The Single European Market and Trade Policy

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PREFACE

The Single European Market (SEM) and the Trade policy represent the very centre of the European Union. Without these two interrelated elements, the whole building would collapse. The European Monetary Union would not have any meaning without them. The SEM and Trade policy have been progressively developed since the entry into force of the Rome Treaty in 1958. They are now an articulated structure allowing the free circulation of productive factors within and outside the territory of the EU. It is a powerful engine for growth, to which the European citizens owe a large part of their well-being. Prosperity represents a pull factor for so many of the immigration flows to what is seen as a land of hope, as Europe is seen. It has not been easy to set up the SEM. This process started in 1958, reaching its first goal in 1969, with the establishment of the customs union (the elimination of tariff barriers). However, it took almost a quarter of a century, until 1993, to transform the customs union into a single market (the elimination of non-tariff barriers). Still today (2017), the SEM is an uncompleted construction. This is mainly in the case of services. A true SEM has not yet been built. This a quite serious stoppage, considering that services represent about 70% of the EU's GDP. In the next years, the need to restore growth will call for incisive measures, by the EU institutions, to speed the completion of the SEM for services, especially as far as the digital market is concerned.

Trade policy has been a quite successful tool, alongside the history of the EU. It has created an area open to international trade and foreign investments. After pursuing a multilateral approach to international trade, the EU has shifted, since the beginning of this century, to a more bilateral oriented policy. Today's main challenges are the Transatlantic Trade and Investment Partnership and the modernization-reform of the customs union treaty with Turkey. However, the environment is not the most promising.

Europe and its process of economic integration are living in difficult years. Growth is still low and fragile. Unemployment is still too high, despite some improvements. The migration issue is far from finding a lasting solution. The enlargement process is virtually blocked. Relations with Turkey are going through a problematic moment. Negotiations with the United Kingdom for Brexit appear to be long and hard. The far-right movement, claiming the dissolution of the EU, obfuscates the political horizon. Furthermore, both in Europe and in the United States protectionist tendencies are more and more considered as an instrument for restoring growth and for job creation. These tendencies are particularly dangerous for the EU as they affect the two main assets: the SEM and Trade Policy.

Faced with this situation the European institutions (Parliament, Commission, and Council) have advanced some proposals for EU reform. It is the beginning of a debate, of an open-ended debate. Advances are expected and needed in fields such as common defence, migration policy and completion of economic and monetary union. It is however necessary that attention should not be diverted from the SEM and Trade Policy because an environment of growth and prosperity is the only one allowing for advances in political unity.

Mushin Kar, Ankara, June 2017

SYNOPSIS

This book explores the space of the free circulation of goods, services and people. The purpose is to give the reader as wide as possible an insight into the working of the engine for growth.

The introductory chapter wants to be a sort of guide for the reader, written with the purpose of facilitating the further exploration of the different constituting parts of the engine. This chapter contains an analysis of the possible consequences of Brexit. Actually, the main concern of the British government, after the vote of 23 June, is how to minimize the price of the UK's withdrawal from the SEM and how to set up a new trade policy.

Chapter one realizes an attentive overview of the main theoretical and empirical studies dedicated to the economic impact of the SEM, identifying its contribution to economic growth in different periods of EU evolution. The upgrading measures of the SEM taken in the years of the great recession are also analyzed relating to their ability for relaunching economic growth in the EU. Brexit is also considered on its impact on the SEM.

Chapter two addresses the question of how the process of economic integration affected industrial location decisions within the EU. The existence and evolution of a core-periphery structure of the EU are investigated in its relationship to the dynamic integration process. An econometric estimation model is employed to analyse the determinants of industrial location and the evolution of concentration/dispersion patterns.

The subsequent two chapters are dedicated to the single market for services, because of two reasons. The growing weight of the service sectors in the member states economies and the fact that it is not exaggerated to affirm that the SEM for services is unfinished. Therefore, chapter three argues that after over twenty years of formal functioning of the EU single market it is very fragmented as regards the service sectors and numerous barriers still exist between member states. The chapter, which among other issues assesses the degree of integration of the service sector within the SEM, identifies and analyses the major benefits of integration of the services and indicates the most important obstacles in attaining these potential gains. In chapter four, tourism is taken as a case to be analysed for services in the scope of the single market. The European

Economic Community did not have a tourism policy at its inception. However, a tourism policy has incrementally been transferred to supranational. The Lisbon Treaty created a new legal basis devoted to tourism which gave the EU institutions the right to act especially when the competitiveness of undertakings in the tourism sector is at stake.

