounted US and Canadian investors by far for the largest share of foreign investors in terms of the number of companies controlled and, even more so, in terms of assets controlled. They were followed by companies from EFTA countries, such as Norway and Switzerland. China, Hong Kong and Macao were the fifth group of investors in terms of share of companies and the sixth in terms of share of foreign-controlled assets. Although their share of investment is relatively low compared to the US and Canada, in particular Chinese investment has been increasing over the past years and covered many sectors, including technology and infrastructure. Some even claim that this comes close to a 'paradigm shift'.

Figure 5: Foreign control of EU companies



Note: Distribution of non-EU controlled EU companies (Number of companies) for a subset of countries of origin (representing about 60 percent of the foreign controlled EU companies). /

Source: European Commission, Press release 13 March 2019

Reforming Trade Defence

Trade defence instruments are one of the classical means for a country to defend itself against unfair practices of other countries. Trade defence measures are allowed in the WTO under defined conditions. The **EU has recently has renewed its legislation on trade defense** in two steps: the introduction of a new methodology for calculating dumping margins and the modernisation of trade defence measures.

As regards the **new methodology**, the European Commission, European Parliament and the Council amended the EU basic anti-dumping (AD) and anti-subsidy (AS) regulations regarding the calculation methodology for dumping margins and the scope of AD investigations in a new regulation that entered into force on 20 December 2017[15]. The purpose of these new rules is to clarify the circumstances in which significant distortions affecting to a considerable extent free market forces exist. Accordingly, the first country report published dealt with China. On the basis of concrete and fact-based information, the Commission concluded that concerning anti-dumping significant market distortions exist in the country.

With respect to the **modernisation of trade defence measures** in April 2013 the European Commission adopted another proposal to further clarify and modernise the EU anti-dumping (AD) and anti-subsidy (AS) regulations on which political agreement between the EU institutions was reached in December 2017 and revised rules entering into force on 7 June 2018[16]. The aim of the revision is to better assure an adequate level of anti-dumping duties (including changes to the so called lesser duty rule — LDR). An overview of the legislation and activities from 2017 can be found in the 37th Annual Report from the Commission on the EU's Anti-Dumping, Anti-Subsidy and Safeguard activities (2017).

[15] (EU) 2017/2321 - amending Regulation (EU) 2016/1036 on protection against dumped imports from countries not members of the European Union and Regulation (EU) 2016/1037 on protection against subsidised imports from countries not members of the European Union

[16] (EU) 2018/825 - amending Regulation (EU) 2016/1036 on protection against dumped imports from countries not members of the European Union and Regulation (EU) 2016/1037 on protection against subsidised imports from countries not members of the European Union

5.3 What Parliament can do: democracy and transparency

As a strong supporter of a fair multilateral rules-based system, the EU has taken the lead in modernising its free trade agreements (FTAs), its Trade Defence Instruments (TDIs) and the WTO. Trade policy is one of the original common policies of the EU falling under exclusive EU competence and since the Treaty on the Functioning of the EU its legislative aspects are subject to co-decision between the Council and the European Parliament. The right to grant consent to trade agreements, also given under the Lisbon Treaty, further strengthens the European Parliament's role in trade policy. As a recent study noted, compared to other Western democracies like the US, Canada or Australia, the European Parliament has a strong role of oversight over trade policy[17].

The European Parliament and its Committee on International Trade (INTA) act as a platform for public discussion on trade policies, a role of increasing importance now that the general public questions globalisation and its effects. **Through its formal competences in the co-decision and consent procedures, Parliament can substantially influence trade policies**. As the effects of comprehensive trade agreements cross over more and more into other foreign and national policy areas, other parliamentary committees are taking an interest in trade policy as well. It has become standard practice that several of these other committees are involved in decision making on trade policy, for instance through opinions to the INTA committee or public hearings. Parliament has become a channel of influence for society, NGOs and the public over sensitive issues such as human rights, labour-rights and environmental protection in trade, and thereby fulfils a legitimizing function[18].

Apart from its visible public scrutiny of trade policies, Parliament also monitors ongoing trade negotiations via a number of more informal instruments, such as debriefings by the European Commission in monitoring groups. Transparency has greatly increased, making the negotiation process more open to interested stakeholders and is at the heart of Parliament's work. Owing to the confidential nature of some parts of trade negotiations, especially in sensitive phases of the negotiation process, some briefings will be held in camera. The standing parliamentary delegations to many countries around the world will also continue to play a key role in developing relations and maintaining a continuous dialogue with those countries. Informed political debate on the basis of studies, briefings, hearings, workshops and democracy support complete the picture of institutional capacity.

The European Parliament can also use its contacts with other parliaments to influence the direction of world trade policies. This is often referred to as **parliamentary diplomacy**. At multilateral level, the Parliamentary Conference on the WTO is an important platform. It is a joint undertaking of the European Parliament and the Inter-Parliamentary Union, which they co-chair, and it seeks to strengthen democracy at international level by bringing a parliamentary dimension to multilateral cooperation on trade issues. The Parliamentary Conference on the WTO has evolved around regular sessions held once a year since 1999. The European Parliament will continue to follow closely the preparation and conduct of WTO ministerial meetings the next and 12th of which will take place in Nur Sultan, Kazakhstan, from 8-11 June 2020. The President or a Vice-President of the European Parliament also attends meetings of the Speakers of parliaments of the G7 and the G20 countries. These meetings can cover many policy topics which may include trade policy. The next G20 Speakers meeting is scheduled to take place in Tokyo in November 2019. Finally, parliamentary delegations discuss trade policy bilaterally with the parliaments of many countries. Discussions with the US Congress in the Transatlantic Legislators' Dialogue often deal with EU-US trade policy. The EU agreements with Canada and Japan reflect the importance of parliamentary diplomacy.

[17] Parliamentary scrutiny of trade policies across the western world, PE 603.477, March 2019
[18] A guide to EU procedures for the conclusion of trade agreements

New challenges will include the question of how the EU will maintain technological leadership, which depends on continuous investment, innovation and cooperation. The EU's aim should be common and effective rules for intellectual property, investment and subsidies. Trade and globalisation will find little support in public opinion if seen as destroying the planet or violating human rights and workers' rights. It will therefore be essential to make sure that globalisation brings benefits to everyone and that European industry and the European economy in general, receive adequate protection against unfair competition on international markets.

The EU will need to defend fair, balanced trade that promotes the EU's social and environmental norms and takes into account the interests of all parts of society. In this respect it will be important for the European Parliament to ensure and to monitor that the value-driven trade agenda of the Trade for all strategy of outgoing Trade Commissioner Cecilia Malmström is taken to the next level. It should call for effectively enforceable instruments that bring sustainable development fully into EU trade agreements. Despite the geo-economic turbulence in today's global trading system, the EU can still reach out to a great deal of untapped potential — with the European Parliament as a key player — in order to play its full part on the world stage, and show that it is greater than just the sum of its parts.

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