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Theory and Politics of European Integration

Lecture 4: Market Size and Scale Effects
Competition and Trade Policies

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Last Lecture

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- **Preferential Trade Liberalisation**
  - The PTA Diagram
    - + Free Trade Equilibrium
    - + MFN Tariff Equilibrium
    - + Unilateral Trade Discrimination
    - + Supply Switches
    - + Welfare Effects
  - Empirics: Is Trade Diversion an Issue?
  - Welfare Effects of a Customs Union
  - Customs Union vs. Free Trade Area
  - WTO Rules and Customs Union/Free Trade Areas
    - + Art. 24 WTO

An example: MFN Tariff

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- **Pre-PTA case (MFN Tariff)**
  - Country A, B + C produce cars
  - Country B + C export cars to A
  - Country A imposes a tariff of 10% in imports of cars
  - Prices: In country B+C the price for a car is 20,000 Euro, in country A 20,000 + 2,000 = 22,000 Euros
  - The **border price** (price before tariffs) in country A is 20,000 Euros (equal to price exporters from A+B receive)
  - The profits of the marginal-cost producer in A, B and C are zero, but some producers realize positive profits (producer's rents)
  - The marginal utility of the last consumer of cars in A+B+C is zero, but the average consumer realises positive rents (consumer rents)

Uniform MFN Tariff

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RoW

Border price

XS^R

P'

P

P'-T

p*

$X^{R'}$ X^R

RoW Exports

Partner

Border price

XS^P

T

$X^{P'}$ X^P

Partner Exports

Home

Domestic price

MS_{MFN}

MS

MD

P'

P

P^a

T

M' M^{FREE}

Home imports

An example: PTA and Price Changes

- **The PTA case: prices**
  - A removes the tariff on cars for B, but maintains it for C
  - The border price for country B equals the domestic price in A, but there is still a difference between the domestic and the border price of 10% for C
  - Since the marginal producer in B can produce at lower costs than A, prices fall in A depending on marginal demand
  - Let's assume prices fall in A by 5%. This implies that the border price for B's exporters increase by 5%. This in turn implies that the domestic price in B for cars increases by 5% as well.
  - The new price in the PTA is thus 21,000 Euros.
  - The border price for exporters from C is consequently ~19,091 Euros.

Domestic Price and Border Price Changes

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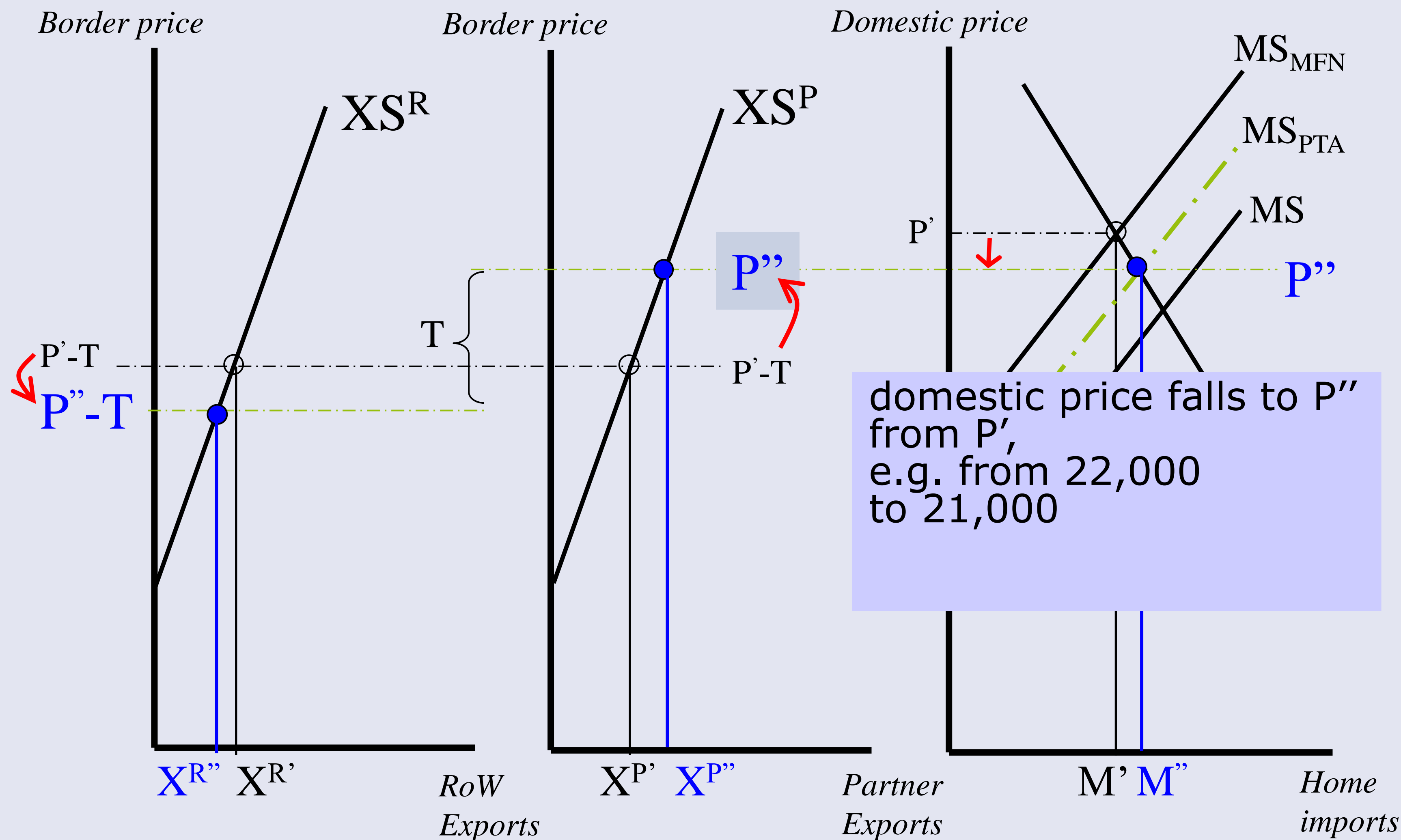

Domestic Price and Border Price Changes

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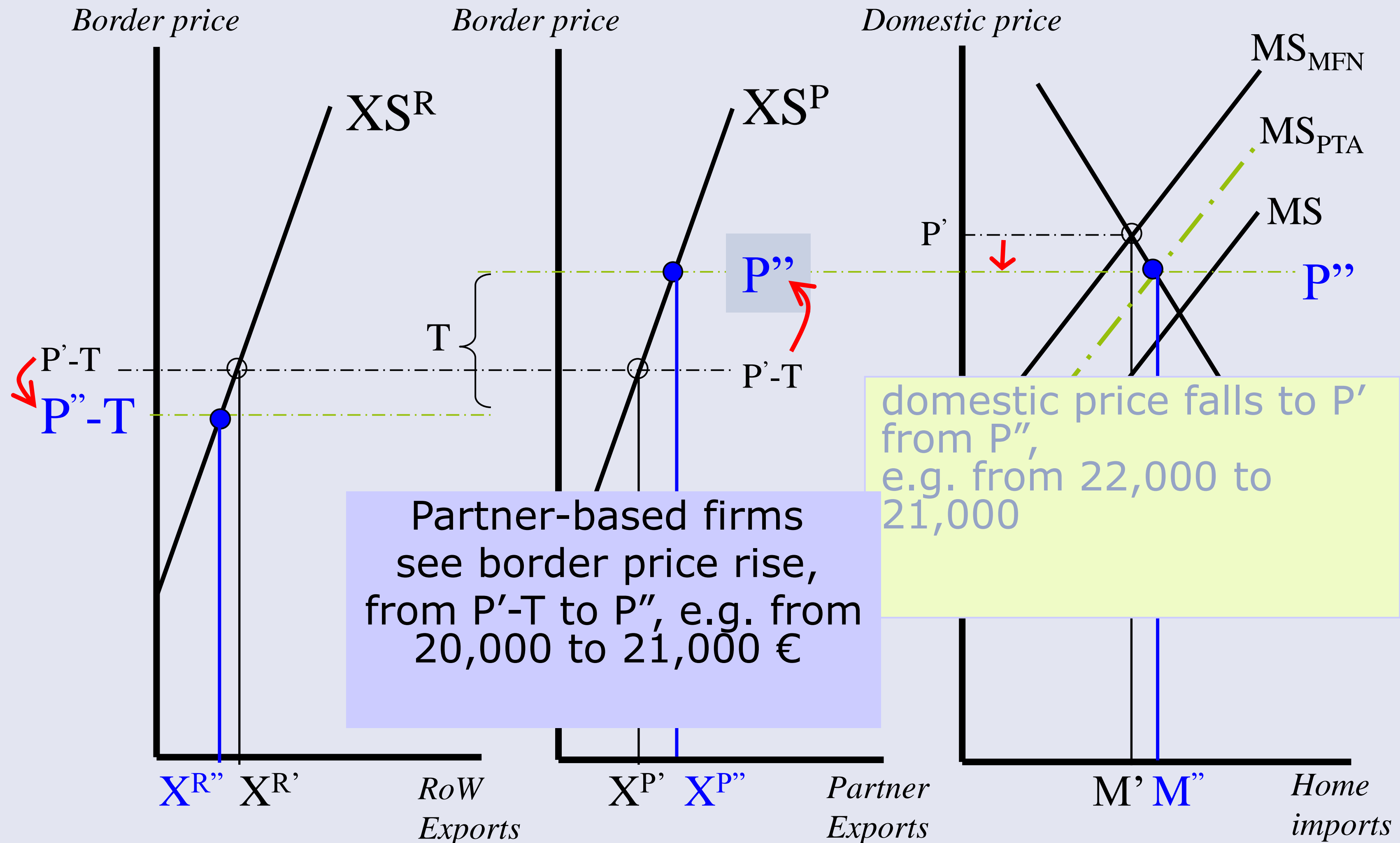

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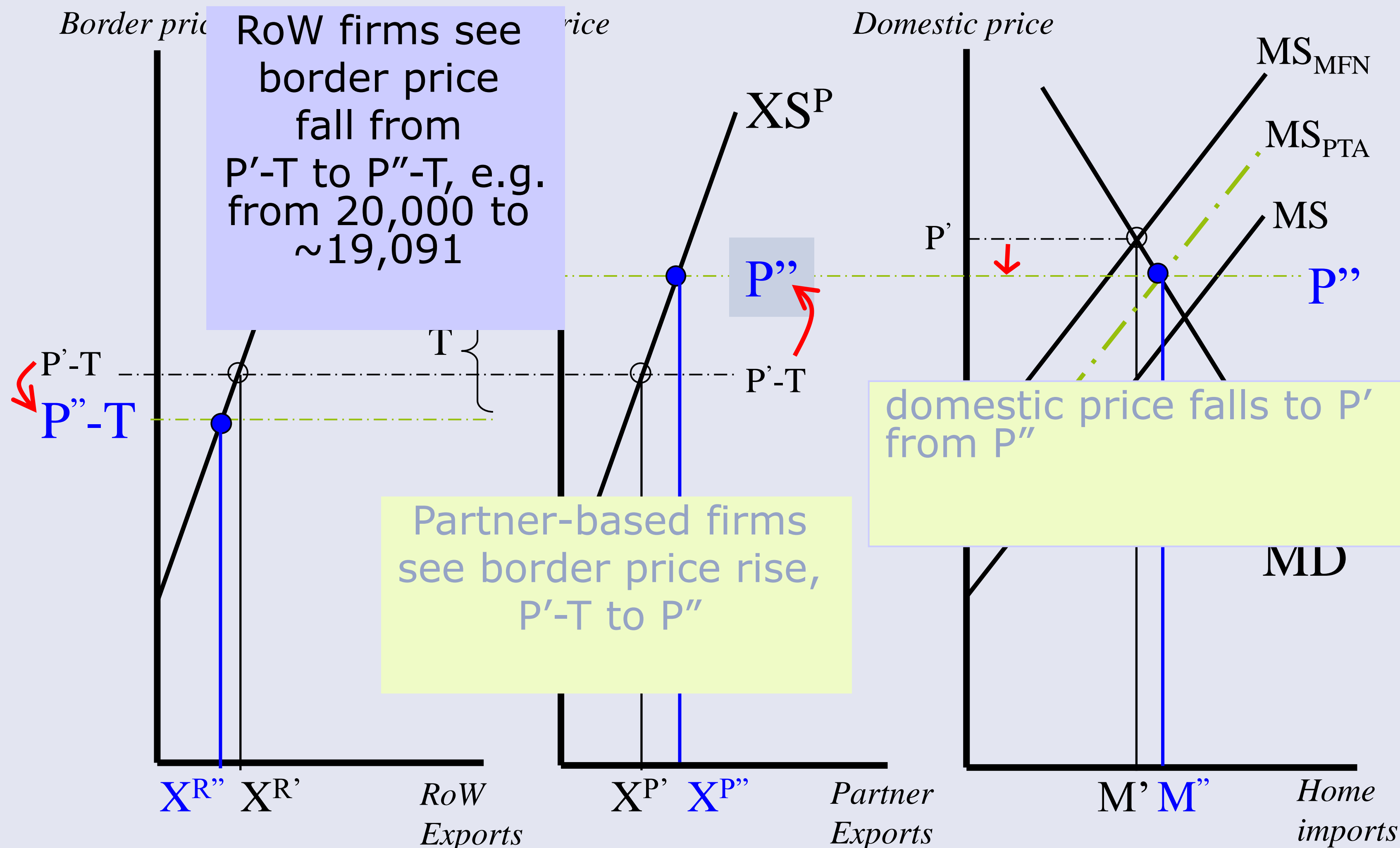

An example: PTA and Quantity Changes

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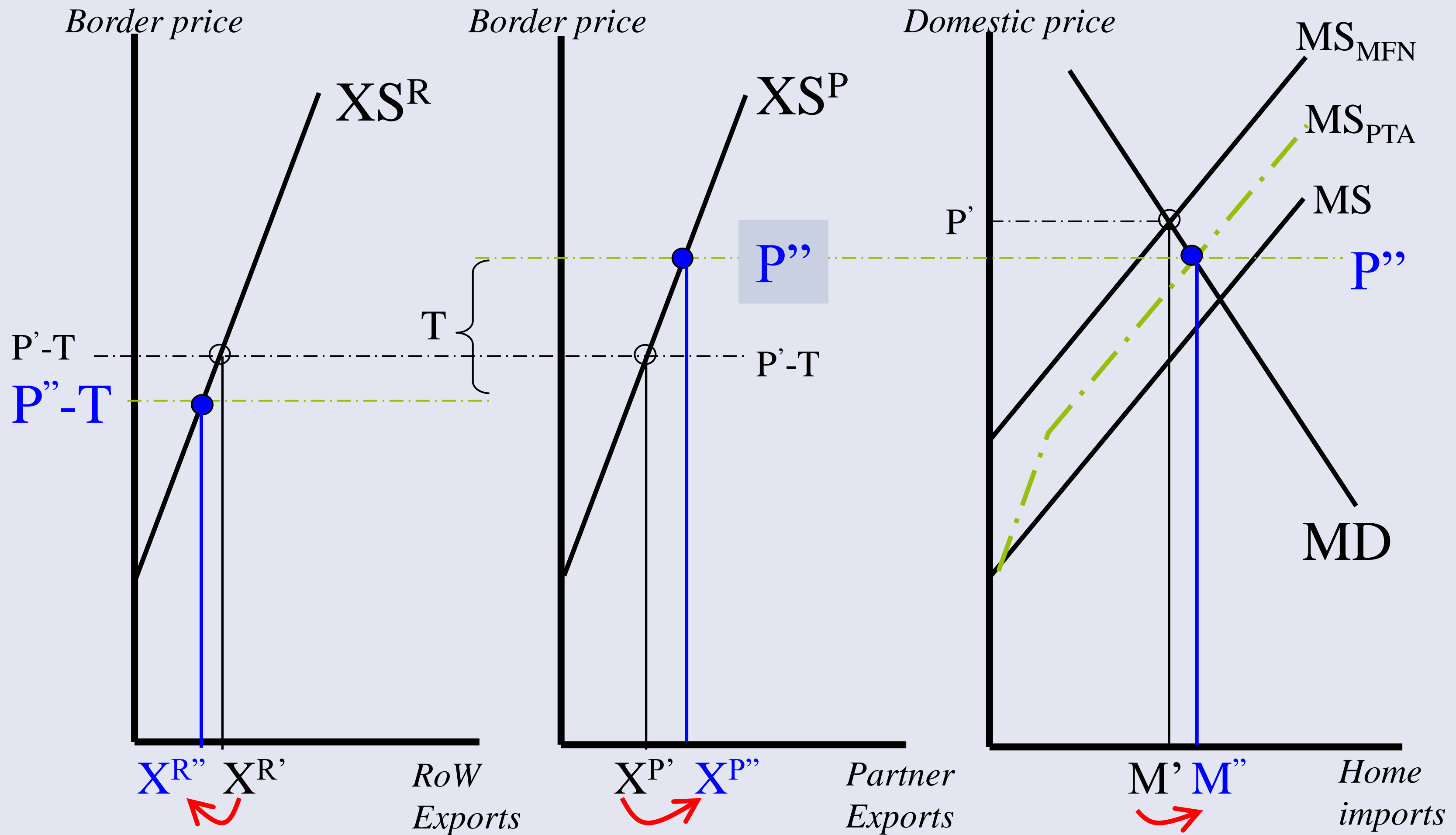
- **The PTA case: quantities**
  - At the lower prices consumer’s in A consume more.
    Let’s assume consumption increases from 20,000 to 21,000 (+1,000) there.
  - Since the price has fallen in A, producers produce less there.
    Let’s say 17,500 instead of 18,000 (-500)
  - Since prices have increased in partner country B, consumers consume less cars there. Let’s say 18,000 instead of 19,000 (-1,000).
  - Since prices have increased in B, producers in B produce more.
    Let’s say 21,000 instead of 20,000 (+1,000).
  - Thus, B exports 3,000 instead of 1,000 cars (+2,000) to A now.

