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Coping with mixed feelings

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What future for European trade policy?

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It is hard to overstate the importance of trade policy for Europe. The EU28 is the largest trading bloc, the top trading partner for about 80 countries worldwide and ranks 1st for in- and outbound investment.

EU agreements to foster trade (and investment), however, have sparked mixed feelings more recently given the backlash against globalisation as well as EU-internal controversies over the power to strike such deals. Nonetheless, free trade agreements (FTAs) are going to remain important for the years to come. Their key advantage is flexibility. The question of a post-Brexit arrangement with the UK is just one case in point.

A wide-ranging network of FTAs support the Union's trade ties and forms a key element of its trade strategy. At present, the EU has 44 agreements in place with more than 60 countries across the globe. The share of EU trade covered by FTAs could soon exceed the 40% mark, with new agreements being concluded or entering into force, e.g. with Singapore, Vietnam, Canada or Japan.

The EU's FTAs vary substantially, depending on partners and policy priorities. Trade agreements are about more than reducing barriers to commerce. Historically, they have served as a policy instrument to strengthen bilateral ties between partners and can also be used to promote policy principles or values.

"New generation trade agreements" with new challenges: New generation trade accords go beyond traditional tariff reductions, including issues like services trade, intellectual property or investment. This reflects the rise of global value chains and multilateral disciplines in some areas being less advanced. Arguably, these issues are particularly relevant for the EU but the new type of trade accords also come with new challenges.

Reconciling the European system of multi-level governance and internal sovereignty sharing with negotiating new generation FTAs remains a key issue. Yet, the EU's ability to conclude trade deals is also contingent on political support. Rising scepticism about globalisation means, that (potential) distributional effects of FTAs and their (potential) interaction with national legislation, is going to feature more prominently throughout negotiations and in the public debate.

FDI dispute resolution has proved one of the most controversial points in recent trade negotiations. A more thorough reform of investment governance could help to address some of the issues with the current system. The EU and Canada have recently made the case for reform but an overhaul of the current system would require substantive global cooperation.

The Trump campaign questioned the usefulness of current trade agreements. Actions following words could easily trigger a slew of legal challenges – both domestic and at the WTO – and cause serious economic damage.

Back in the spotlight: Trade policy

Trade policy has never been uncontroversial. However, 2016 brought it back in full spotlight with (fears of) globalisation seeming to reshape politics in developed economies.

Free trade agreements (FTAs) have come particularly under fire. Challenged by anti-globalisation protests and called into question in election campaigns, the future of trade accords like TTIP or NAFTA currently look uncertain. At the same time, the global trading system may well be in for a new round of trade deals, e.g. if the UK opts for restructuring its trade relationships with the EU and other countries via FTAs.

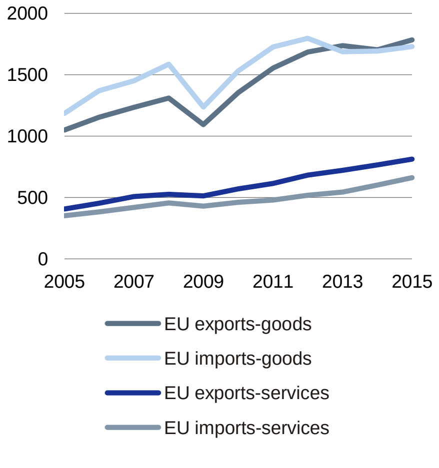
As for the EU, the seesaw about CETA showed some of the issues that far-reaching trade agreements are facing. These are both legal and political, including questions such as the scope of the Union's trade policy competence, what issues trade accords can and should address, the public perception of (EU) trade negotiations and some FTAs in particular.

Stable trade relations with its partners are key for an advanced economy like the EU, its consumers, and companies and FTAs can play a vital role in supporting ties. In fact, the certainty they can add is (all the more) valuable in times of high (political) uncertainty. Yet, EU trade policy risks being caught up between domestic and global challenges at the moment.

The key domestic issue is ensuring support for common trade policy – both among the public and EU member states. Notably, this includes better communication of EU trade policy, its rationale, implementation and results as well as strategies to address the disruptive effects of trade (and the fears thereof). Globally, the EU has been trying to reconcile its bilateral and regional agenda with support for the multilateral trading system. The latter looks likely to be further tested in the coming years, e.g. due to looming trade disputes between key players – take for example the recent challenge of the US and the EU over methodologies for antidumping duties by China – or countries prioritizing bilateral goals over multilateral commitments. While the EU has a well-developed FTA network and agenda to fall back on, some of the most difficult issues in its FTA negotiations, e.g. the investment dispute settlement, could be easier to address – internally and externally – with a stronger multilateral framework.