Chapter five is dedicated to the free circulation of labour. It argues that liberal thought provides for a useful interpretation of labour mobility in the EU (of EU nationals) and of its interrelation with the free circulation of goods and services whose growth effect reduces the need to emigrate, acting as a sort of retaining factor. At the same time the growth of intra-EU trade, the freedom of establishment and the creation of trans-border value chains have created new job opportunities for people with high skills and competencies. The quantitative diminution of flows has thus been accompanied by a qualitative upgrading of labour mobility.

The analysis of the SEM is completed in chapter six, dedicated to the energy sector. The authors argue that it was not an easy decision for the member states to open their national markets to competition. Energy has been seen as a public good rather than private, and a political good and governments want to keep energy prices under their control. Finally, energy is a strategic good, so States want to improve their own energy supply security.

Chapter seven examines issues related to both single market and trade policy. In a certain sense it is a bridge between the two parts of this book. The chapter compares GDP growth and stability in the economies of Poland and Turkey in 2000–2015 as well as their bilateral trade, under the customs union agreement. Results are that regional economic integration enables the speeding-up of the process of convergence with more developed countries.

Chapter eight intends to shed light on the EU trade policy, which had swings between multilateralism and bilateralism, in parallel with global economic developments throughout the last decades. In addition, also discussed are the effects of the Great Recession on the development of multilateralism, the stance of the WTO, proliferation of bilateral trade agreements, and the trends in international trade. This chapter thus addresses two of the three dimensions of EU trade policy. The third one, unilateralism, is dealt with in chapter nine. The EU is a multilateral organization by its very nature, consequently tending to behave multilaterally, as a first approach. However, some external factors and the internal dynamics have affected this approach. Since external and internal dynamics have been intermingled and are equally important, the chapter explains the factors and dynamics which led the EU to develop specific unilateral instruments.

Chapter ten is dedicated to the transatlantic partnership; specifically, to the Transatlantic Trade and Investment Partnership (TTIP). This is quite a debated and topical issue. The EU and the United States are each other's main trading partners in goods and services and account for the largest bilateral relationship in the world. TTIP aims to achieve a further opening of both economies. This initiative has the long-term objectives of achieving sustainable growth and creating jobs by means of mutually eliminating regulatory barriers in a comprehensive way.

Finally, chapter eleven addresses the EU-Turkey Customs Union. This chapter aims to explain the economic relations with Turkey and the situation of the Customs Union and discuss the possible scenarios for Turkey-EU relations with a focus on the changes in economic conditions, especially in the EU's external trade policy in an international environment where the WTO's Doha round is not proceeding.

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The views expressed in the twelve chapters reflect the perspectives and convictions of their respective authors.

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Ankara Yildirim Beyazit University, June 2017

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INTRODUCTION

THE SINGLE MARKET AND TRADE POLICY: THE TWO MAIN ASSETS OF THE EU AND THE PRICE UK SHOULD PAY FOR GIVING THEM UP

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Our internal market is Europe's best asset in times of increasing globalisation

It is anachronistic that the 21st century Europeans and Americans still impose duties on each other's products

—Jean-Claude Juncker
2014

Introduction

Europe has been severely hit by the Great Recession. Growth is sluggish and unemployment widespread. Restoring growth and improving employment are the priorities of the European Commission headed by Jean-Claude Juncker. Pundits, commentators, scholars, and *in primis* politicians do not hesitate to indicate "austerity"[1] as the prime responsibility for the lack of growth. Some of these, the so-called hard Eurosceptics, blame the euro too as a further ingredient of the economic stagnation of the EU and, more specifically, of the Euro area. Consequently, expansive fiscal policies are invoked, along with the dismantling of the monetary union.

[1] Austerity should not be confused with the sound management of public finances. The first is a sharp reduction of public deficit and public debt, because of lavish fiscal policies. The second is a responsible policy aiming to maintain the budget balance close to equilibrium and public debt at a sustainable level.

The combination of expansive fiscal policies and the re-establishment of national monetary sovereignty should produce the effect of propelling growth and job creation. A quite improbable theory!

The Single European Market (SEM) and the EU's Common Trade Policy represent the best asset of the EU. Without these two core elements, the EU simply could not exist. As we read in the Commission's president priorities:

> Our internal market is Europe's best asset in times of increasing globalisation. I therefore want the next Commission to build on the strength of our single market and to fully exploit its potential in all its dimensions. We need to complete the internal market in products and services.

Completing the SEM implies offering more integration-induced opportunities to EU and foreign investors within the territory of the 27 member states (Brexit is already a reality) or, better, within the European Economic Area.

Trade Policy, with its open stance (except for agriculture) is the EU's second engine for growth. Despite the crisis, the SEM remained open. Protectionist tendencies were rejected. Moreover, new free trade agreements have been implemented, while others are under negotiation. The ones already implemented, such as the Customs Union with Turkey, have progressed although imperfections of the CU mechanism could generate undesired negative effects for the latter. The solution, however, is to perfect the Customs Union and possibly transform into a European Economic Area, waiting to have Turkey within the single market, not moving back to a free trade area, as some commentators are arguing.