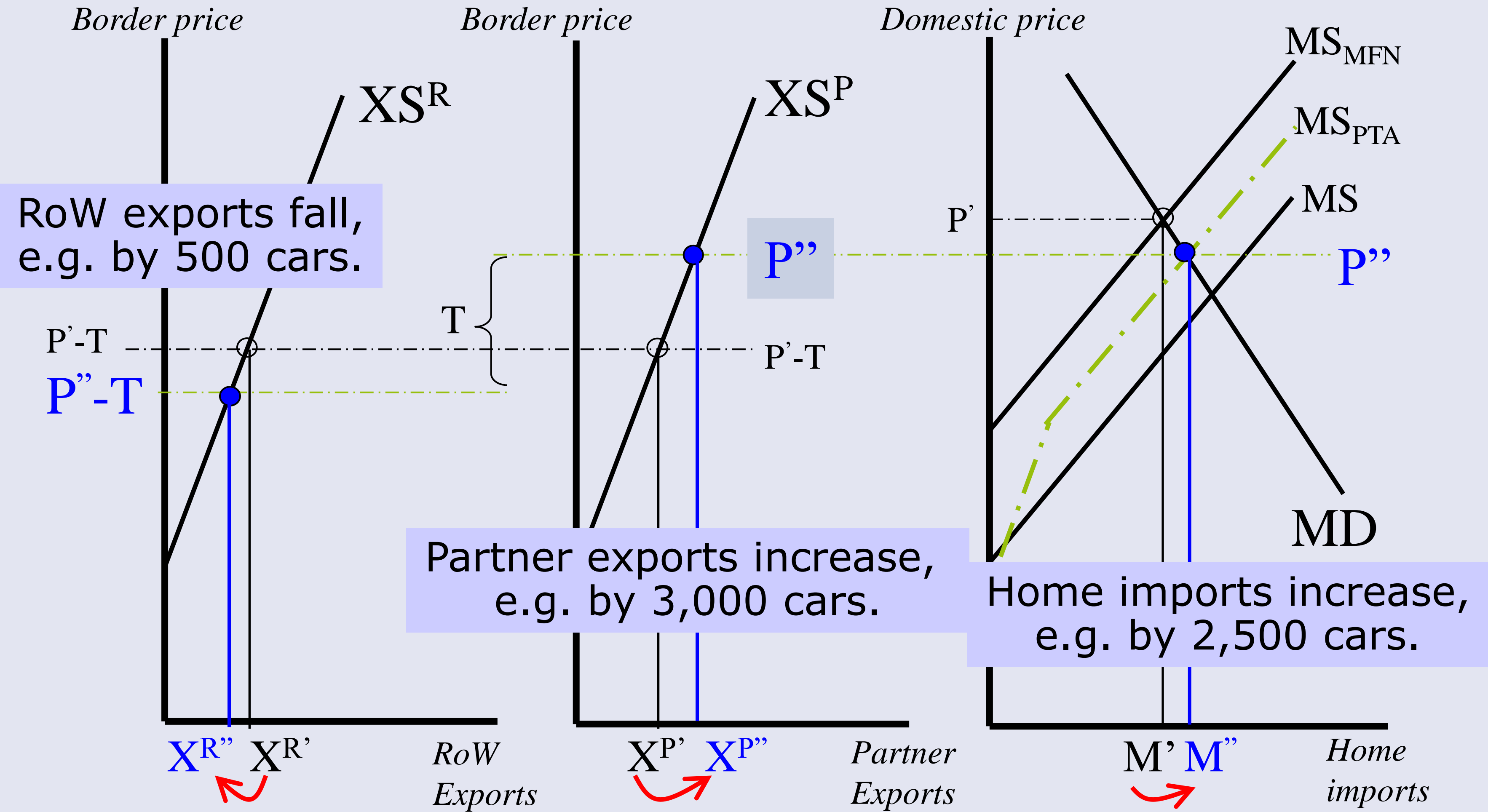
An example: PTA and Quantity Changes

- **The PTA case: quantities**
  - Since the border price for C's exporters has fallen, they export less cars to A. Let's say 500 instead of 1,000 (-500).
  - Thus, A imports 3,500 instead of 2,000 cars now.
  - 2,500 from B and 500 from C.
  - The import increase by 1,500 cars is sometimes called **"trade creation"**.
  - The replacement of exports from C by imports from B (500) is sometimes called **"trade diversion"** or better **"supply-switching"**.
  - Note that this implies switching from suppliers with lower marginal costs in C to a supplier with higher marginal costs in B.

Quantity Changes: Supply Switching



Quantity Changes: Supply Switching



An example

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- **The PTA case: welfare (country A)**
  - Consumers benefit from lower prices (times the quantity of consumption before the PTA) plus from higher marginal utility from further consumption.
  - Producers lose from lower prices (times the new production level) and in addition from lower production
  - However, the consumer gains are larger than the producer losses.
  - But: The government loses tariff revenues.
  - Note: By importing more from B, A has switched from the marginal supplier in C (20,000 Euros before the PTA) to a higher-cost supplier in B (21,000 Euros) (supply-switch or trade diversion).

Today's Reading

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- **Market Size and Scale Effects**
  - Baldwin & Wyplosz (2015) "The Economics of European Integration", McGraw-Hill, Ch 6.
- **Competition and State Aid Policies**
  - Baldwin & Wyplosz (2015) "The Economics of European Integration", McGraw-Hill, Ch 11.
- **Trade Policies**
  - Baldwin & Wyplosz (2015) "The Economics of European Integration", McGraw-Hill, Ch 12.

Market Size Matters

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- European leaders always viewed integration as compensating small size of European nations.
  - Implicit assumption: market size good for economic performance.
- Facts: integration associated with mergers, acquisitions, etc.
  - In Europe and more generally, ‘globalisation.’

Sketch of economic logic

Liberalisation → de-fragmentation → pro-competitive effect → industrial restructuring (M&A, etc.)

- RESULT: fewer, bigger, more efficient firms facing more effective competition from each other.

Monopolies and duopolies

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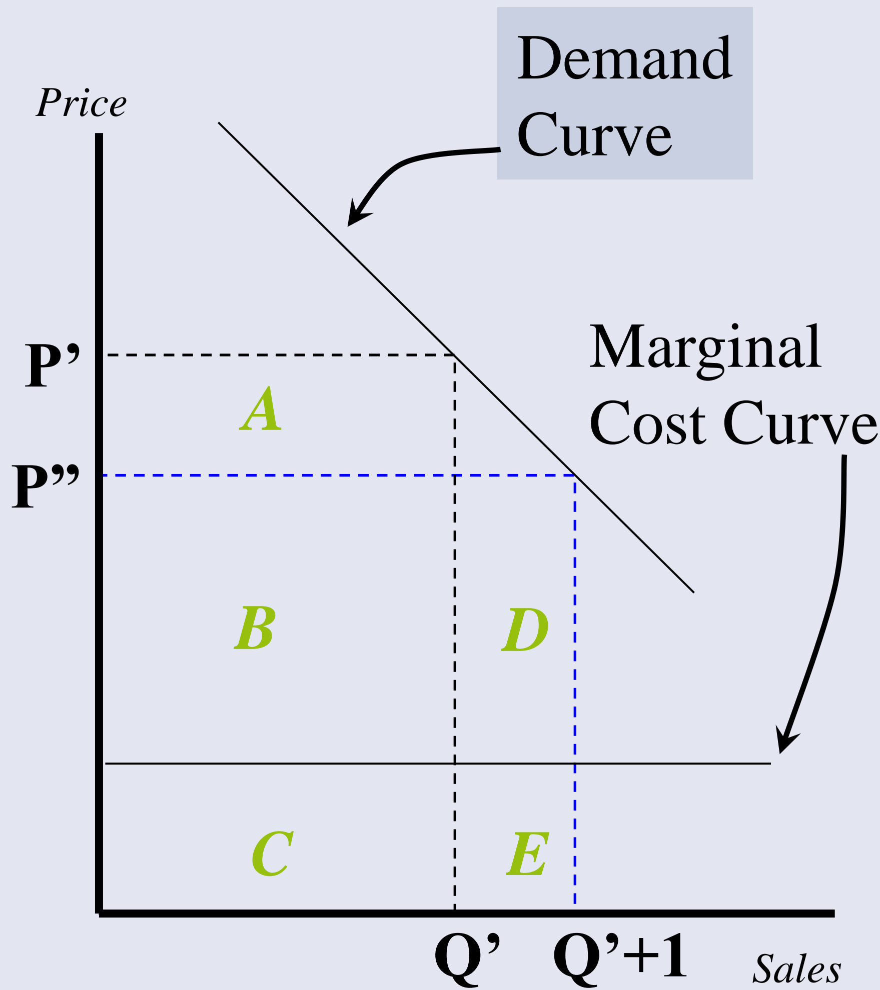
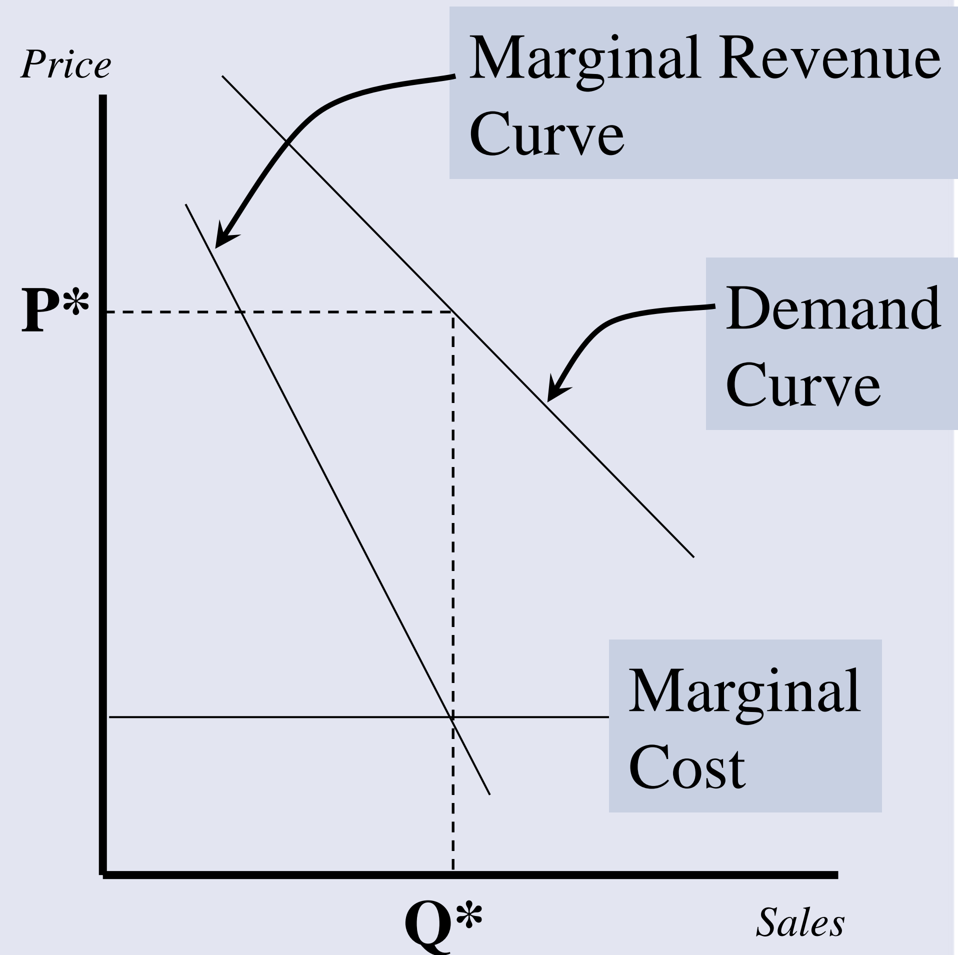
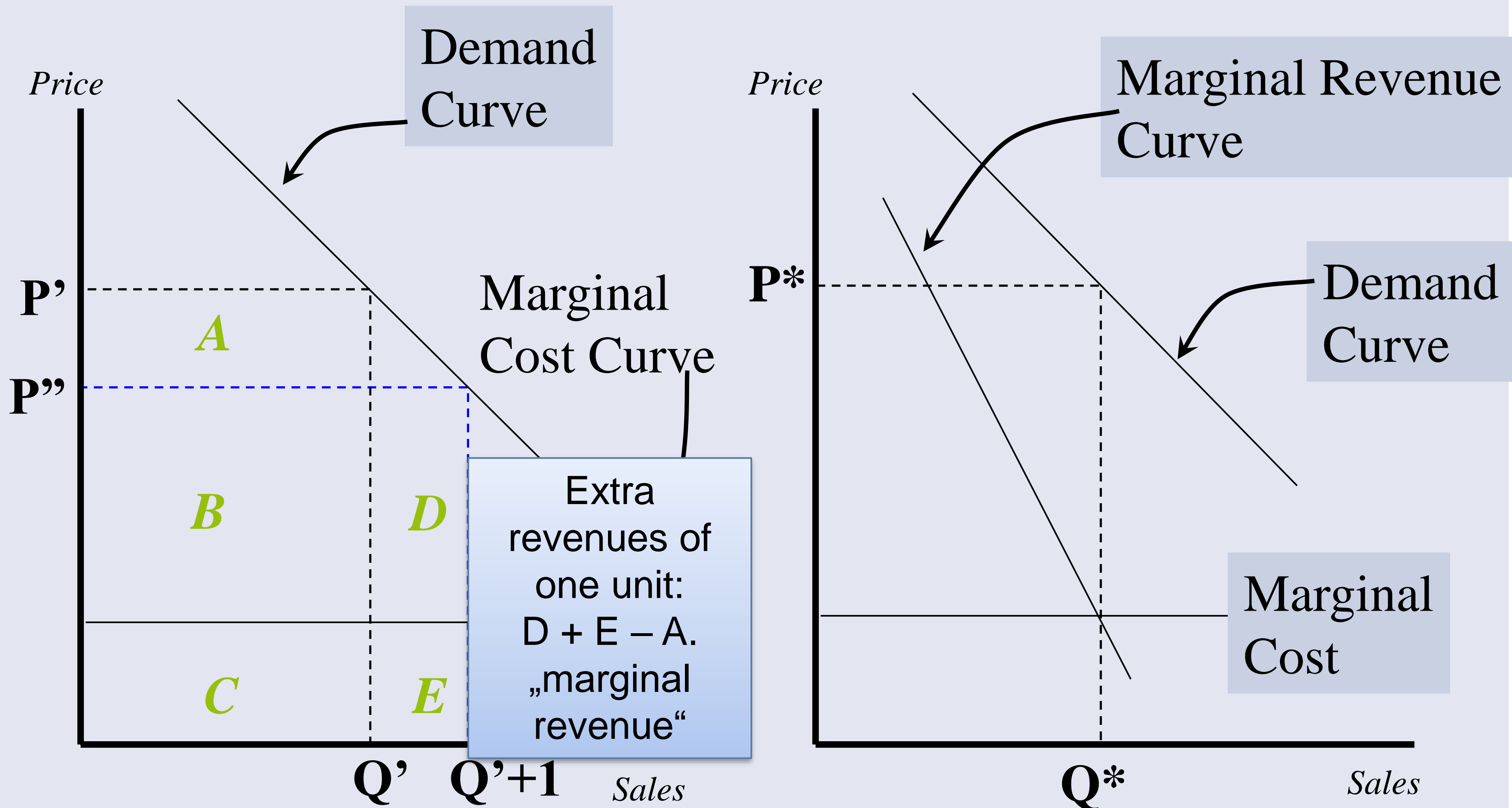
- Firms are not price takers
- Elasticity of demand curve constrains price levels
- Profit maximum is achieved if prices are chosen in a way that marginal revenues equal marginal costs
- Duopoly: Price and production depends on expectations on behaviour of competitors
- **Cournot-Nash**-equilibrium: Optimum is achieved when symmetric firms produce same level of output