The EU in global trade: Growth in interconnectedness during past decade 1

In EUR bn



Sources: European Commission, Eurostat

The EU's trade position

Europe plays a key role in world trade. Altogether, the EU28 is the largest trader in goods and services. With EUR 2,388 bn it ranks 2nd in imports (US: EUR 2,522 bn) and takes the top position for exports (EUR 2,603 bn, followed by China with EUR 2,258 bn).[1]

EU total trade in goods increased by 57% from 2005 to 2015 and – albeit from a lower basis – services surged by 94%. Notwithstanding the growth in absolute volumes, the EU's share in world trade, 14.7% for trade in goods and 22.2% for trade in services in 2015 compared to 17.5% and 24.1% in 2005 respectively, slightly declined due to a mix of domestic and external factors.[2] Shares for the US are similarly lower than 2005 while China's role in world trade has clearly

[1] Volumes for trade in goods and services excluding intra-EU trade, 2015. Source: European Commission, Eurostat (2016).
[2] Domestic factors include demography and the effects of the financial and economic crisis. External factors include the growing importance of emerging economies in world trade, notably China which increased its trade substantially since the country entered the WTO in 2001.

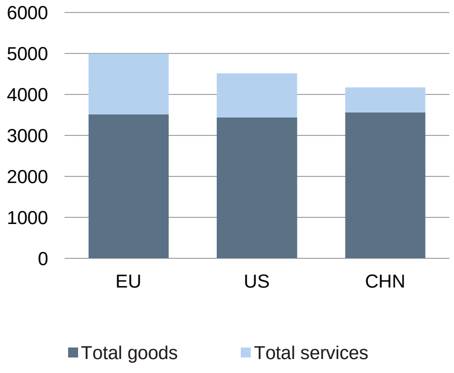
increased during the past decade (14.9% trade share for trade goods, i.e. + 6 pp compared to 2005, and + 4.7 pp for trade in services bringing the share to 9.1%).

Similarly, the EU28 is a key source of and destination for global investment. In 2014, it ranked first in inbound investment with a total of EUR 118.9 bn in inflows and EUR 96.1 bn in outflows (2nd to the US which recorded outflows of EUR 253.6 bn). Foreign direct investment in the EU (2014: EUR 4.583 bn) makes up for about 26% of global FDI stocks and investment in European firms in other parts of the world (EUR 5.749 bn) amount to more than a third of global stocks.[3]

The quick glimpse at trade and investment figures emphasizes the EU's global interconnectedness. As a bloc, the EU28 is the top trading partner for about 80 countries worldwide and the 2nd most important partner for another 40.[4] A wide-reaching network of trade agreements and investment treaties that has developed over decades supports these connections.[5]

Three largest traders worldwide 2

In EUR bn (2015), for EU: trade with extra EU28



Sources: European Commission, Deutsche Bank Research

The EU's trade agreements

At present, the EU has 44 trade agreements in place with more than 60 countries across the globe.[6] In addition, five accords have been finalised but are not yet being applied (with East African countries, Ecuador, Singapore, Vietnam and West Africa).

Trade agreements are flexible instruments and their content reflects relations with and priorities of the EU and its different partners. Basically, EU trade policy distinguishes between three types of accords[7], i.e.

i. *Partnership and Cooperation Agreements* – which leave customs as they are and provide a general framework for bilateral and economic relations, for example with African and Caribbean partner countries.
ii. *Customs Unions* – which eliminate duties with the respective trading partner and establish a joint tariff for foreign imports, for example with San Marino and Andorra or the Customs Union with Turkey (for trade in goods).
iii. *Association Agreements, Stabilisation Agreements and (Deep and Comprehensive) Free Trade Agreements and Economic Partnerships* – which remove or reduce customs tariffs in bilateral trade, for example with South Korea (FTA), Canada (deep and comprehensive FTA) or Serbia and Albania (both with Stabilisation and Association Agreements).

Trade agreements are about more than reducing barriers to trade. They are a policy instrument to strengthen bilateral ties between partners and can also be used to promote certain principles or values (e.g. environmental protection or animal health). FTAs are typically based on the idea of reciprocal liberalisation. However, Economic Partnership Agreements do not necessarily require (immediate) reciprocal market opening from partners, reflecting their history as an attempt to promote economic development through trade. Some trade accords are part of broader political agreements, e.g. association agreements.

The EU's trade agreements are quite heterogeneous, reflecting characteristics of trading partners' economies, bilateral trade ties as well as their dates of negotiation and conclusion. Notably some of the older agreements are currently undergoing modernisation.

FTAs: More and broader scope 3

FTAs aim to reduce tariffs and non-tariff barriers (NTBs) between partners. While strengthening ties, economic integration is less advanced than in a Customs Union (also requires common external tariff) or a Common Market with free movement of capital, labour and people and (some) harmonisation of policies.

During GATT (1948-1994) members notified 124 regional trade agreements (on trade in goods). Since 1995, about 400 arrangements for goods and services have been notified. WTO members currently have 19 customs unions and 238 FTAs in force (total regional trade agreements: 431).

FTAs can vary considerably in terms of scope and ambition, particularly for issues beyond tariffs. Services have increasingly formed part of trade agreements and by now the majority of physical agreements cover both goods and services. In addition, FTAs have been including elements that are only partly or not covered by WTO rules.

Sources: WTO (2016), Deutsche Bank Research

[3] See European Commission, Eurostat (2016).
[4] See European Commission (2015).
[5] Other factors are of course the EU's geographical position and the multilateral trade system of which the EU and its member states have formed part.
[6] Source: European Commission, DG trade. Dec. 2016. This includes different types of agreements. Accords with country groups are counted as one.
[7] Source: European Commission http://ec.europa.eu/trade/policy/countries-and-regions/agreements/

Do trade agreements really increase trade? 4

The short answer is "yes" on average – but not all trade agreements do so to the same extent (see e.g. Baier/Bergstrand 2007, Baier et.al 2007 and Kohl 2014).

One explanation for varying impact is the heterogeneity of agreements for example in terms of design, institutional quality etc. Different characteristics of accords can also affect the credibility of commitments.

Handley and Limao (2015) find that credible preferential trade agreements can increase trade even if applied barriers are already low and that agreements can play an important role in removing uncertainty about future trade policies which in turn spurs export investment.

Source: Deutsche Bank Research

Trade agreements are not all alike

Trade agreements can be classified in different ways, ranging from age or partner country characteristics, the degree of market access they foster, the type of trade they cover, whether they require reciprocal market opening, and potentially also looking at more political elements they include.[8] Breadth of trade accords is easier to capture than depth. In the first case, issue areas (e.g. goods, services, intellectual property) that are typically addressed in different chapters, can serve as one proxy.[9] Depth is more elusive: Some trade agreements for instance contain provisions to somewhat open up labour or capital flows bringing it closer to a common market. Also, accords can contain provisions and set up fora for dispute settlement or establish policy dialogues in certain areas, which can be a way to foster closer cooperation.

A recent distinction is between "classic" trade agreements which mainly focus on liberalisation of trade in goods and "new / 2nd generation accords" which cover areas beyond trade in goods, such as services, intellectual property or rules for investment. While still seeking tariff reductions in some areas, a key focus is the reduction of non-tariff barriers. Basically, the 2nd generation accords are broader and deeper, the recent agreement with Canada (CETA) being one example for this type of agreements.

Agreements on trade and investment tap very different worlds

While trade and investment are (ever more) closely linked, particularly through global value chains, it is worth pointing out some distinctions between agreements on trade compared to the area of investment. First, the basic goal of rules in the two areas differs. Rules for trade originally aimed at smoothing flows of goods by reducing protection at the border (thereby encouraging trade) whereas arrangements for FDI are about protecting property rights of foreigners within another country's borders (thereby attracting investment). In practice, things are more complex but the different origins still show in today's debates. Second, the degree of multilateralisation and institutionalisation is more advanced for trade.

GATT and later the WTO have provided a relatively advanced multilateral framework for trade relations and have reached broad membership and coverage of global trade (by now 164 WTO members, with exchange among them accounting for more than 94% of global merchandise trade and 97% for services[10]). The issue here has always been to reconcile bilateral and plurilateral trade deals with(in) the multilateral system.

Trade agreements aim for privileged market access for the countries doing an agreement. Yet for GATT/WTO most favoured nation (MFN), i.e. that countries cannot discriminate between trading partners and that special favours granted to one need to apply for all members, is a core principle. WTO provides for exceptions from MFN for regional trade agreements provided that they meet the conditions specified in GATT and GATS. This is relevant for example for the tariff part of negotiations as the rules stipulate that "substantially all of trade" must be liberalised.[11]

[8] For example establishing regular policy dialogues in a particular area.
[9] Beyond issue areas the approach to market opening (negative or positive list) is a factor to consider for breadth and depth.
[10] Membership includes the EU and member states. Trade shares excluding intra-EU trade, 2014. Source: WTO.
[11] See WTO for further information on regional trade agreements in the world trading system and Matsushita (2010) for further discussion.

Basically, the WTO provides an institutional framework for trade in goods (incl. issues related to it), trade in services (GATS), trade-related aspects of intellectual property rights (TRIPS) and a mechanism for dispute settlement. Agreements by WTO members need to be "WTO compatible", i.e. respecting global trade rules and disciplines, and members need to notify the organisation of new accords.