Economic logic (background): Monopoly case

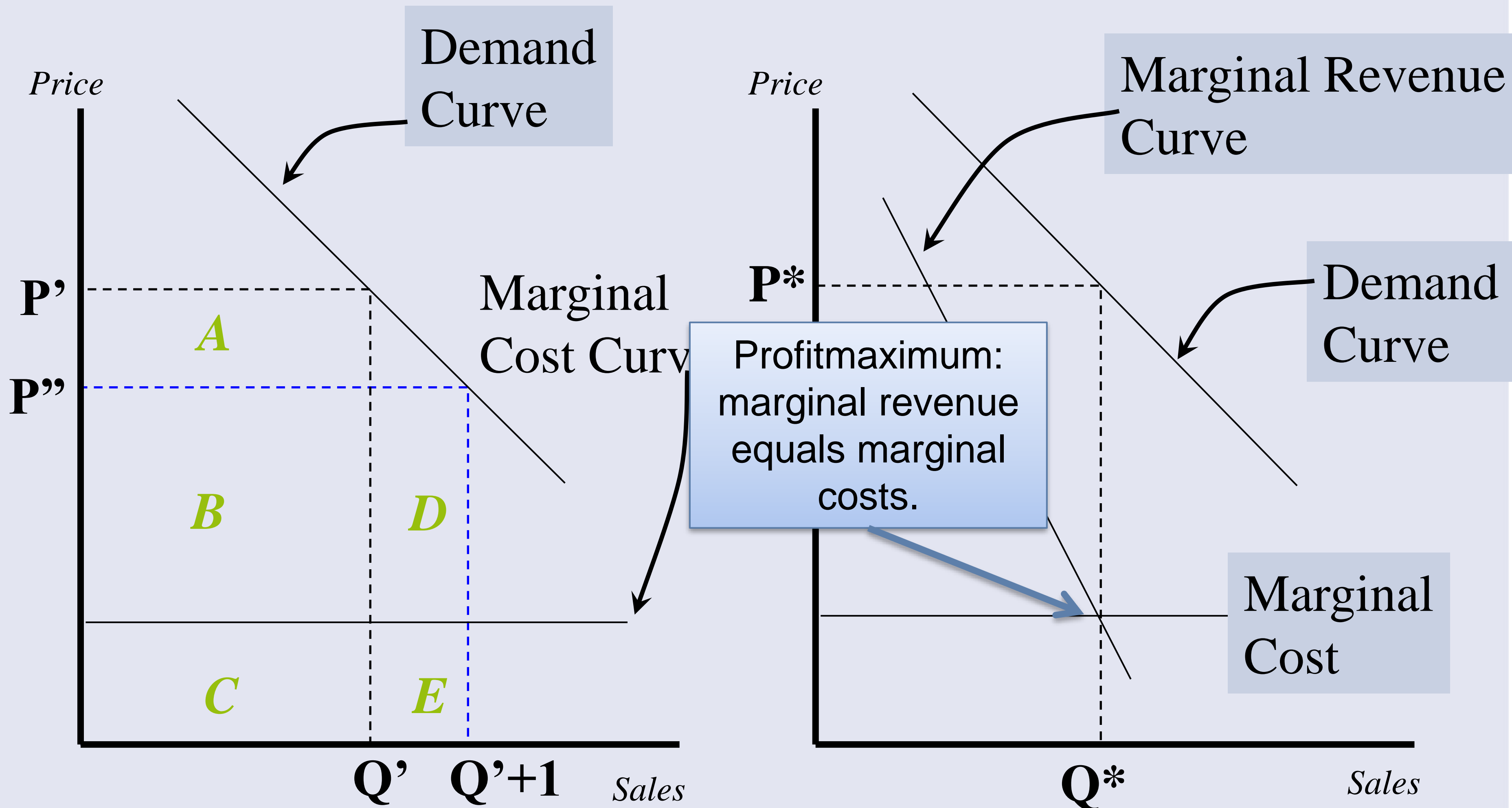




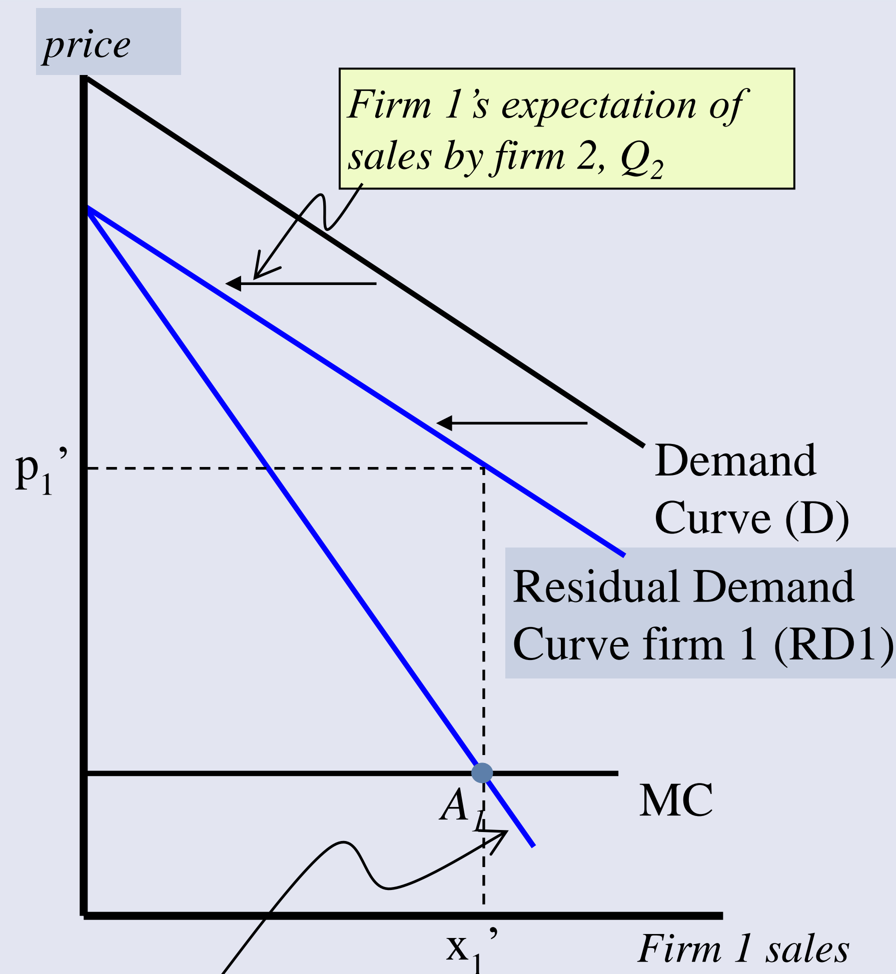
Economic logic (background): Monopoly case

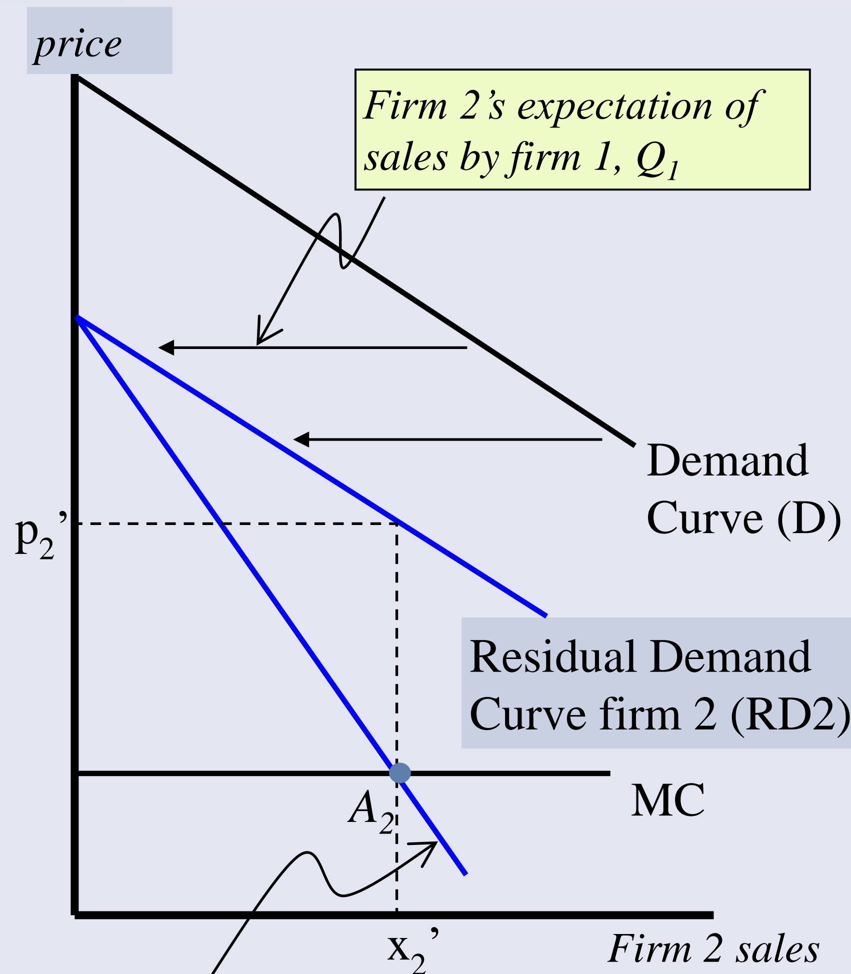


Economic logic (background): Monopoly case

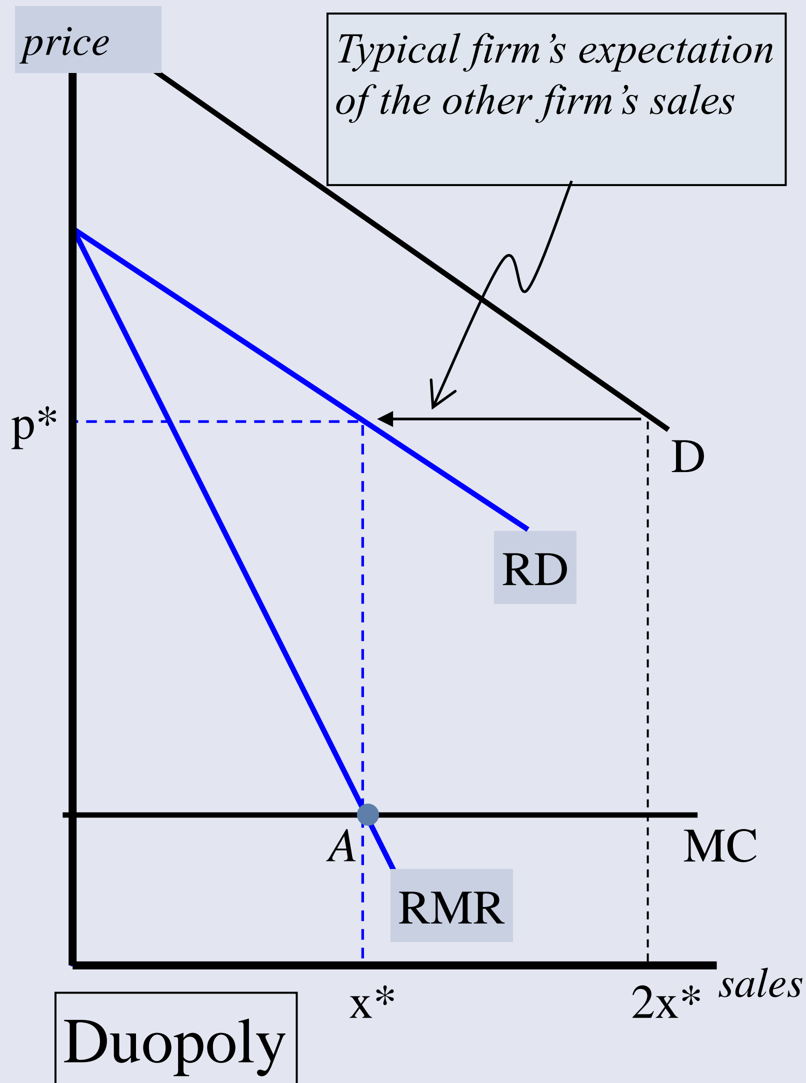


Duopoly case, example of non-equilibrium





Duopoly and oligopoly case, equilibrium outcome



price

Typical firm's expectation of other the other firms' sales

p**

D

RD'

A

MC

RMR'

x**

sales

3x**

Oligopoly

Bringing this to trade

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- Brander and Krugman (1983)
- Building on Nash, they combine increasing returns to scale, imperfect competition and trade
- Presentation of theory here in Breakeven-Competition (BE-COMP)-Diagram

Breakeven-Competition (BE-COMP) Diagram

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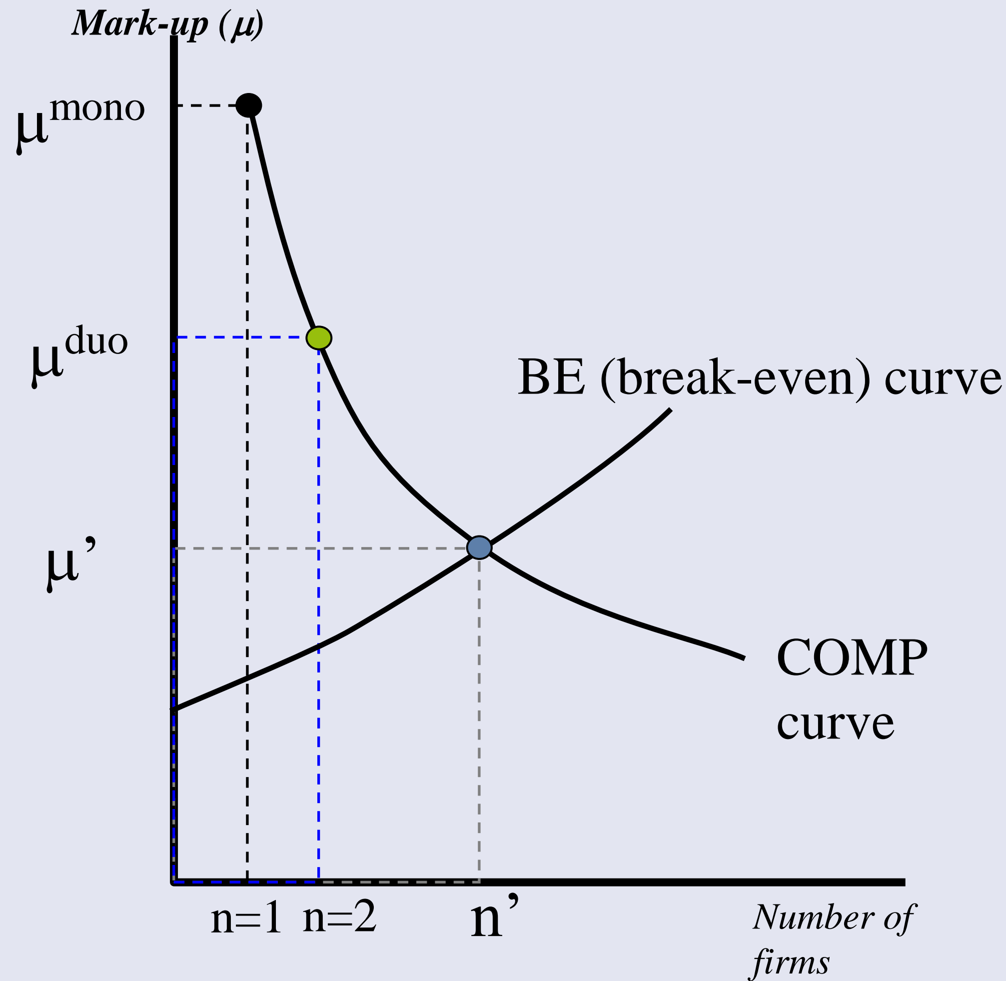
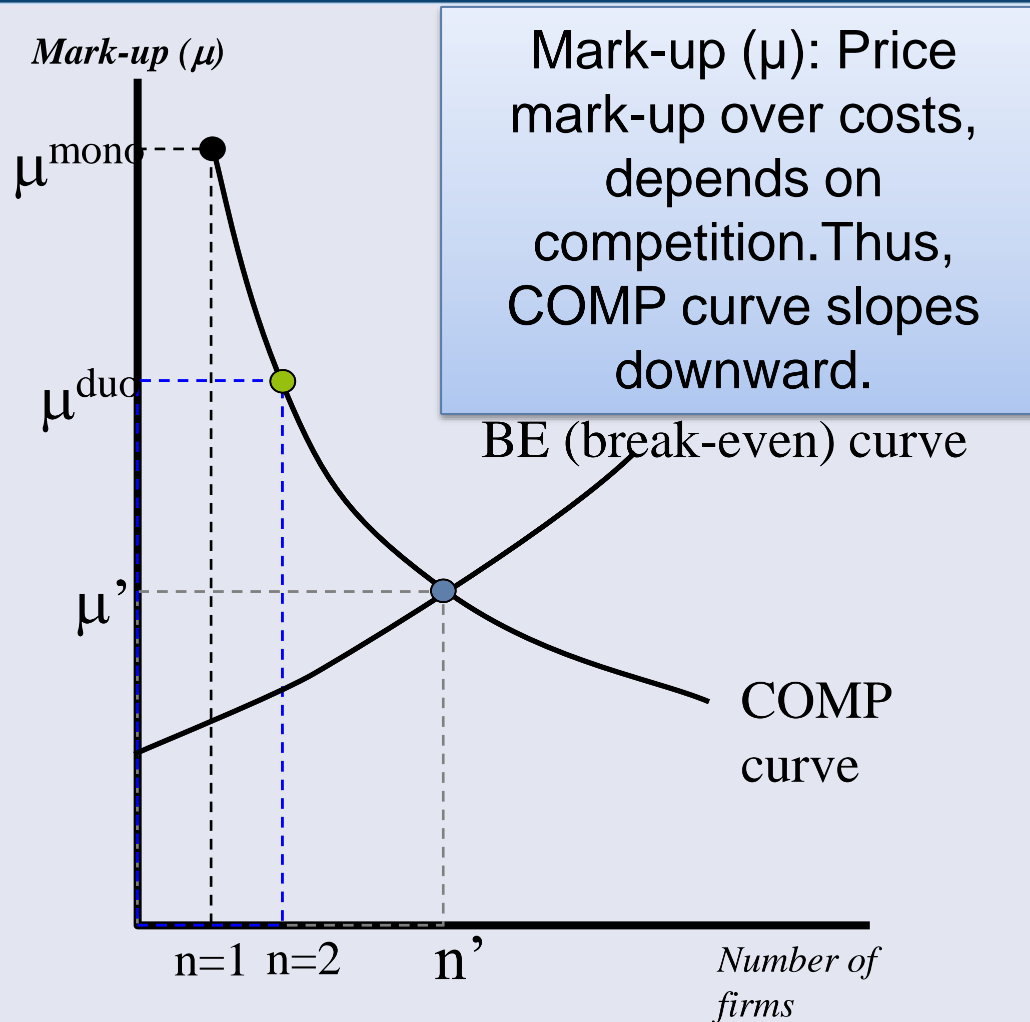


Breakeven-Competion (BE-COMP) Diagram



Mark-up (μ): Price mark-up over costs, depends on competition.Thus, COMP curve slopes downward.

Breakeven-Competion (BE-COMP) Diagram

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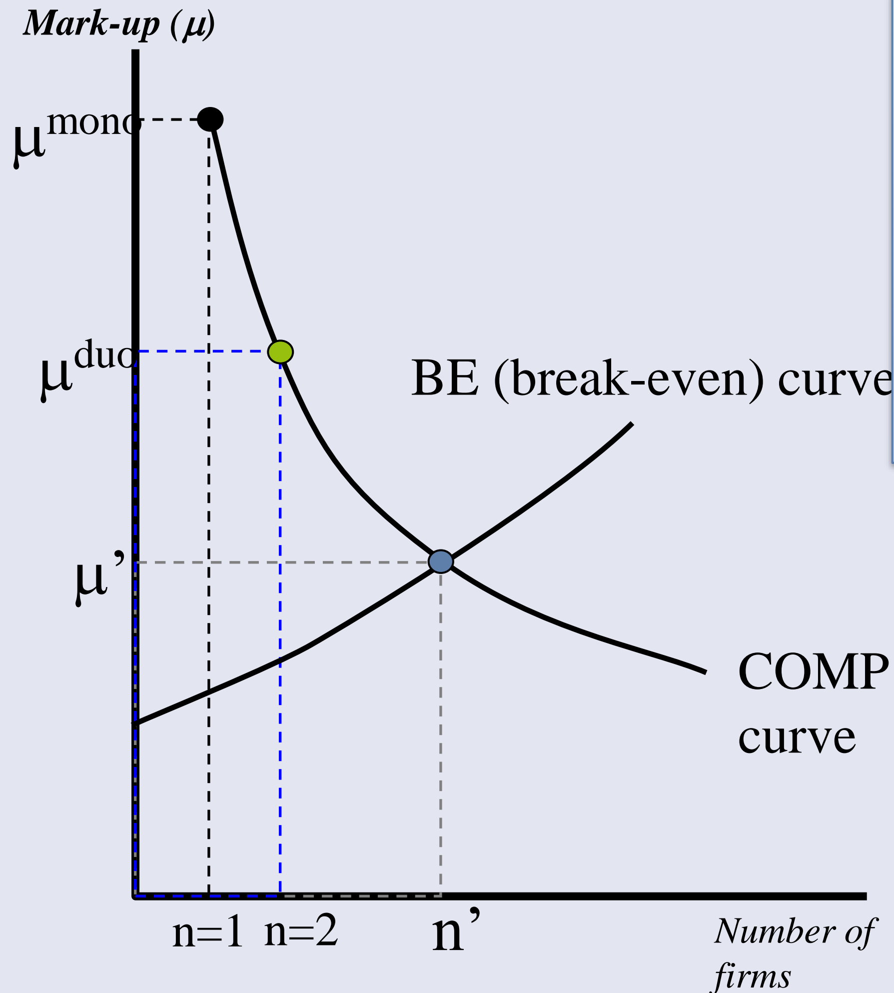

Breakeven (BE) curve:
With increasing returns to scale only a limited number of firms can survive. Survival depends on mark-up μ.
Slopes upward. Why?

Details of COMP curve

Details of BE curve: closed economy

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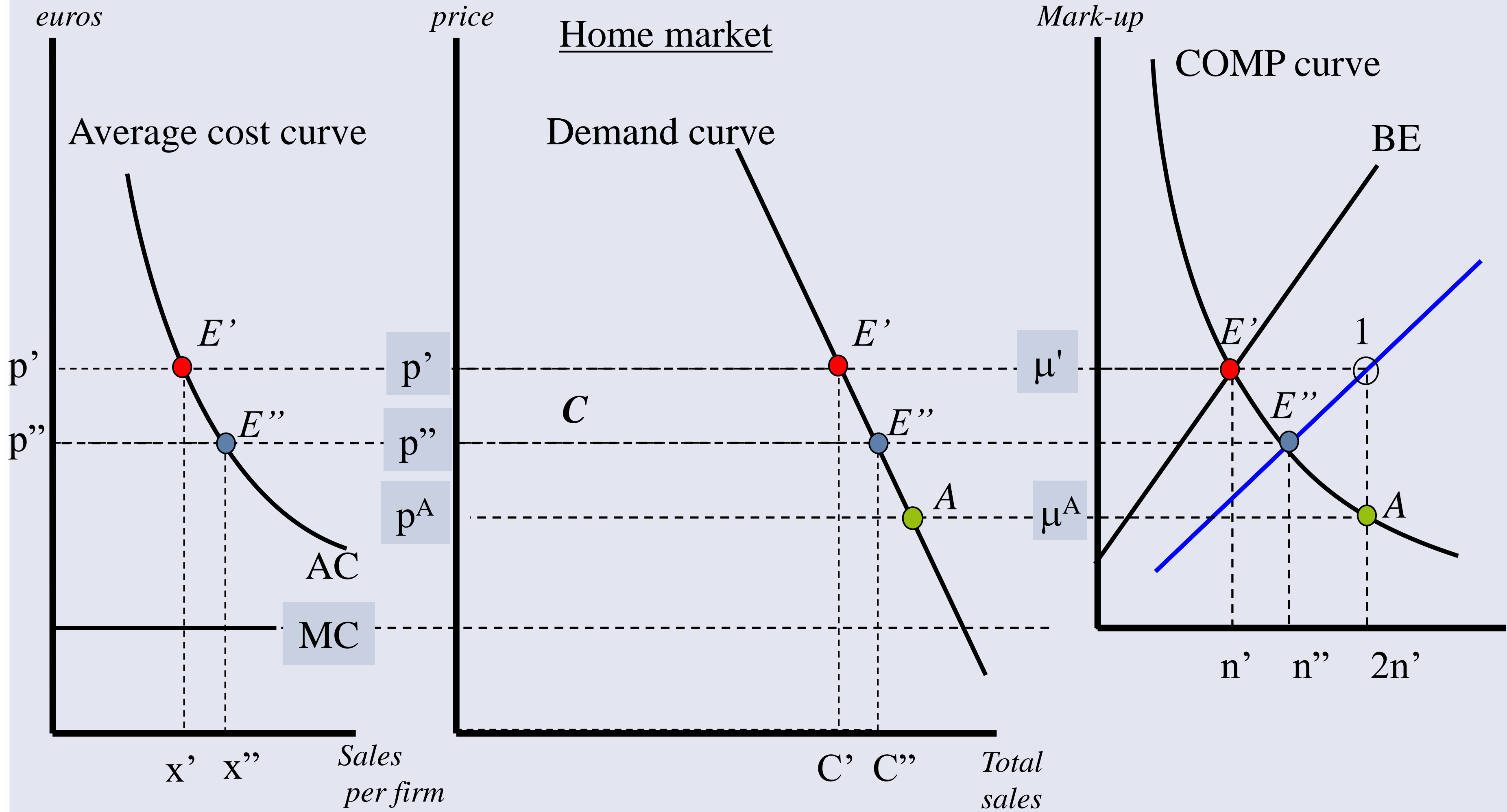
Outline of BE-COMP Diagram: Not-trade-to-free-trade



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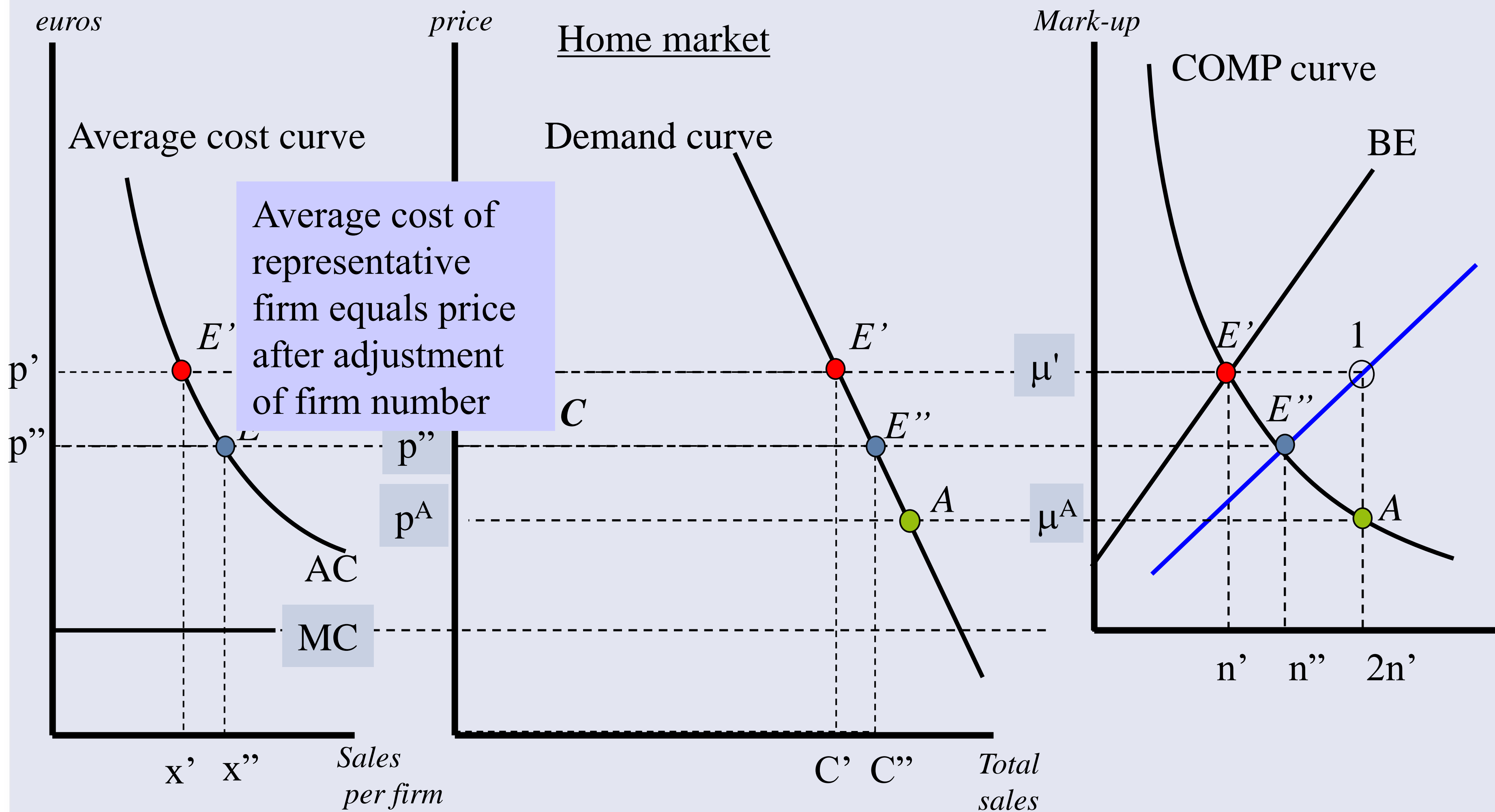

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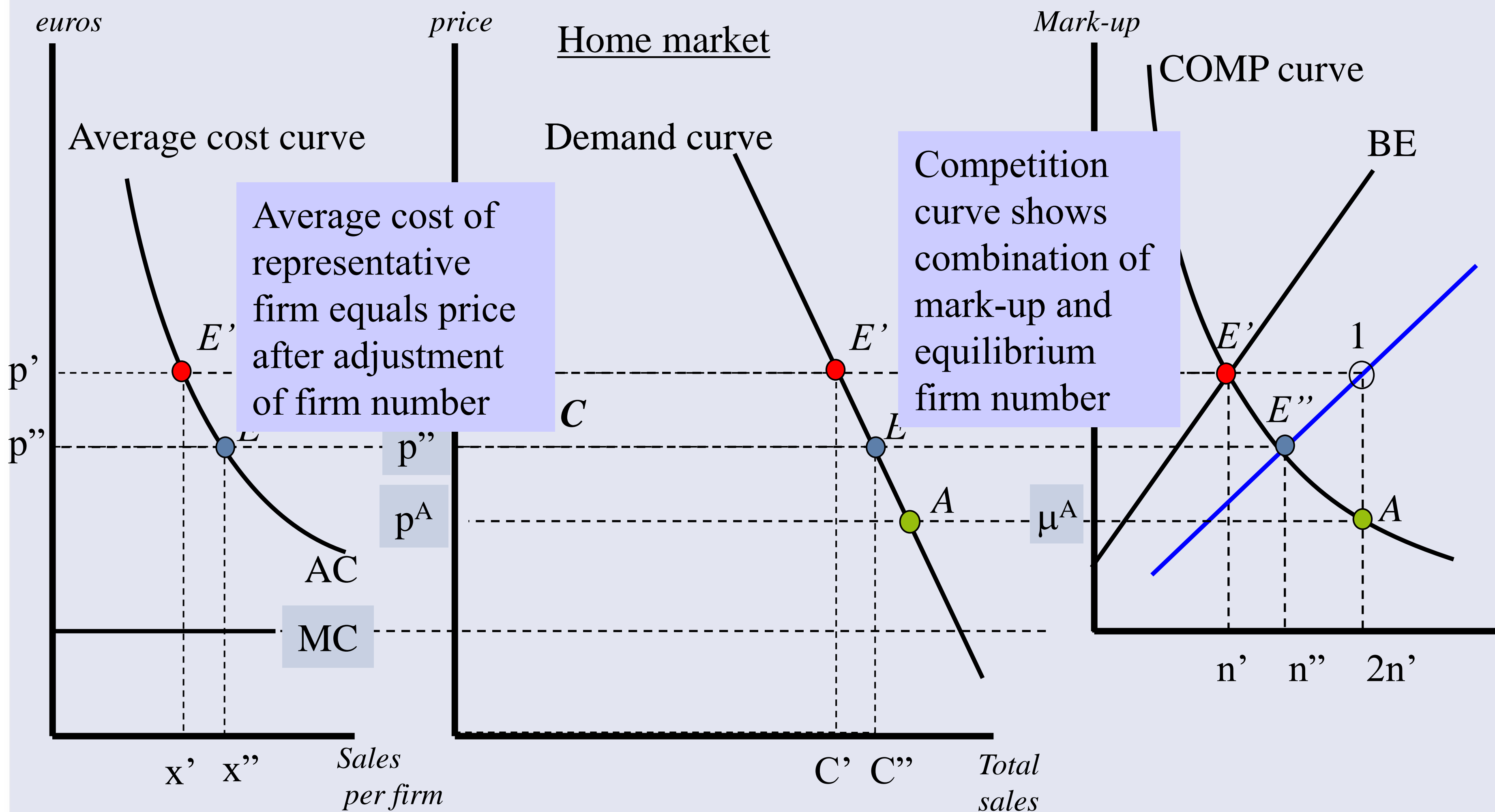

Outline of BE-COMP Diagram

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euros *price* Home market *Mark-up*

Average cost curve

Average cost of representative firm equals price after adjustment of firm number

Demand curve

Breakeven curve is upward shifting, since sales per firm fall with increasing firm number such that higher mark-up is needed to breakeven

COMP curve

BE

E' E'' E' E' E'' 1 A C

p' p'' p'' p^A

AC MC

x' x'' *Sales per firm*

C' C'' *Total sales*

n' n'' 2n'

Addressing European integration

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- Assume that no-trade-to-free-trade liberalization provides (i) each firm with a market of twice its size and (ii) double the number of firms in each market
- What happens to mark-up, equilibrium number of firms, average costs, price and demand?

No-trade-to-free-trade integration

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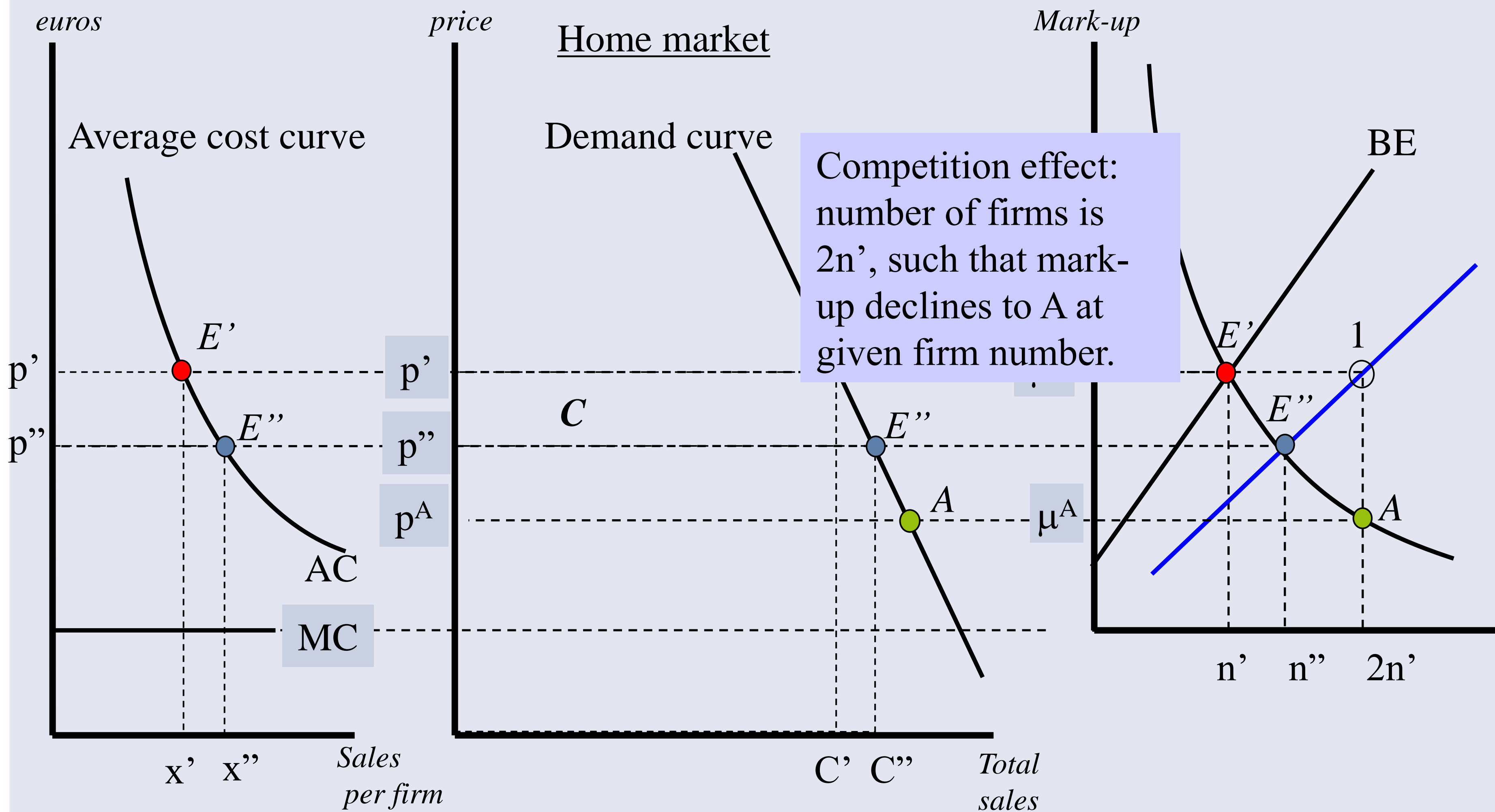
No-trade-to-free-trade integration



No-trade-to-free-trade integration

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euros

Average cost curve

E'

E''

p'

p''

AC

MC

x' x''

Sales per firm

price

Home market

Demand curve

p'

p''

p^A

C

E''

A

C' C''

Total sales

Mark-up

Market size effect: BE curve shifts outward to the right. At given number of firms (point 1) we have no equilibrium).