Arrangements for investment have developed quite differently. There is no parallel international organisation or body of rules for investment.[12] Some aspects of investment policies are dealt with as part of multilateral trade rules (GATS for services-related, TRIPS for intellectual property and TRIMs for trade-related investment measures) but by and large investment has mostly been protected through bilateral agreements (BITs). In some cases, there are also sectoral agreements (e.g. Energy Charter Treaty) or investment provisions are part of regional and bilateral trade agreements (e.g. NAFTA or CETA). Globally, there are 2.324 BITs and another 297 treaties with investment provisions in force.[13] The EU or its member states are currently signatories to about half of the existing BITs.[14]

Dealing with disputes

ISDS in brief 5

The current system of investor state dispute settlement (ISDS) in investment agreements emerged in the 1960s. Before, investment was mainly protected through „diplomatic protection", i.e. investors' home countries helped to settle disputes (the disadvantage being that private investors' problems could turn into diplomatic frictions).[15]

ISDS as part of investment agreements allows investors to directly bring disputes against host states. Investment agreements typically refer to different sets of arbitration rules, e.g. ICSID (World Bank) or UNICTRAL (UN) to enforce obligations contained in BITs.

Sources: Choi (2007), UNCTAD (2015), Deutsche Bank Research

A key issue in trade and investment agreements is the resolution of disputes in cases where commitments are (allegedly) not met. For trade, there is an established dispute settlement mechanism within the WTO. FTAs, which need to be compatible with WTO rules, can specify the WTO as designated forum to resolve disputes or agree on alternative procedures for partners, ranging from consultation mechanisms, arbitration or the establishment of standing bodies.

In contrast, for investment there is no unified set of rules on investment protection and investment dispute resolution at the moment. The existing investment agreements contain rules for treatment of foreign investment[16] and provide for investors to bring disputes. Agreements typically refer to different sets of arbitration rules. Basically, the current system of Investor-State Dispute Settlement allows investors to resort to international arbitration (on the basis of different sets of rules) when they see obligations included in BITs violated. Usually, disputes are adjudicated by ad hoc tribunals of arbitrators appointed by the parties to the dispute and tribunals are disbanded afterwards.

The current system of ISDS has been criticised from different sides and for various reasons. Notably, these include potential disadvantage for developing countries which potentially face claims for compensation from investors, low public trust in an ad hoc system, and increasing complexity with the spread of BITs. However, it is still pending a thorough reform. At the same time, dispute resolution for investment has become one of the most difficult issues in the public debate about 2nd generation trade agreements like CETA in Europe (but also beyond).

2nd generation trade agreements – what are really the issues?

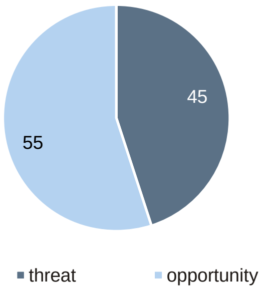
There are two key reasons to negotiate 2nd generation comprehensive accords for Europe. Trade in goods and services and investment as well as issues like intellectual property have become increasingly linked, which speaks for a

[12] Negotiations at the OECD on a multilateral agreement on investment did not conclude successfully in the 1990s.
[13] As of Jan. 2017, Source: UNCTAD, International Investment Agreement database.
[14] For investment agreements notified by EU member states see http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:C:2016:149:TOC
[15] See Choi (2007).
[16] Investment protection standards to some extent reflect global principles though.

Opinions about globalisation in Europe 6

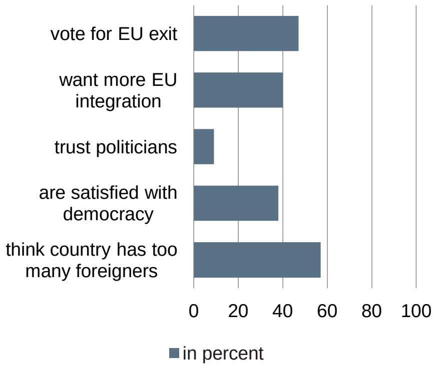
Respondents in percent

"Globalisation is a..."



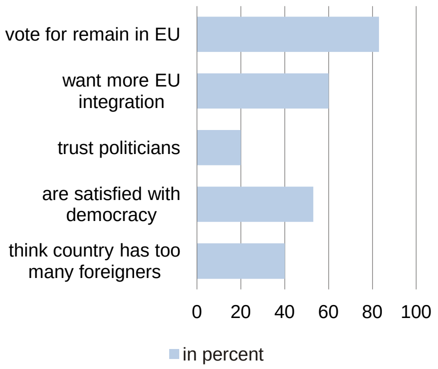
Sources: Bertelsmann foundation (2016), Deutsche Bank Research

Very different views: Globalisation as a threat ... 7



Sources: Bertelsmann foundation (2016), Deutsche Bank Research

... or an opportunity 8



Sources: Bertelsmann foundation (2016), Deutsche Bank Research

comprehensive approach. Second, some of the issues beyond trade in goods are less covered by multilateral disciplines – either because there has not been agreement on them and/or multilateral rules have not kept pace. To that extent, FTAs can be a way to bridge some gaps but also to potentially lead by example – particularly when it comes to issues such as addressing NTBs or dispute resolution.