BE

E'

1

E''

A

μ^A

n' n'' 2n'

No-trade-to-free-trade integration

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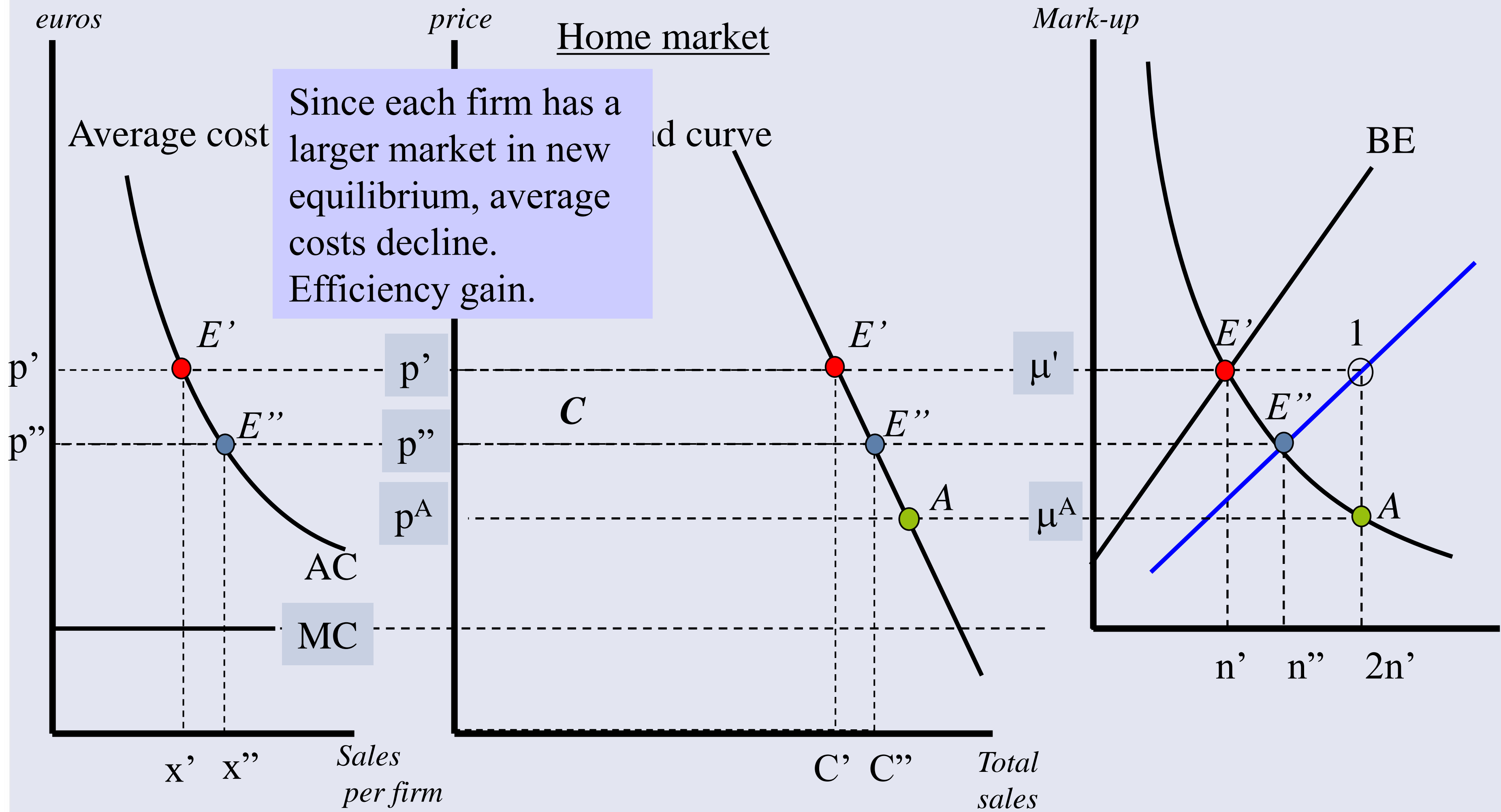
Smaller mark-up and higher competition reduces prices to p^A. Below breakeven point for given number of firms. Industrial restructuring results in E'' equilibrium number of firms.

No-trade-to-free-trade integration



No-trade-to-free-trade integration

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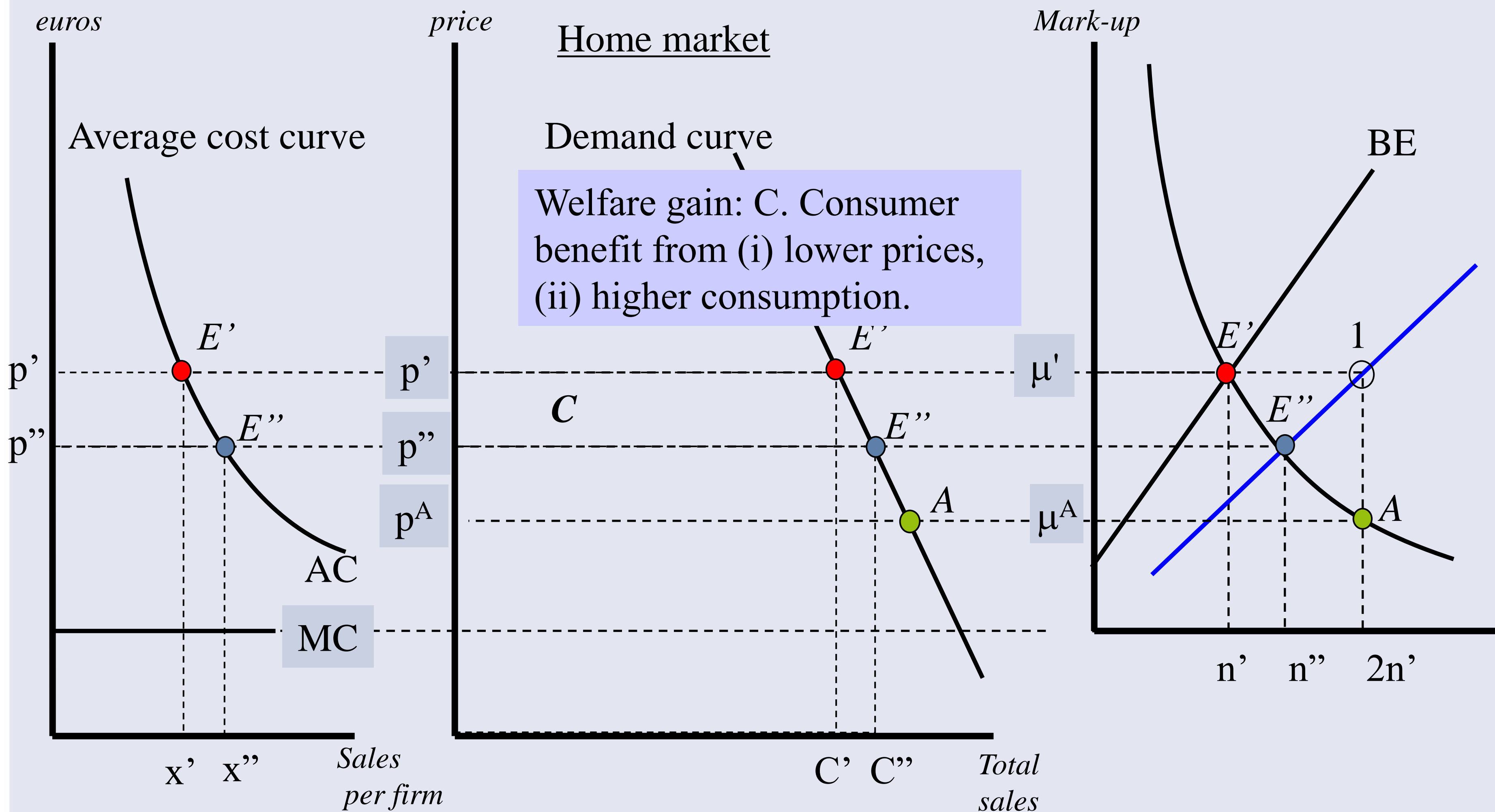

Economic logic

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- Integration: no-trade-to-free-trade: BE curve shifts out (to point 1). (Larger market effect)

- Defragmentation:
  - PRE: typical firm has 100% sales at home, 0% abroad; POST: 50-50 ,
  - Can’t see in diagram.

- Pro-competitive effect:
  - Equilibrium moves from E’ to A: Firms losing money (below BE).
  - Pro-competitive effect = mark-up falls.
  - short-run price impact p’ to p^A.

Economic logic (cont.)

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- Industrial Restructuring:
  - A to E”,
  - number of firms, 2n’ to n”.
  - firms enlarge market shares and output,
  - more efficient firms, AC falls from p’ to p”,
  - mark-up rises,
  - profitability is restored.
- Result:
  - bigger, fewer, more efficient firms facing more effective competition.
- Welfare: gain is “C”.

Facts

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- M&A activity is high in EU.
- much M&A is mergers within one member state
  - about 55% ‘domestic’;
  - remaining 45% split between:
    - one is non-EU firm (24%),
    - one firm was located in another EU nation (15%),
    - counterparty’s nationality was not identified (6%).
- Empirical evidence: Single Market Program reduced Price-Cost Margins by 4 per cent on average.
  - High variance:
  - -15 per cent in office equipment sector
  - -0.1 per cent in brewing
  - In auto sector, the price-cost margin actually rose!

Facts

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Distribution of M&A quite varied:

- Big 4: share M&As much lower than share of the EU GDP.
- I, F, D 36% of the M&As, 59% GDP.
  - Except UK.
- Small members have disproportionate high share of M&A.
- This picture fits pretty well into theoretical expectations: Small countries suffer more from fragmentation of markets such that pressure for industrial restructuring is higher compared to countries with a larger market share

Facts

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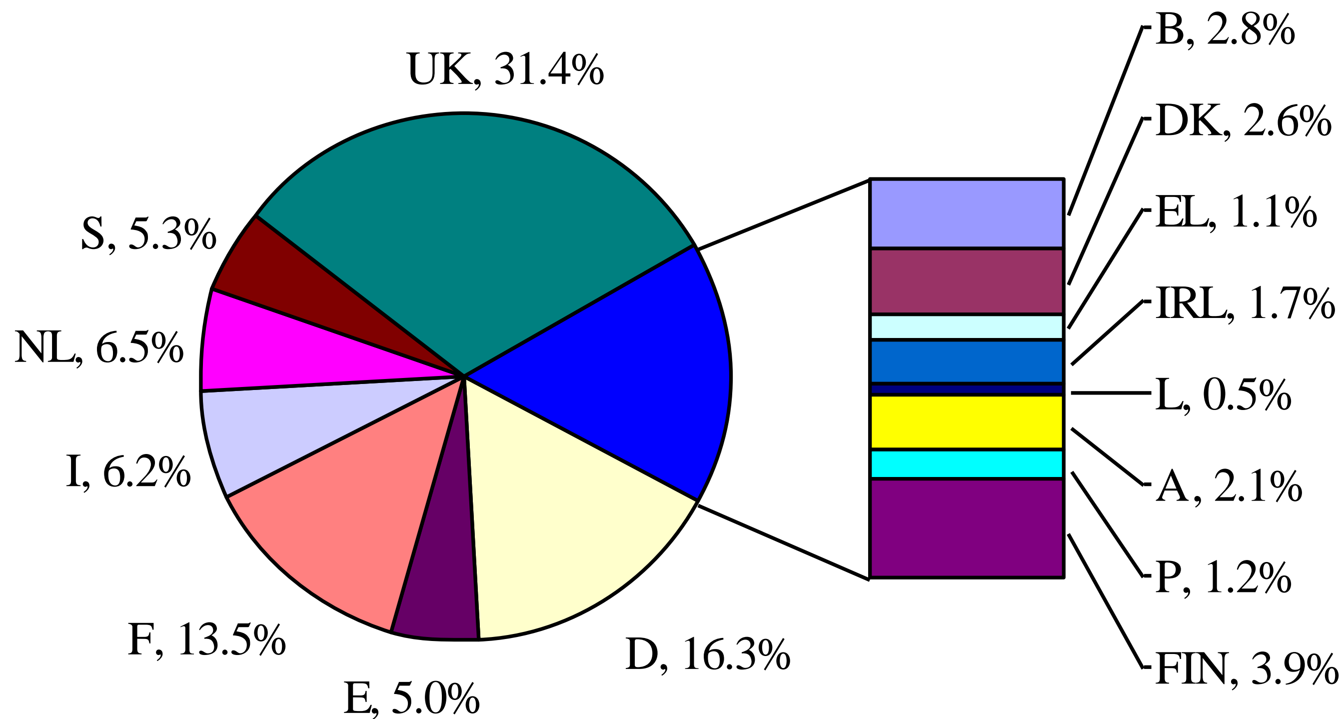

Facts

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- Why M&A mostly within EU?
- Why UK's share so large?
- Non-harmonized takeovers rules.
  - some members have very restrictive take-over practices, makes M&As very difficult.
  - others, UK, very liberal rules.
- Lack of harmonization means restructuring effects vary impact by member states.

- **Competition and State Aid Policies**
  - Baldwin & Wyplosz (2015) “The Economics of European Integration”, McGraw-Hill, Ch 11.

EU's role in competition policy

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- Founders of the EU understood that pressures to collude and subsidize would arise in the course of economic integration. And anticipation of such unfair practices could reduce political support for economic integration in all nations.

- Thus, the Treaty of Rome includes broad prohibitions on private and public policies that distort competition.

- The European Commission has sole power to regulate the EU's competition policy (i.e., its decisions are not subject to approval by the Council or the Parliament but they can be overturned by the EU Court).

The economics of anti-competitive behaviour

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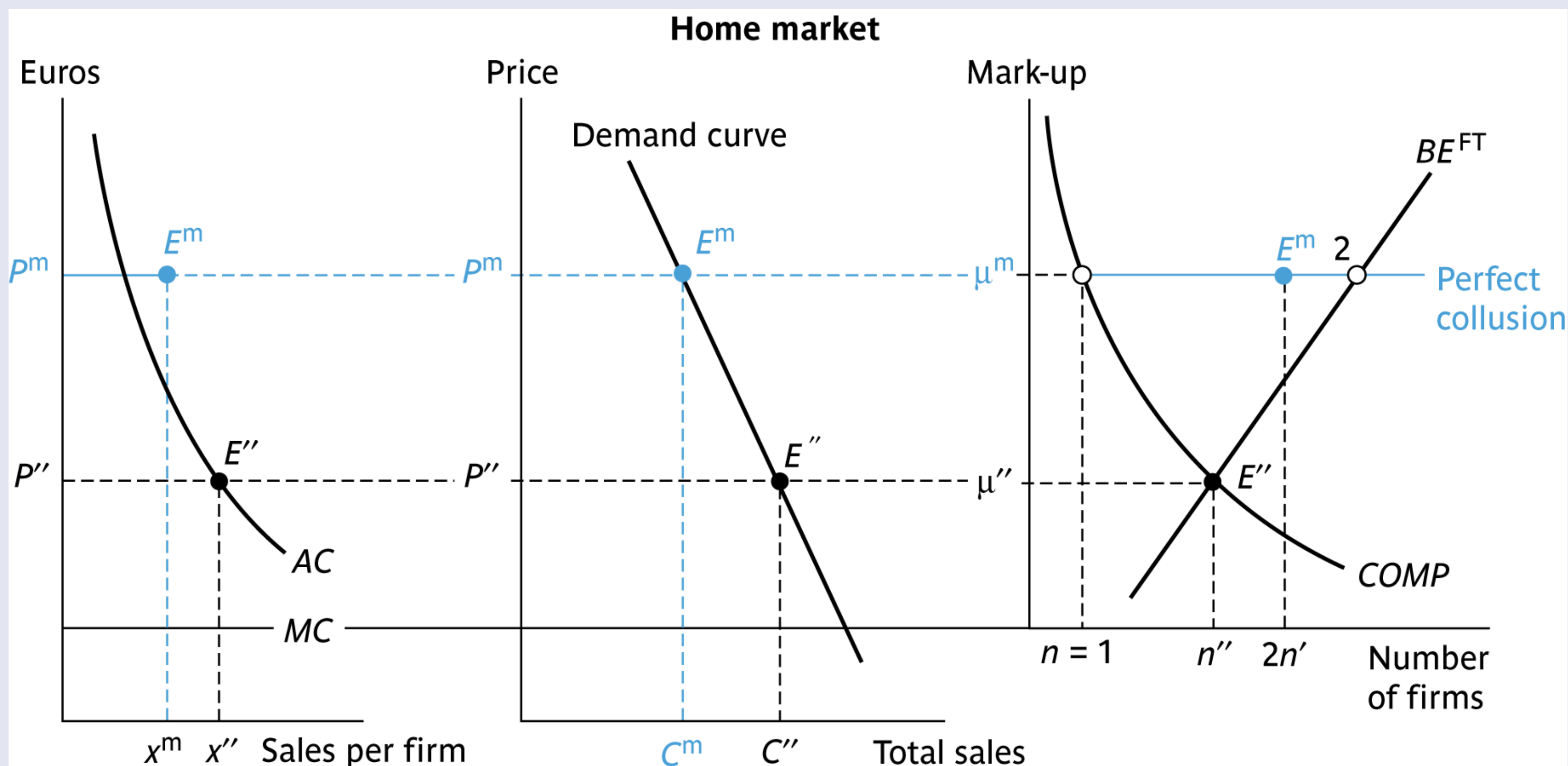
- Collusion among firms result in high prices leading to lower demand and production: it is illegal under EU law and economically harmful for Europe as a whole.

- Perfect collusion in the BE-COMP diagram:
  - firms co-ordinate prices and sales perfectly;
  - maximum profit at monopoly price and split sales among firms;
  - assume that firms all have equal market share.

The economics of anti-competitive behaviour

- → Collusion is good for firms' profits, but price is higher, and consumption and production are lower. Moreover, since firms are smaller average costs are higher, so the industry is less efficient.



Economic effects: Perfect collusion

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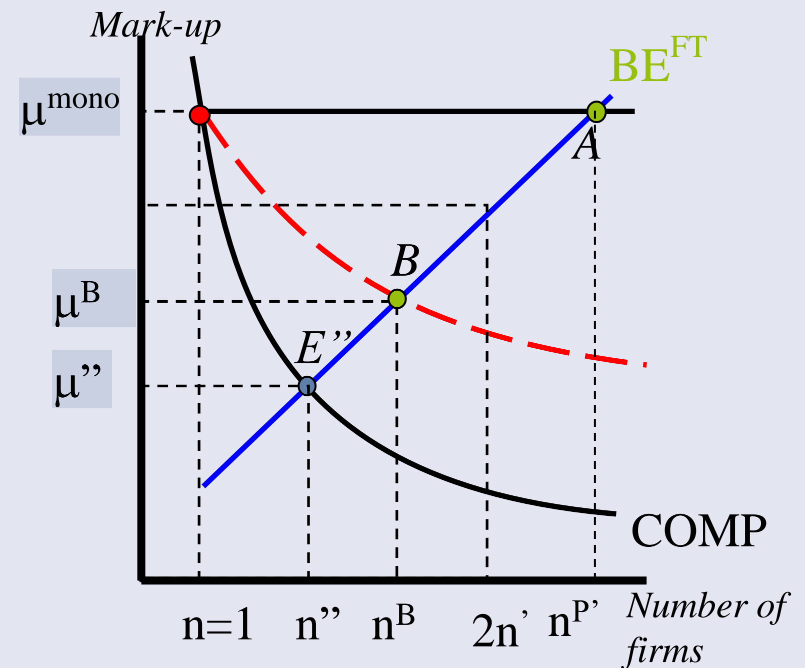
- Perfect collusion:
  - Firms set prices to monopoly level and divide profits equally.
  - Price increases.
  - Markup increases.
  - More firms enter market.
  - Eventually, zero profit condition restored, i.e. price equals average costs.