From the EU's perspective, pursuing broad and deep trade accords make the most sense with partners of sufficient market size, already decently developed trade ties (broad product range, goods and services, mutual investment), growth prospects to increase them further and partners with more similar preferences in some of the more controversial areas (e.g. when negotiating rules to facilitate regulatory convergence or mutual recognition).

However, agreements to foster trade and investment have sparked mixed feelings. Two things come together here: First is an issue over competencies to strike comprehensive trade deals. Second is anti-globalisation sentiment and public scepticism about (some) trade deals. The seesaw about CETA exemplifies both points.

What is the scope of the common commercial policy (again)?

The EU's common commercial policy (CCP) has evolved over the years, also to accommodate for new issues on the trade policy agenda. The Lisbon treaty (2009) strengthened the EUs powers on trade, notably on services, commercial aspects of intellectual property rights, and by bringing foreign direct investment within the CCP's scope, allowing for a more comprehensive approach to trade and investment issues.[17]

Yet how far exactly the EU's competences extend is still subject to debate. This matters for the legal nature of the EU's trade accords and the approval process an agreement needs to go through. In a nutshell, if a trade accord falls under exclusive competence, it can be concluded as 'EU only' and approval can be by qualified majority.[18] If a trade accord affects areas which are exclusive competences of member states, there has to be national ratification. If a trade agreement concerns shared competences, they tend to be concluded as mixed agreements.[19]

The reason for this arrangement is simply that the EU's competences over trade should parallel its internal competencies for rule-making. From a political perspective, however, mixed agreements mean a longer approval process with an uncertain outcome – and the backlash against globalisation and populist challengers amplify this.

New types of trade deals trigger new types of opposition

The concerns that new trade agreements can raise are – just like the accords – a mix of classic and new issues. First is rising pressure on import competing industries and fears of potential job losses. Second are concerns about potential weakening of standards, e.g. on labour, health and environment, resulting in lower levels of consumer and worker protection. This often goes together with fears about trade agreements limiting the ability to regulate, an issue, which also looms large in the debate about investment dispute resolution. Third, the process of negotiating trade agreements has been criticized for its lack of transparency. The first point is about the classic (re)distributional effects of trade. The other issues are essentially about trust in government / EU / elites in general (or the lack thereof).

[17] Note that the Lisbon treaty also strengthened the role of the European Parliament in trade matters.

[18] The voting procedure for Council depends on the exact content of the agreement.

[19] In cases of shared competence there is a choice between full national ratification or if a qualified majority (depending on content) agrees, it can be concluded as EU only. For further discussion see Peers (2016) and Puccio (2016).

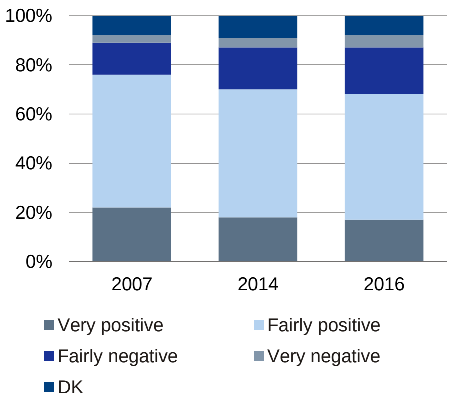
The scope of CCP and the EU-SGP FTA 9

Negotiations for an FTA between the EU and Singapore were completed in October 2014. The agreement is still pending formal approval and ratification. It covers trade on goods, services, intellectual property rights and investment. The European Commission has asked the Court to clarify on the question which areas fall under EU-exclusive, shared or member states' competences which has implications for the conclusion of the accord ('EU only' or jointly with member states). The opinion could set a precedent with respect to the question to what extent FTA agreements can be concluded by the EU (and the EP's consent) or mixed. Thereby it would also speak to the question of member states' role and reach in the Union's external relations, the relation between the EU's legal system and external competences after Lisbon reforms and the possibility of accommodating new trade agreements with evolving EU secondary legislation. The Court's judgement is expected for spring.

Sources: Puccio (2016), European Commission, Deutsche Bank Research

Shrinking majority with positive view on trade 10

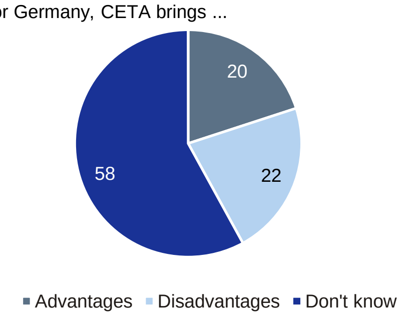
Associations with "free trade". Total EU



Source: Eurobarometer, Deutsche Bank Research

The uncertain majority: Germans' opinion on CETA 11

For Germany, CETA brings ...



Poll as of Oct. 28 2016.

Source: ZDF Politbarometer

These concerns are mutually reinforcing. Also, it is this combination, which makes it very attractive for populists to oppose EU trade deals and capitalize on fears. Against this background, ratification of trade deals at national level becomes less and less certain. The worst-case scenario for EU trade policy at the moment is thus a scenario of paralysis and increasing irrelevance.

Coping with mixed feelings: What future for European Trade Policy?

To be clear: The combination of competency issues and rising discontent with globalisation seriously risks undermining European trade policy and ambitious FTAs as part of it. But there are several reasons not to jump to conclusions.

Legal challenges can help to clarify

First, the combination of a broader set of issues being negotiated in trade agreements and the broadening of competencies prompted the question how far the scope of CCP really extends. Ultimately, it's a system evolving, given new issues on trade policymakers' agenda and the EU's multi-level governance structure. The pending cases about the EU's competence to conclude the EU-Singapore free trade agreement as "EU only" as well as the legal challenges about the provisions on investment disputes exemplify this.

There is no blue-print for trade policymaking in a multi-level system like the EU. A growing body of legal interpretation on these topics can provide some guidance – and thereby help going forward even if rulings point out some limits of competencies or tensions between domestic constitutional rules and commitments through (EU) trade accords.

For example, the application for a preliminary injunction at the German Constitutional Court in the CETA was ultimately rejected in October 2016, allowing the German government to back the agreement in the Council, but subject to conditions.[20] Bottom-line is that this might help to reduce uncertainties with respect to (provisional) application. On the EU-Singapore case, the advocate general Sharpston issued her opinion late December, arguing that the EU Singapore FTA can only be concluded jointly by the EU and the member states. While the final ruling by the ECJ is still out (likely to follow Q1 2017) the advocate general has put forward a differentiated view on the competency issue, arguing that while a wide-range of matters in the agreement are covered by the EU's external competencies, some aspects are not (exclusive).[21]

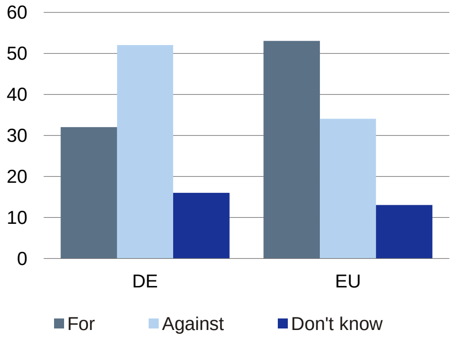
The crucial point is that rather than seeing legal cases as (in)validating EU trade policy or its approach to FTA negotiations, they can on the upside provide clarification. Also the competency issue, it also emphasizes the need for carefully drafting mandates.

[20] These are to ensure 1. That provisional application only applies to the parts of CETA that lie indisputably within scope, 2. Sufficient democratic legitimacy with regards to the CETA-joint committee, 3. There is a possibility to unilaterally terminate the provisional application. See German Constitutional Court, press release No.71/2016. The investment Court system will be assessed in the main proceedings. In addition, as part of the deal to back the agreement, the Belgium federal government will seek the Opinion of the European Court of Justice on the compatibility of the Investment Court System (ICS) in Chapter Eight of CETA with the Treaties.

[21] See ECJ press release No.147/16. http://curia.europa.eu/jcms/upload/docs/application/pdf/2016-12/cp160147en.pdf

Little love for TTIP in Germany 12

Opinion on a free trade and investment agreement between the EU and the USA

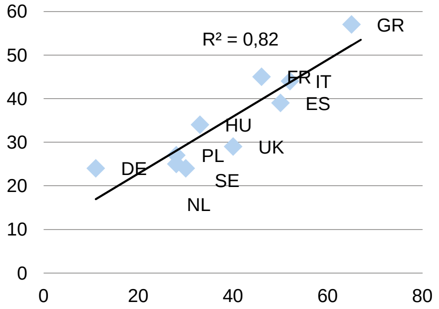


Poll conducted Nov. 3.-16. 2016

Source: Eurobarometer (2016), Deutsche Bank Research

Global economic engagement and countries' (self)perception 13

X-axis: Global economic engagement is a bad thing. Y-axis: Country is less important than it was 10 years ago. Share of respondents in %.



Source: Pew Global Attitudes (2016), Deutsche Bank Research

Public opinion – in principle and in practice

Second, trade liberalisation has never been uncontroversial. But – perhaps surprisingly given the current discussion about globalisation discontent – public opinion is not outright hostile to free trade in principle.

Public opinion in the EU tends to be fairly divided on trade issues with a slight majority in favour of openness. For example, a recent pan-European poll by Bertelsmann showed 55% with favourable views on globalisation compared to 45% seeing it as a threat. Similarly, the regular Eurobarometer survey suggests that more Europeans see globalisation positive (48%) than negative (40%) – which is about the same as a decade ago (46 and 39% in 2007).[22] Associations with "free trade" are also mostly positive on average. On specific issues like trade agreements, (evidence on) public opinion is rather selective and arguably a number of other issues may come into play when judging the potential effects of individual accords (which polls most of the time do not allow to really discern).