The economics of anti-competitive behaviour

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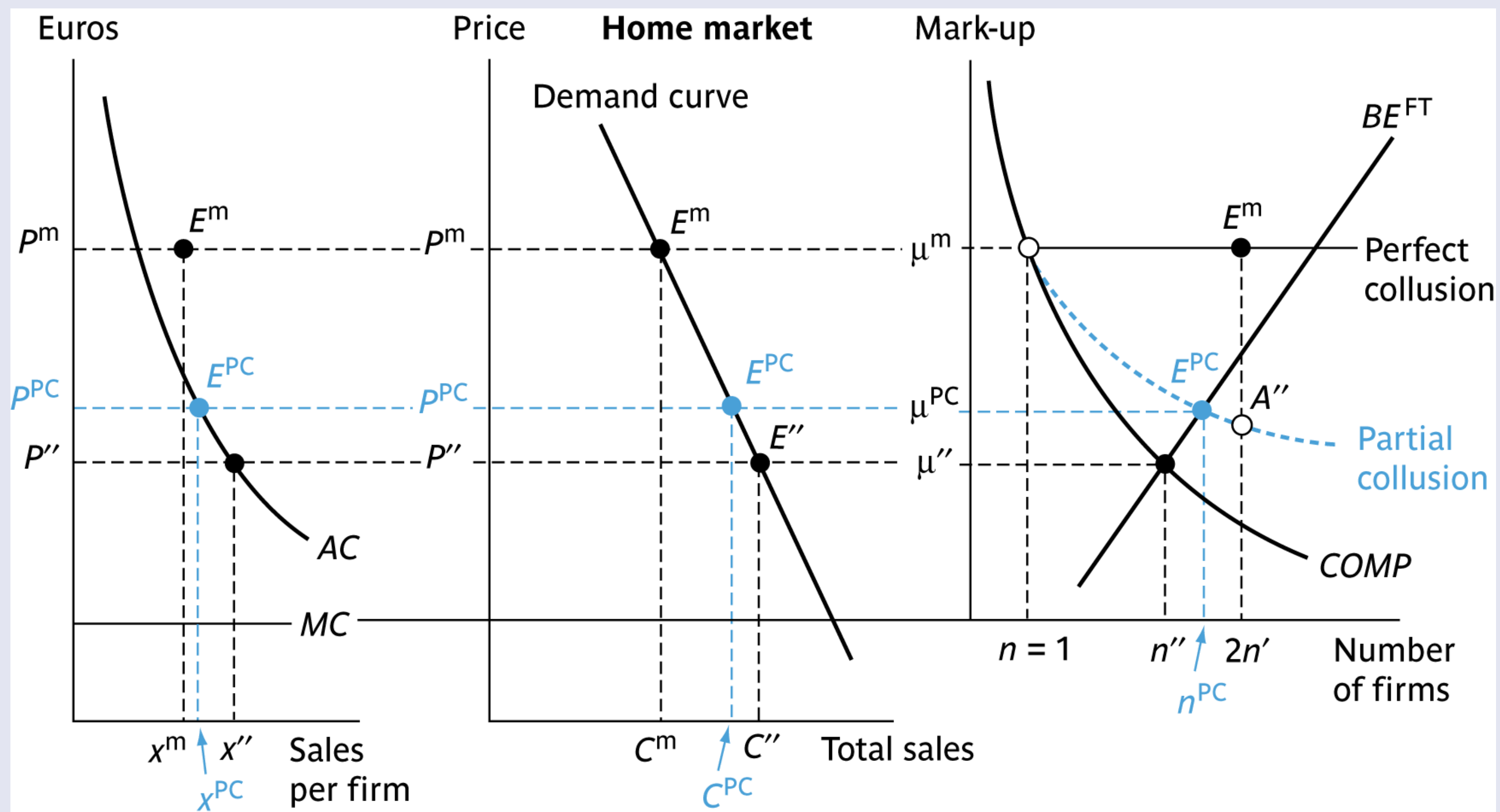
- Perfect collusion difficult to maintain because of ‘cheating’.
- Partial collusion: some restrictions on sales of all firms so the mark-up is lower than the monopoly mark-up but higher than the *COMP* mark-up.



Economic effects: Partial collusion

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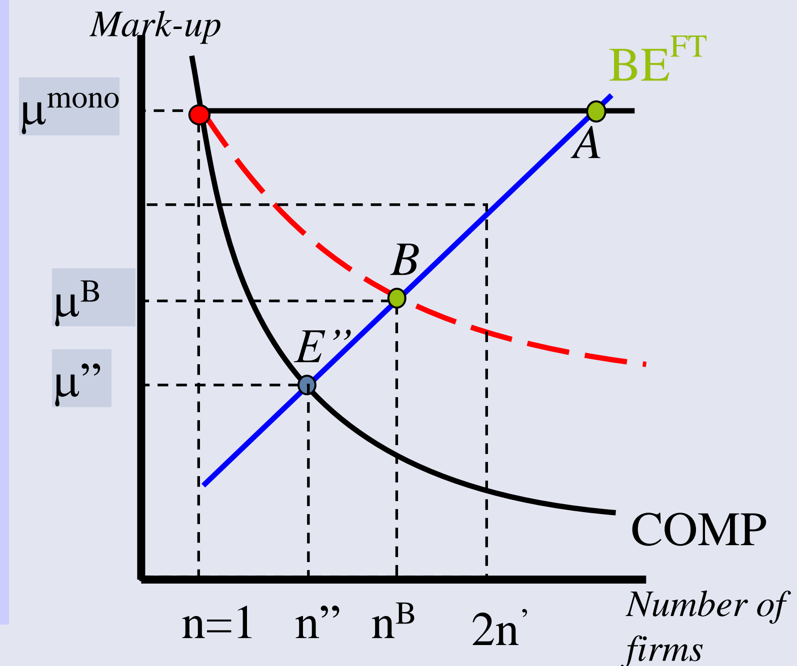
- Less opportunities to cheat
- $2n'$ is too high for all firms to break even.
- Industrial consolidation proceeds as usual, but only to n^B.
- Zero profits earned by all at point B.
- Prices higher, $p^B > p''$, smaller firms, higher average cost.



The economics of anti-competitive behaviour

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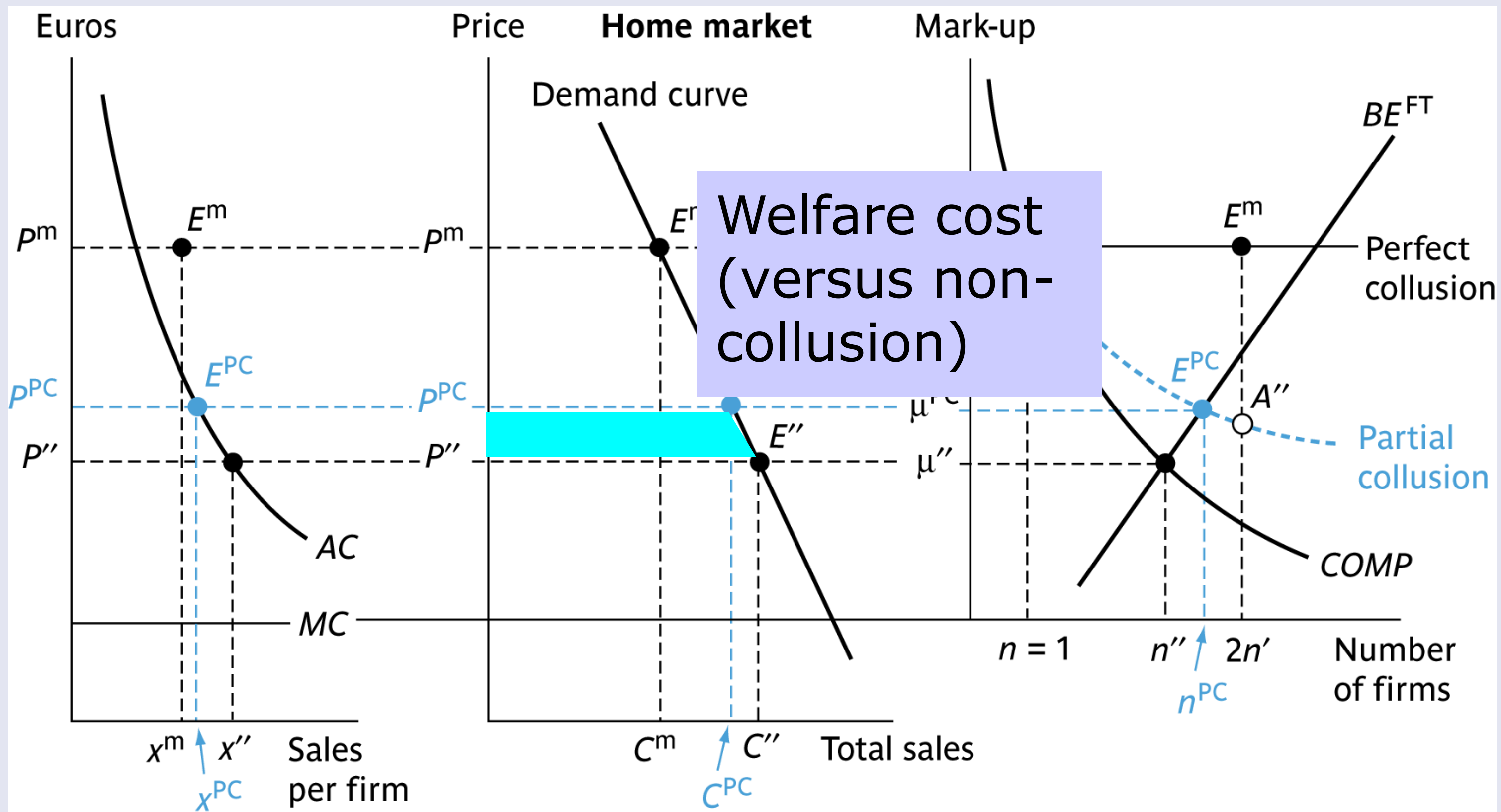

Economics of cartels

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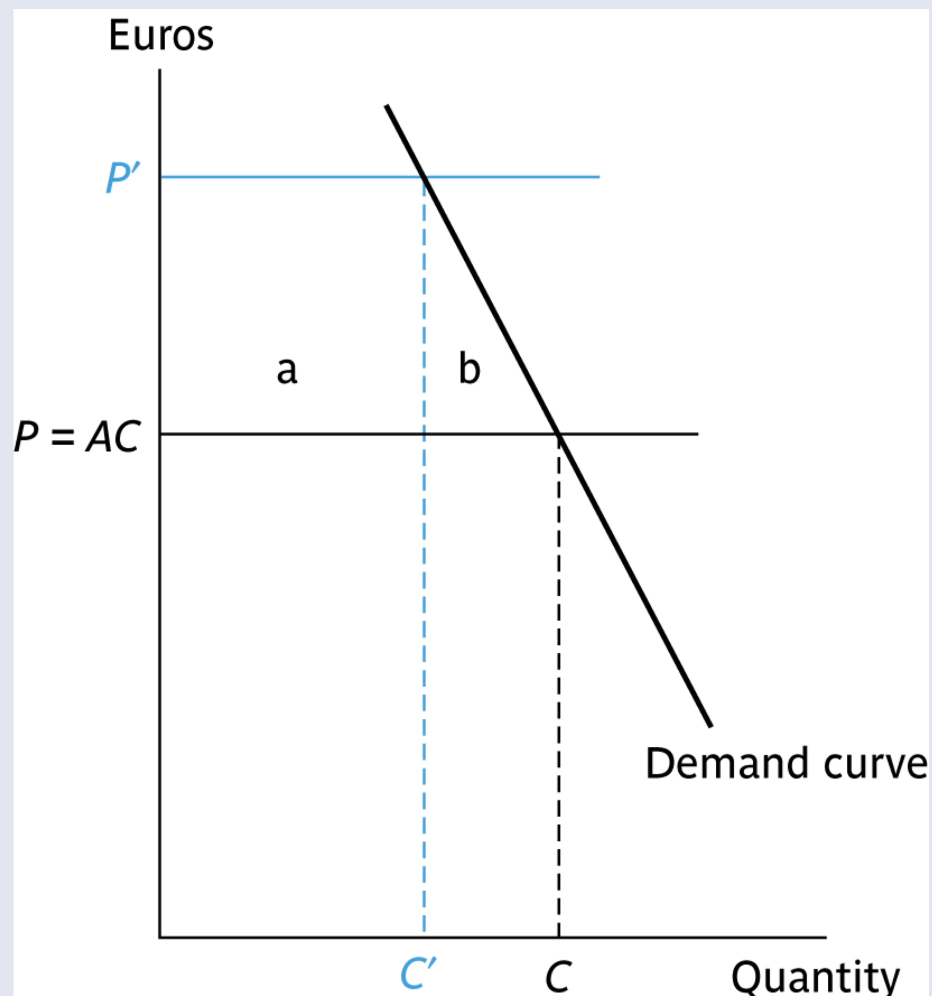
- Suppose price without cartel would be P=AC while the cartel raises price to P′:
- ΔConsumer Surplus = -a - b;
- Δprofit = a;
- net welfare effect = -b.

- Outcome:
- ‘rip-off’ effect;
- Inefficiency effect.



Examples of cartels

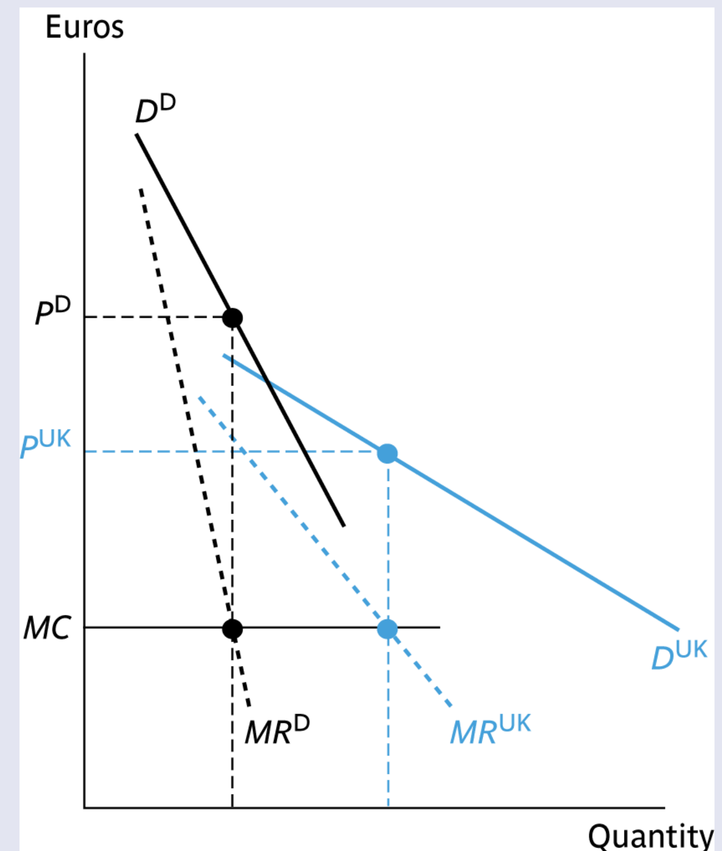
- In 2011, the Commission fined Procter & Gamble and Unilever for operating a cartel with Henkel in the market for household laundry powder detergents in 8 EU countries. Henkel was part of the cartel, but got immunity for revealing the cartel to the Commission;

- The Commission convicted 4 brewers (Heineken group, Grolsch, Bavaria, and InBev group) of running a cartel in the Netherlands. The cartel was discovered when a similar cartel in Belgium was uncovered (when InBev gave evidence to the Commission in order to reduce its fine);

- In 2010, the Commission concluded that 10 DRAM producers (only one European) were running a cartel between 1998 and 2002.

Economics of exclusive territories

- More common anti-competitive practice is ‘exclusive territories’ (e.g., one company would agree to sell only in its local market in exchange for a similar promise by its foreign competitors).
- **Segmenting the market:**
- German demand curve steeper, i.e. higher willingness to pay (lower price elasticity)
- UK has flatter demand curve (e.g. more opportunities to substitute, higher price elasticity)
- Profits are maximized where marginal revenue and marginal costs curve intersect
- This implies requesting higher price in DE relative to UK

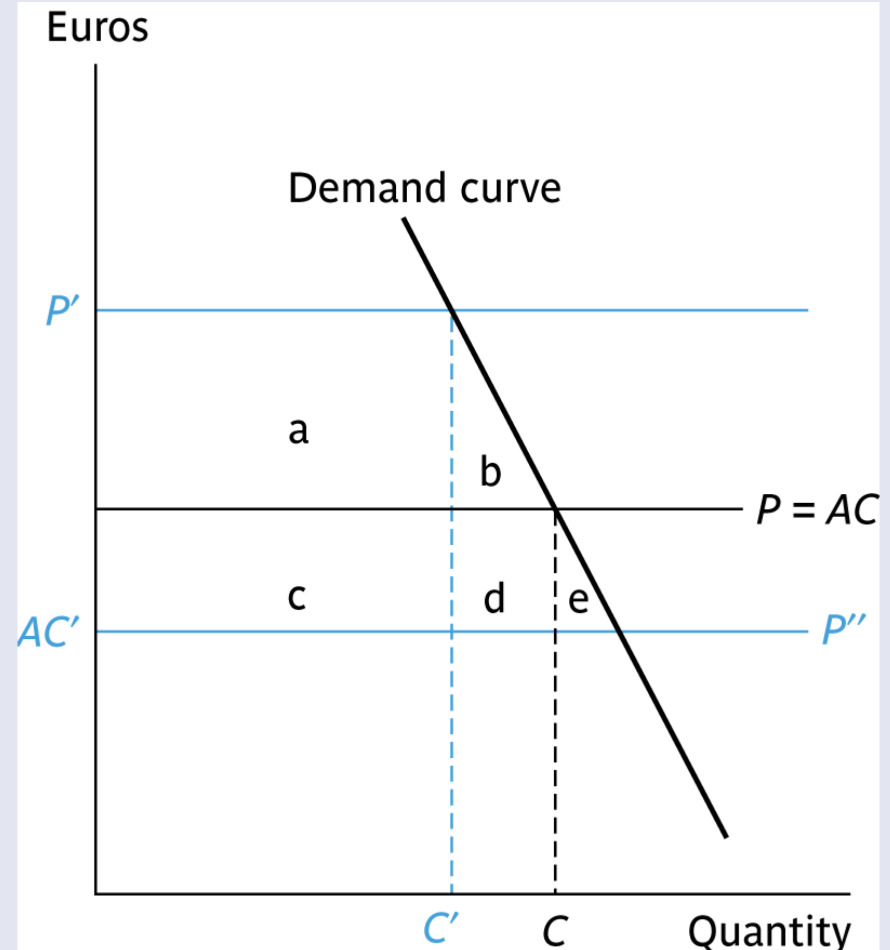


Abuse of dominant position

- Dominant position not a problem per se: it may reflect superior products and/or efficiency.
- However dominance may tempt firm to extract extra profits from suppliers or customers.
- The 'abuse of dominant position' is illegal under EU law.
  - examples:
    - Microsoft refused to supply information to Sun Microsystems for the communication with its operating system. During the investigation the Commission found evidence of additional illegal behaviors with the most recent case in 2008 involving Office and Internet Explorer.
    - The Google case in 2013 (see Box 11.4)

Merger control

- Initially P=AC. Merger of firms lowers AC to AC' but raises price to P':
- ΔCS = -a – b;
- ΔPS = a + c;
- net welfare = -b + c.



- With free entry then eventually P
- driven down to AC', boosting
- efficiency also for consumers.

EU Competition Policy

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- To prevent anti-competitive behavior, EU policy focuses on two main axes:
- Antitrust and cartels. The Commission tries:
    - to eliminate behaviours that restrict competition (e.g. price-fixing arrangements and cartels)
    - to eliminate abusive behaviour by firms that have a dominant position
- Merger control. The Commission seeks:
    - to block mergers that would create firms that would dominate the market.

State aid economics

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- Look at two cases:

  1. Restructuring prevention.

  2. Unfair competition.

Restructuring prevention

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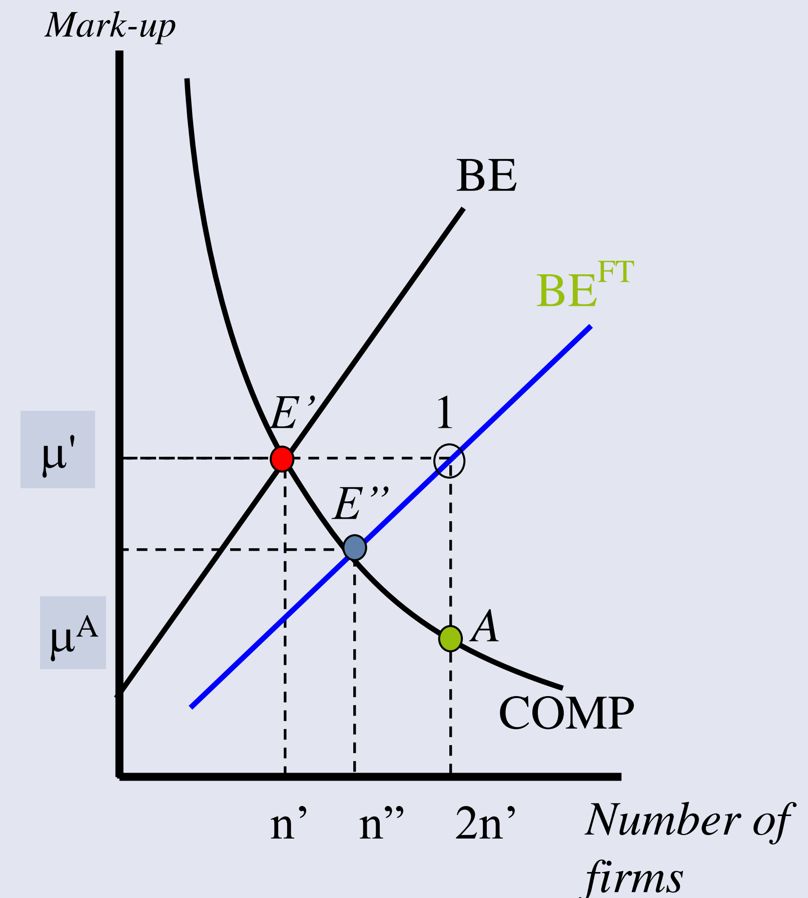
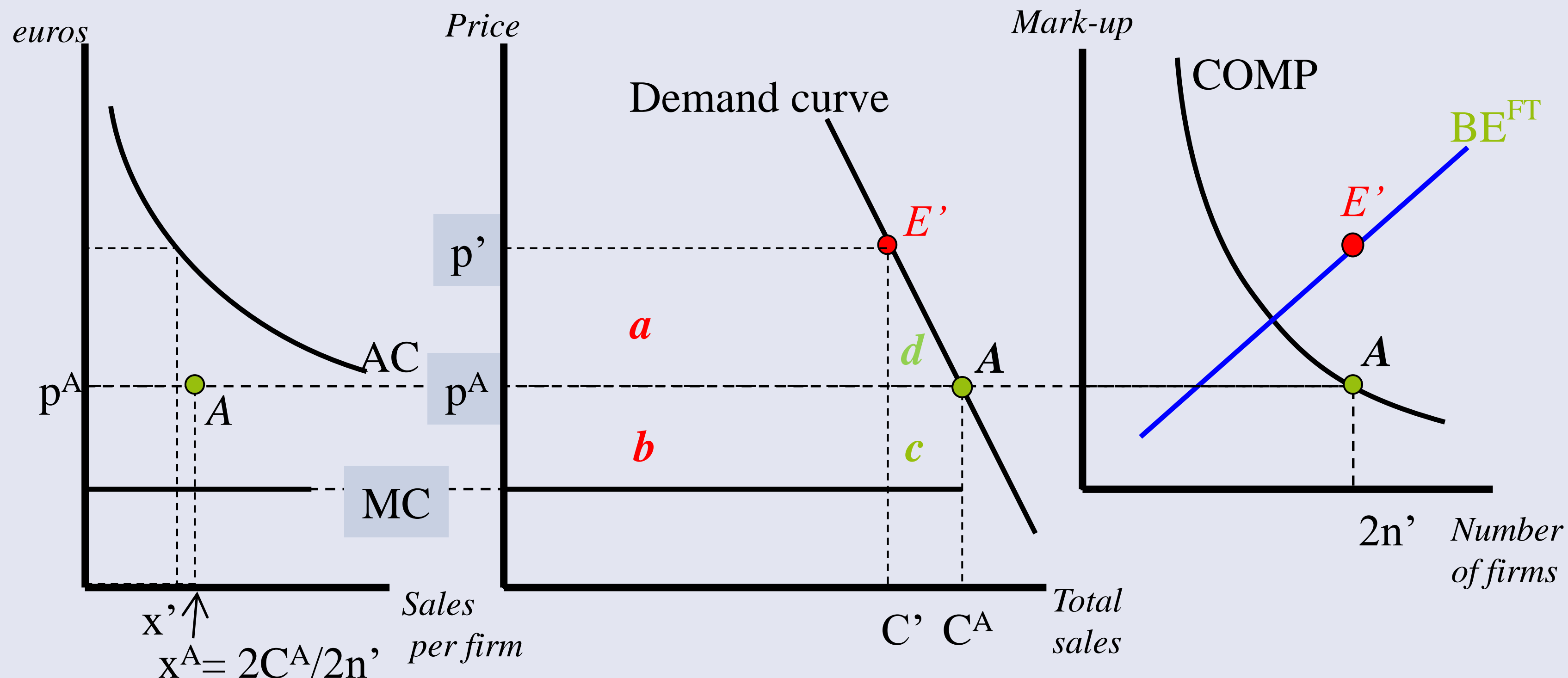
- Consider subsidies that prevent restructuring
- Specifically, each governments make annual payments to all firms exactly equal to their losses
  - i.e. all 2n’ firms in Ch. 6 analysis break even, but not new firms
  - Economy stays at point A
- This changes who pays for the inefficiently small firms from consumers to taxpayers.



Restructuring prevention: size of benefit

- Pre-integration: fixed costs = operating profit = area "*a+b*"
- Post-integration: operating profit = *b+c*
- ERGO: Breakeven subsidy = *a-c*
- Net Benefit: b+c+a-c=a+b



Restructuring prevention: welfare impact

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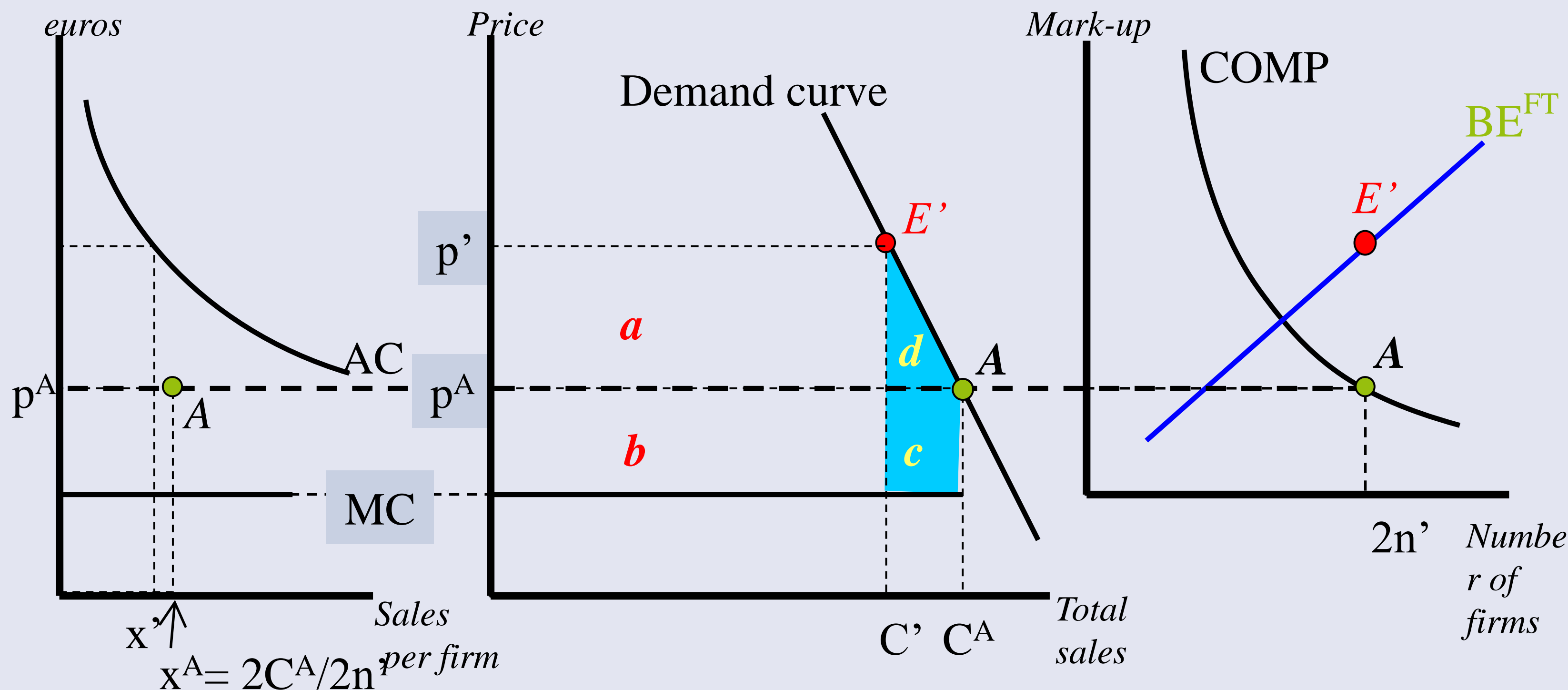
- Change producer surplus = zero (profit is zero pre & post)
- Change consumer surplus = a+d
- Subsidy cost = a-c (producer's loss)
- Total impact = a+d – (a-c)= d+c



Does it make sense to subsidize?

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- Static welfare gains resulting from inefficiency of imperfect competition, i.e. differences between average and marginal costs
  - Higher production = higher welfare under increasing returns to scale

- However, subsidizing loss-making enterprises creates dynamic losses -> reduced innovation and technological progress

Only some subsidize: unfair competition

- If Foreign pays ‘break even’ subsidies to its firms
- All restructuring forced on Home
- 2n’ moves to n”, but all the exit is by Home firms
- Unfair
- Undermines political support for liberalization

EU competition policy

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- Treaty of Rome prohibited any action that prevents, restricts or distorts competition in the common market and it puts the Commission in charge of enforcing these strictures.

- The Commission has considerable powers in this area:
  - the Commission has the right to make on-site inspections without prior warning;
  - with a court order, the Commission can even inspect the homes of company personnel;
  - the Commission has the right to impose fines on firms found guilty of anti-competitive conduct, with a maximum of 10% of the firm's worldwide turnover;
  - when it comes to subsidies, the Commission has the power to force firms to repay subsidies it deems to be illicit.

EU competition policy

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- To prevent anti-competitive behavior, EU policy focuses on:

- Antitrust and cartels. The Commission tries:
  - to eliminate behaviours that restrict competition (e.g. price-fixing arrangements and cartels);
  - to eliminate abusive behaviour by firms that have a dominant position.

- Merger control. The Commission seeks:
  - to block mergers that would create firms that would dominate the market.

EU law on anti-competitive behaviour

- Article 101:
  - forbids practices that prevent, restrict or distort competition;
  - typically prevents horizontal or vertical anti-competitive agreements;
  - exemptions possible where benefits exceed anti-competitive effects (e.g., R&D agreements).

- Article 102:
  - restricts the abuse of a dominant market position;
  - dominant position depends on market share;
  - practices banned: refusal to supply, unfair prices and conditions, predatory pricing, loyalty rebates, exclusive dealing, abuse of intellectual property rights.

Control of mergers

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- Merger Regulation, introduced only in the late 1980s:
  - anti-competitive behavior addressed: ‘a concentration which would significantly impede effective competition in the common market’;
  - no more notification requirement and increased role of national competition authorities.

EU policies on state aid

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- Treaty of Rome bans state aid (broadly defined) that provides firms with an unfair advantage and thus distorts competition.
- Exceptions relate to social policy; natural disaster aid; economic development aid to regions.
- Example: the airline industry:
  Restructuring of the European airline industry has been exacerbated by the terrorist attacks of September 2001. Subsidies could only cover only the ‘exceptional losses’ due to the attacks. Commission has managed to resist the desire of several Member States to support their national airlines as done in the US, also because low-cost airlines (e.g, Ryanair and easyJet) have done well without subsidies. Moreover, artificial support for inefficient national carriers hinders the expansion of low-cost airlines.

- **Trade Policies**

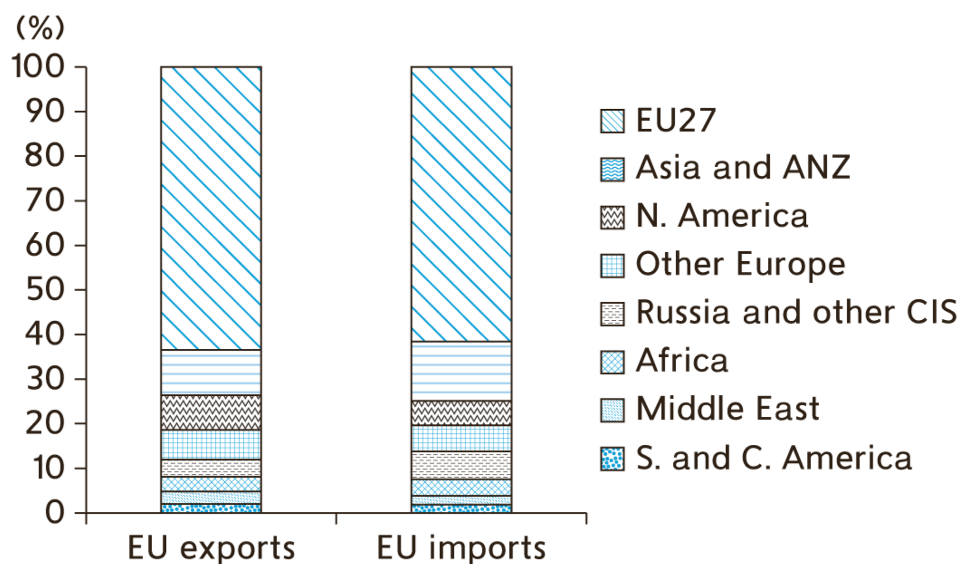
  Baldwin & Wyplosz (2015) "The Economics of European Integration", McGraw-Hill, Ch 12.

Trade: Facts

- Two-thirds of EU25 exports are to other EU25 nations.
- More than 90% of this trade is actually among the EU15 (10 new Member States are fairly small economically).
- Add all other European nations, three-fourth of Europe's trade is within Europe.
- North America and Asia are the EU25's main markets outside Europe, each accounts less than one-tenth of EU exports.
- Africa, Latin America and the Middle East are not very important.
- The pattern on the import side is very similar
- Rounding off, three-fourth of EU imports are from Europe, with the fourth quarter split into two more or less even groups of nations – Asia, and all other nations. Trade with non-European nations is balanced.

The facts

- The EU is the world's biggest trader; its dominance of trade in services is even greater. In particular:
  - 2/3 of EU27 exports are to other EU27 nations; and up to 3/4 if also considering EFTA nations and Turkey;
  - after Europe, North America and Asia are the EU27's main markets;
  - Africa, Latin America and the Middle East are not very important as EU export destinations.