The aggregate data that there is, neither provides for strong rejection of EU trade policymaking nor strong backing. Research based on micro-level data has tended to suggest that preferences for economic openness are based on how trade affects individual levels of income.[23] However, some research also finds that perceptions of trade's effect on the economy as a whole also come into play.[24] Also, for the 2nd generation trade agreements it is reasonable to assume that issues other than distributional effects play a more prominent role.

What are the implications for European trade policy? First of all, public opinion neither provides for rejection nor enthusiastic support. Rather, it emphasizes the need to (better) communicate trade policy's rationale, implementation and results both at European and member state level. If anything, this is even more important when it comes to issues beyond traditional tariff protection. At the same time, EU trade policymakers are well-advised to take the mix of concerns about trade's distributional effects[25] and the more general sense of (economic) weakness and decline seriously. Trade is easier to blame than technology and if there is the perception that the benefits created are too small and not shared widely enough the foundations for openness – something the European economy thrives on – are eroding.

For trade agreements this suggests that (potential) effects on jobs and also on income distribution are likely to play a bigger role when considering accords or scoping them. Having said that, the potential job effects can be hard to pinpoint. Distributional consequences and concerns about job losses need to be addressed. But this also means walking a tightrope to avoid a policy discussion (too) focused on the status quo and with little value attached to (potential) dynamic gains from trade. The distributional concerns also require policy responses beyond trade, including for instance investment in education, labour market and competition policies. Clearly, part of these measures do not provide "quick fixes" for current problems. Nevertheless, they form a nonnegligible part of a sustainable EU trade policy in the mid- to longer term.

The EU's trade policy and the international context

EU trade policy has pursued a two-pronged strategy during past years, increasingly seeking bilateral and regional trade agreements but supporting the multilateral trading system. Much speaks for continuity here. A recent example is the initiative by the EU and Canada to consider a more thorough reform of investment governance and possibilities for a multilateral investment court – which could help to address some of the issues with the current system and

[22] Eurobarometer includes an option for „don't know" (12%). Eurobarometer 86, Nov. 2016.
[23] See for example Scheve/Slaughter (2001) or Mayda/Rodrik (2005).
[24] See Mansfield/Mutz (2009).
[25] See Peters (2016) for a more extensive discussion about income inequality.

facilitate consideration in trade agreements.[26] However, an overhaul of the current system would require substantive global cooperation also beyond the EU to be effective.

Finally, a key question for European trade policy is beyond the domestic realm and concerns the future of the multilateral trading system. The EU stands to benefit from a rule-based multilateral trade order and so does the multilateral system from the bloc's support.

From a trade perspective, Brexit not only means entering uncharted territory for the EU27 and the UK – it also creates a unique and unprecedented situation for the WTO. This means that there are going to be a lot of detailed questions that need to be dealt with, including – but not limited to – adjustments of commitment schedules or the question how a transitionary arrangement between the UK and the EU27 would fit in with WTO rules. It is becoming increasingly clear that Brexit means leaving the Single Market and the UK Prime Minister Theresa May has announced that she would like to restructure relationships with the EU and the rest of the world through trade deals.[27]

Thus, Brexit looks set to further add to the global number of FTAs in the medium term. How the global trading system is going to deal with the growing complexity remains to be seen. On the one hand, it has become increasingly clear throughout past years that growing and more heterogeneous membership of the WTO can make it difficult to reach consensus at the multilateral level (for example on services). At the same time, at some point it might be easier to work out a plurilateral or multilateral consensus on issues rather than having to deal with an increasingly more complex set of bilateral accords.

Watch the words and the actions

Both China's and the US are going to shape the future of the WTO in the next years through words and actions. China has thrived within the global trading system since joining in 2001 and this year it was president Xi making the case for free trade in Davos. To that extent, there is some overlap with the European approach that continues to emphasize openness and multilateralism. At the same time, looking beyond the rhetoric, there are issues that remain more controversial to deal with, e.g. China's treatment of foreign companies' in its domestic market or technology transfer.[28] Looking at the US, seeing actions following words would prove much more problematic for the global trading system. It could easily trigger a slew of legal challenges – both domestic and at the WTO – and give rise to trade wars causing serious economic damage.