Source: WTO online trade statistics database

The facts

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- Top Ten Partners of the EU by individual countries (2010, bill €)

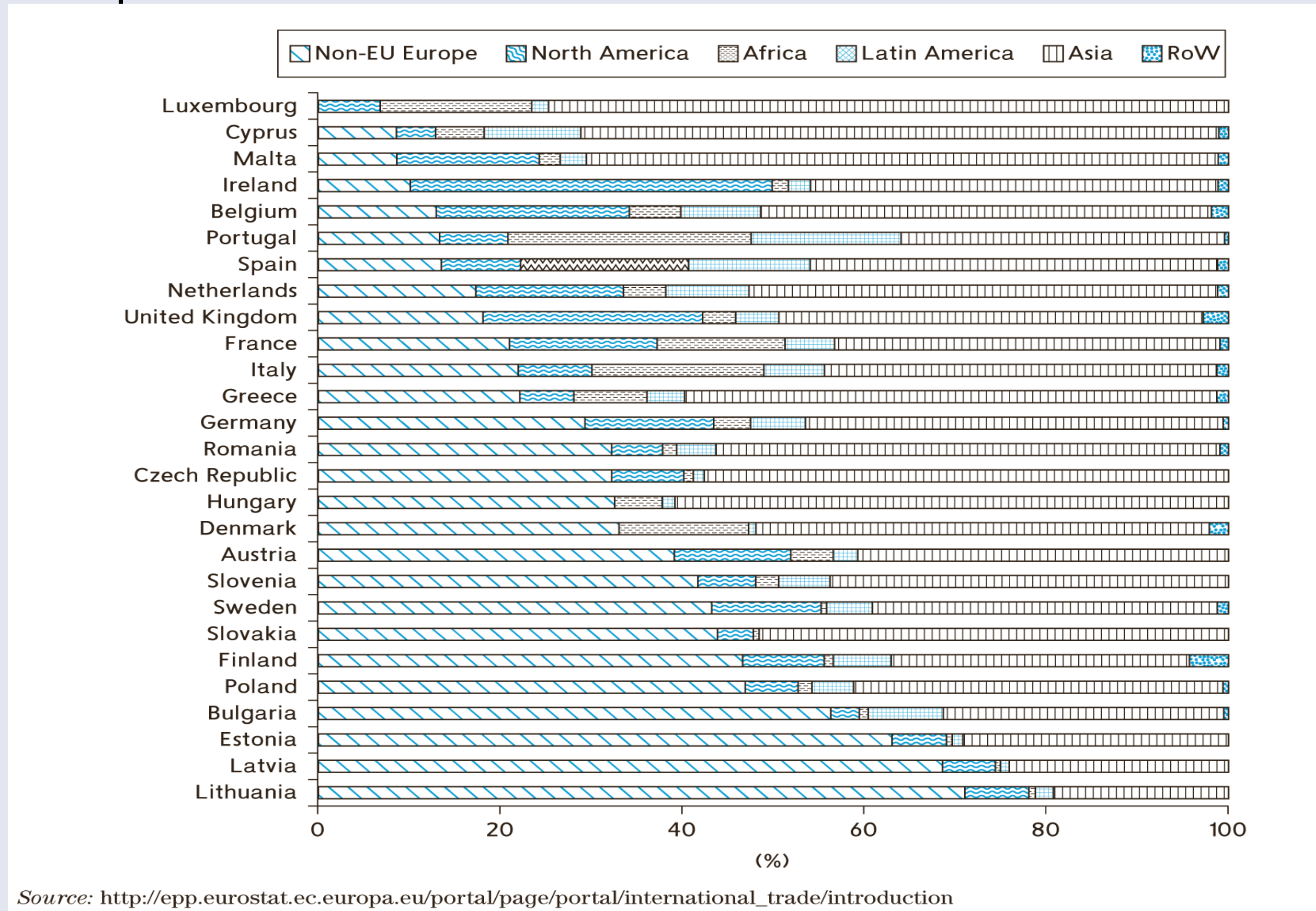
Table 12.1 The EU's top 10 import and export partners, 2010 (€ billions)

Partner	Exports	Share (%)	Partner	Imports	Share (%)
USA	242	18	China	157	10
China	113	8	USA	105	7
Switzerland	105	8	Russia	72	5
Russia	87	6	Switzerland	68	5
Turkey	61	5	Norway	59	4
Japan	44	3	Japan	51	3
Norway	42	3	Turkey	26	2
India	35	3	Korea	26	2
Brazil	31	2	India	22	1
Korea	28	2	Brazil	19	1
UAE	28	2	Libya	16	1
Hong Kong	27	2	Taiwan	16	1

Source: http://epp.eurostat.ec.europa.eu/portal/page/portal/international_trade/introduction

The facts: differences among Member States

- Member States have quite different trade patterns. Source of imports:



Source: http://epp.eurostat.ec.europa.eu/portal/page/portal/international_trade/introduction

The facts: composition of the EU's external trade

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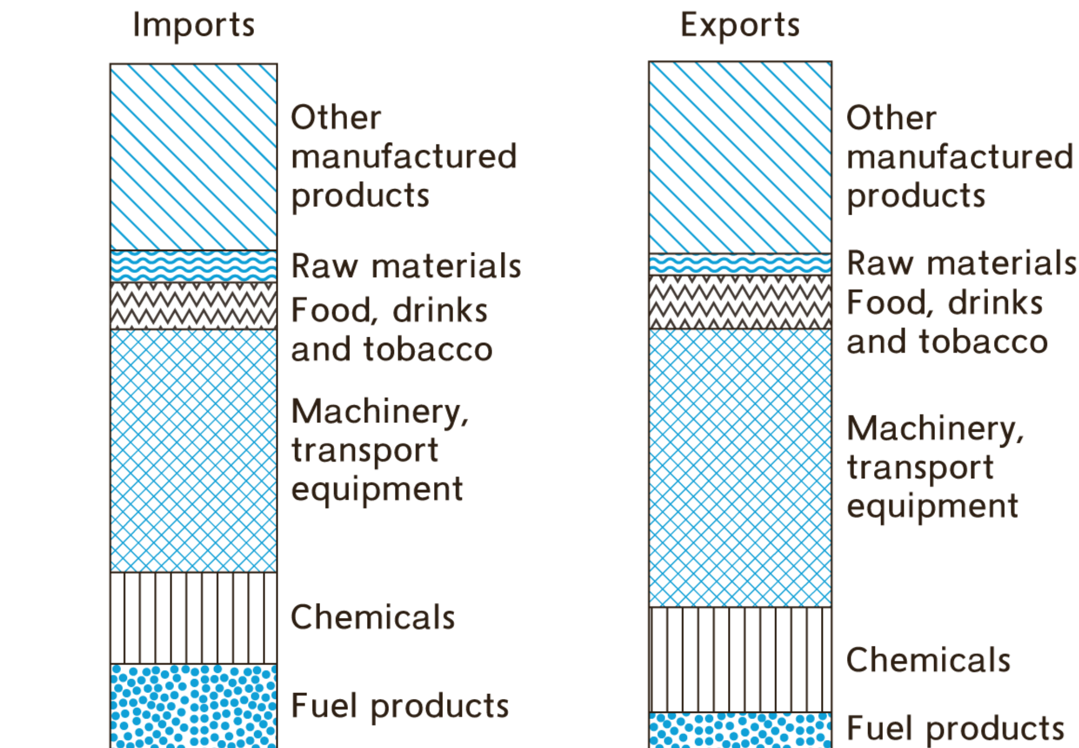
- Manufactured goods account for almost 90% of EU exports;
- on import side, 2/3 of spending on manufactured goods;
- EU27 is a big importer of fuel (about 1/5 of total).



Source: http://epp.eurostat.ec.europa.eu/portal/page/portal/international_trade/introduction

The facts: composition of the EU's external trade

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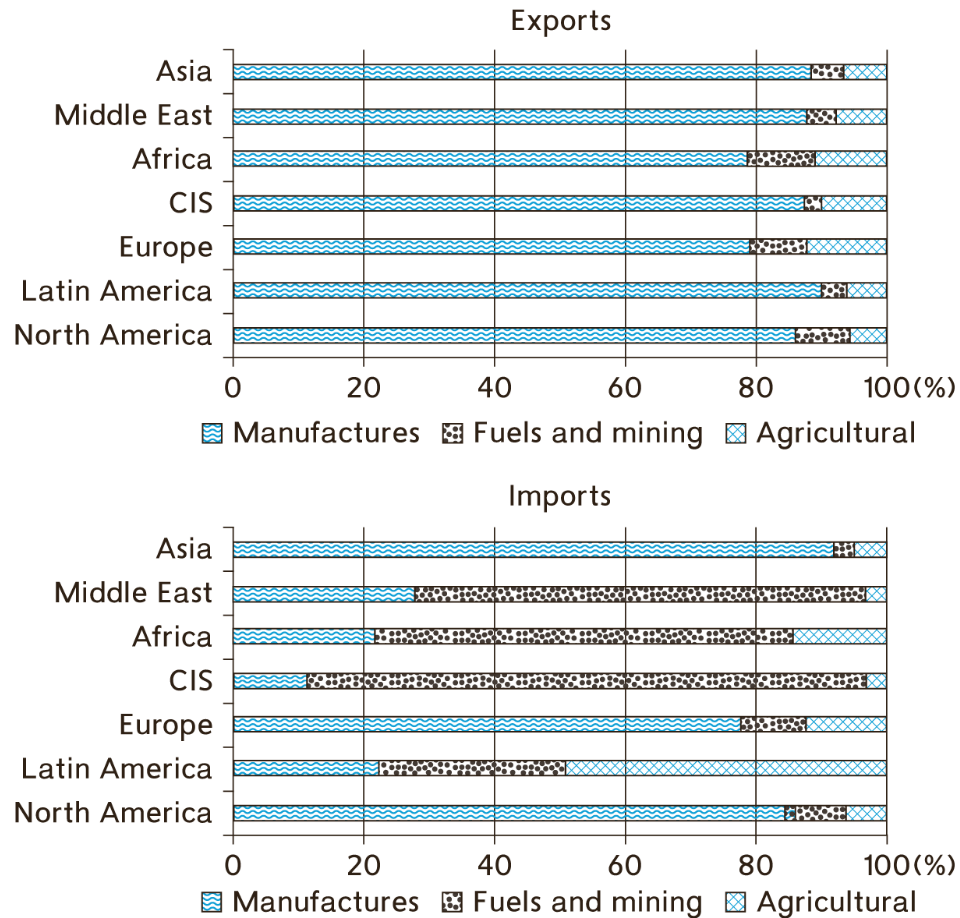

Source: http://epp.eurostat.ec.europa.eu/portal/page/portal/international_trade/introduction

The facts: EU's Common External Tariff (CET)

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- The average CET rate is about 6%, with wide variation:

Table 12.2 EU's Common External Tariff (CET), 2010

	Average (%)	Max (%)	Share of extra-EU imports duty free
Animal products	23	162	10
Dairy products	49	163	0
Fruit, vegetables, plants	11	161	12
Coffee, tea	7	55	78
Cereals and preparations	18	111	2
Oilseeds, fats and oils	6	94	70
Sugars and confectionery	28	118	0
Beverages and tobacco	19	166	15
Cotton	0	0	100
Other agricultural products	5	117	68
Fish and fish products	12	26	5
Minerals and metals	2	12	56
Petroleum	3	5	84
Chemicals	5	13	43
Wood, paper, etc.	1	10	85
Textiles	7	12	2
Clothing	12	12	0
Leather, footwear, etc.	4	17	17
Non-electrical machinery	2	10	53
Electrical machinery	3	14	55
Transport equipment	4	22	17
Other manufactures	3	14	55

Source: WTO online database, 'World Tariff Profiles', www.wto.org

EU institutions for trade policy

- The customs union was the EU's first big step towards economic integration. A customs union requires political coordination (i.e., a common external trade policy).

- The Treaty of Rome granted supranational powers to the EU's institutions (i.e., 'exclusive competence') and the various Treaties have granted the EU more power in the area of trade.

- In the twentieth century, the EU's power on trade policy was basically limited to tariffs. As the range of important trade barriers broadened, the competence of the EU extended: small steps in the Maastricht and Nice Treaties and a big step forward with the Lisbon Treaty:
  - it extended the Common Commercial Policy to explicitly include trade in services, foreign direct investment and some aspects of intellectual property rights (copyrights, patents, etc.).

EU institutions for trade policy

- The European Commission has the task of negotiating trade matters with third nations on behalf of the Member States. The Commission also takes the lead in trade policy in the sense that it has the right of initiative on, for example, trade agreements.

- Negotiations are conducted in accordance with specific mandates defined by the Council and the Parliament (called 'Directives for Negotiation').

- Decisions are taken on the basis of the 'ordinary legislative procedure'. The Council must adopt any agreements negotiated by the Commission after the Parliament has given its consent.

- A big change from the Lisbon Treaty is that the European Parliament is now co-legislator with the Council on all basic EU trade legislation.

- The European Commission is also in charge for investigating dumping complaints and anti-subsidy measures.

EU trade policy: broad goals and means

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- For most of its life, EU external trade policy meant negotiating:
  - reciprocal tariff cuts in FTAs with other Europeans;
  - reciprocal tariff cuts with non-European nations in the GATT/WTO;
  - unilateral tariff preferences for developing nations.

- This started to change with a 2006 landmark communication from the Commission known as Global Europe: it identified ASEAN, Korea, India and Mercosur as priority partners for new FTAs.

- There was also a shift towards deeper agreements that covered issues such as investment, public procurement, competition, IPR enforcement and regulatory convergence issues (to be dealt with FTAs since the WTO agenda does not include them).

- Recent EU trade strategy also includes to tackle market access for services and investment by opening up public procurement and removing restrictions of the supply of raw material and regulatory barriers.

EU trade policy: existing agreements

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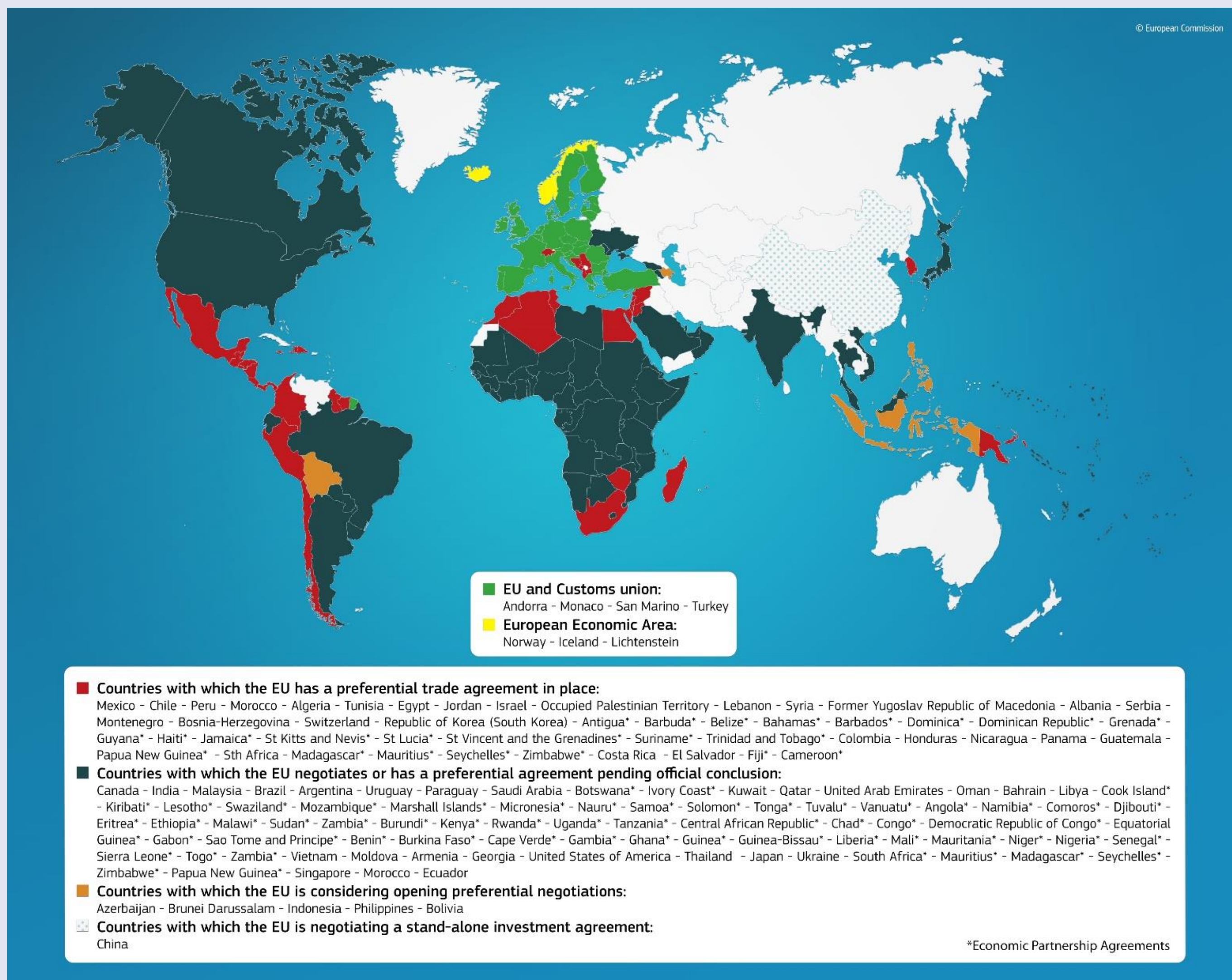
- EU has special deals with 139 nations; often more than one per partner.
- Each can be very complex ...



Source: http://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149622.jpg

EU External Trade Policy: European circle

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European-Mediterranean area:

- West, Central and Eastern Europe
  = Single market in industrial goods;
  - EU + EEA + Swiss bilateral agreements
- Euro-Mediterranean Association Agreements:
  - Morocco, Algeria, Tunisia, Egypt, Israel, the Palestinian Authority, Lebanon, Jordon, Syria and Turkey.
  - Asymmetric (EU cuts its tariffs faster) FTAs in manufactures, by 2010.
  - Turkey unilaterally in Customs Union in manufactures.

EU External Trade Policy: European circle (cont.)

- European-Mediterranean area (cont.):
  - Asymmetric dependence (e.g. 70% of Morocco's exports to EU, but <1% of EU to Morocco)

  - EFTA's "FTA union" with EU; EFTAns mimic EU to avoid discrimination against EFTA-based exporters.

Former Soviet Republics & Western Balkans

- Partnership and Cooperation Agreements (PCAs).
  - These are GSP+ (GSP=Generalised System of Preference).
  - Russia, Ukraine, Georgia, Belarus, Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Moldova and Uzbekistan.
  - Asymmetric tariff reduction without requiring PCA partners lowering theirs.
- Stabilisation and Association Agreements (SAAs).
  - Former Yugoslavian states.
  - Croatia has started membership; others likely to follow.

EU trade policy: non-regional FTAs

- In recent years, a number of non-European nations have sought out FTAs with the EU. The EU is almost always open to FTAs (as long as they exclude agriculture).

- The EU has signed a number of these deals (as of late 2011):
  - Mexico, Chile, Mercosur (Brazil, Argentina, Uruguay and Paraguay), the Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates), India, the ASEAN nations (Indonesia, Malaysia, Philippines, Thailand, Singapore, Vietnam, Cambodia, Burma/Myanmar and Laos) and South Africa;
  - negotiations for an FTA between the EU and Colombia, Peru and Ecuador have started;
  - On the way: EU-USA arrangement (TTIP); EU-Japan arrangement; discussion with China on investment protection

EU trade policy with former colonies

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- Colonial ties almost always involved important trade relations. To avoid imposing the CET on imports from former colonies, EEC6 signed agreements with many of them: asymmetric deals where EU tariffs were set to zero but the poor nations did not remove theirs.

- These agreements have been renegotiated various times and in 2000 the EU and the ACP nations agreed to modernize the deal (also because it was inconsistent with the WTO as it distinguished among developing nations on the basis of colonial ties).

- With the Cotonou Agreement, ACP nations commit to eventually removing their tariffs against EU exports by negotiating bilateral Economic Partnership Agreements (EPAs). Interim agreements have been signed with many of the ACP nations but only one final agreements has been implemented (with Caribbean countries).

EU trade policy with poor nations: GSP

- Poor countries receive preferential treatment in the GATT/WTO: ‘Generalized System of tariff Preferences’ (GSP).

- The EU was the first to implement a GSP scheme, in 1971, and it now grants GSP preferences to almost every developing nation in the world:
  - general GSP for all developing nations at the EU’s discretion;
  - super GSP, which involves extra ‘generous’ EU unilateral preferences for nations that the EU wishes to encourage for some reason or another:
- ‘Everything but Arms’ (EBA) for least developed nations, which grants (on paper) zero-tariff access all goods, except arms and munitions.

NEXT LECTURE

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- **January 11, 2020, 11:00 hours**
- **Reading:** Baldwin & Wyplosz (2015) “The Economics of European Integration”, McGraw-Hill, Ch 7.