It is not the first time that trade (deals) have been a hot topic in US election campaigns. However, a zero-sum view of trade and disregard for multilateral rules just does not square with the core ideas underpinning the multilateral trade system. Both abrogating free trade agreements and turning away from the multilateral trading system might prove to be short-sighted and ultimately hurt the US economically and strategically.[29]

So far, President Trump has marked a shift in rhetoric and communication style when it comes to trade policy. The big questions remains whether his views on trade, which run counter pro-openness republican mainstream, are going to be backed or moderated by Congress. Clearly, the former is going to be a bigger challenge for the global trading system. The US turning their back on the WTO

[26] See for example the European Commission and the Canadian government co-hosting an expert discussion on the issue in Dec. 2016 and the ongoing public consultation on a multilateral reform of investment dispute resolution http://trade.ec.europa.eu/doclib/press/index.cfm?id=1610
[27] See Theresa May's speech delivered on Jan. 17th 2017.
[28] See for instance the recent letter by German ambassador Clauss (http://www.china.diplo.de/Vertretung/china/de/02-pol/Erklaerung-kondolenzseiten/170116-statement-s.html)
[29] For further discussion of the economic and geopolitical implications see for example Noland, Hufbauer, Robinson and Moran 2016.

would certainly be a historic break both given the country's tradition of supporting the post World War II global trade order and for the WTO as an organisation. It would come at high costs for both and imply (re)assessing the role of the EU and China in the world trading system.

Three key issues which matter for the EU, China and the US and the trading system at large are developments around China's market economy status, the use of trade defence measures and developments in the steel sector.

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Appendix

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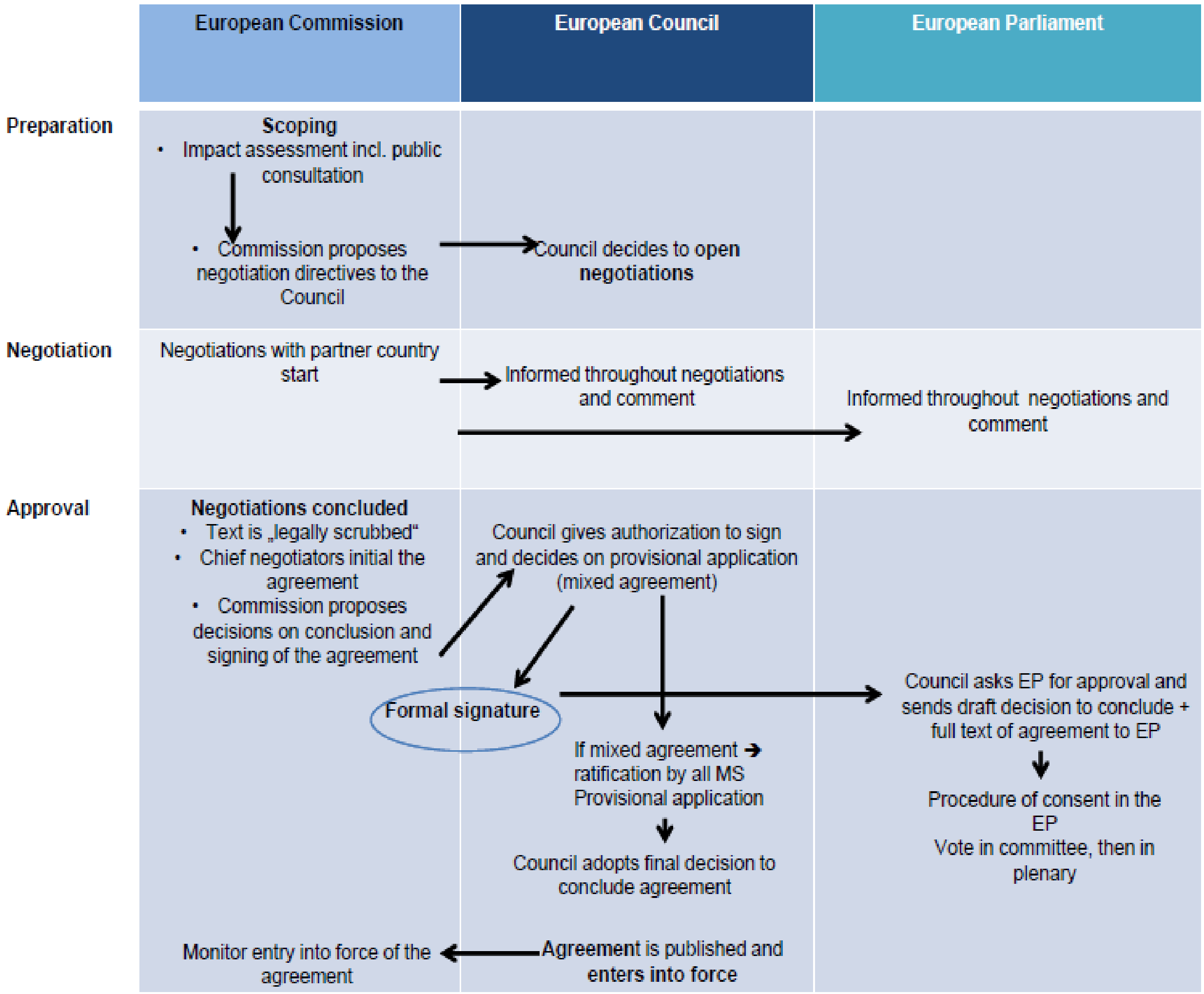

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