As Juncker stated:

> Under my presidency, the Commission will negotiate a reasonable and balanced trade agreement with the United States of America […] It is anachronistic that, in the 21st century, Europeans and Americans still impose customs duties on each other's products.

It is surely anachronistic; however trade negotiations on the Transatlantic Trade and Investment Partnership (TTIP) have been suspended, due to the negative stance of some EU governments. Europe has thus downscaled the potentialities of commercial policy as an engine for growth.

The theory of real economic integration, de-fragmentation of markets and creation of pro-competitive effects within an integrated economic area, has been widely proven. Empirical analysis has shown how much the

SEM has fostered competition. Various "Single Market Reviews"[2] and other documents published by the European Commission have reached the conclusion that the SEM is a powerful instrument to promote economic integration and to increase competition within the EU and that it has been the source of large macro-economic benefits. However, these gains could have been substantially larger if the removal of most of the remaining cross-border barriers had been achieved.

1. Supply side structural reforms for growth and employment

In recent years policy makers and economists have long discussed Europe, on austerity versus flexibility in the management of public finances in relation to growth and employment. The EU has been criticized for having looked only to austerity and not to growth. The debate is well-known. The single market, as well as trade policy were blatantly excluded from the discussion (we should credit the Eurosceptic former United Kingdom premier David Cameron for being the only one to stress their importance), mentioned only sporadically by the European leaders of the "Continent". As we have already mentioned the TTIP negotiations with the United States have been suspended.

Forgetting these two assets is serious, because it means forgetting the two most powerful growth engines of the EU. It also means forgetting the structural reforms that the EU can implement, most of them being costless.

This is a "forgetfulness" in which there is a lot of ideology, furthermore a very shortsighted selfishness on the part of the policy makers. For a government, it is much easier to summon the merits of a public investment program or income support and so on in terms of State interventionism, than those arising from an agenda implemented at European level for measures in favour of the single market or trade agreements. Their effects cannot be linked to economic policies as easily and directly as public interventions. Then the fact that the first does not work, or has only scant relief effects, is quite secondary.

So, what is liberal is always poorly palatable for the politician because its emphasis is not on the State or on the governing class, but on the individual and his freedom of action. The politician does not see any reward when his action is the product of liberal measures.

Liberalism, as we know, does not have a mystique, while there is a vast one in speaking out against the market, its alleged distortions, failures and

[2] See: https://ec.europa.eu/growth/single-market_en.

incapacity of self-regulation. Speaking out against the "Europe of merchants" and "Europe of banks" makes much more cash (in terms of votes) than happens in speaking in favour of economic freedom.

Without claiming to build a mystique to the market and trade, the deepening of the single market and of trade policy represents structural reforms equipped with powerful engines for the development of incomes and employment. Their implementation requires only the political will of the EU partners, without requiring any treaty reform or requesting the pooling of more doses of national sovereignties.

In a global market economy, as this is the reality we face today, growth and employment are a function of business competitiveness, which is in turn dependent on the efficiency of the markets. Market efficiency, in turn, is a function of well-conceived economic policies aiming at promoting growth.

It is time to see which policies the EU will be able to implement and perform in a more efficient way than its member states. It is the so-called principle of subsidiarity, according to which:

> Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member states, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level. (TEU, art. 5)

The theory of fiscal federalism gives two clear indications in this respect: the single market and trade policy. The first and the second are the mandatory tasks of Einaudi's project for a European Federation.[3] In the TFEU customs union and common trade policies are part of the Union's exclusive competencies (art. 3), while the single market is a shared competence (art. 4).[4]

2. The Single European Market

Between 1996 and 2012, several assessments of the performance of the single market have been carried out by the Commission and by scholars. As the Single Market Review of 1996, a series of studies promoted by the

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[3] Luigi Einaudi, "The economic problems of the European federation", Edizioni di Capolago, Lugano 1944.

[4] The single market is a shared competence because the EU's Directives have to be adopted by member states through their own internal legislative procedures.

Commission have indicated that the expected results of the Cecchini Report[5] had been achieved. In particular: a) competition to the single market had led to reductions in prices and costs and the consequent expansion of production; b) the single market had experienced trade creation effects, but not those of trade diversion; c) price reductions had been manifested in high-tech sectors, but also in more traditional sectors such as food and electrical machinery; d) finally, a greater price convergence had taken place.

The following is a brief summary of the economic evaluation of the single European Market.

As we read in the 2007 Single Market Review:[6]

> [T]he Internal Market is a powerful instrument to promote economic integration and to increase competition within the EU and it has been the source of large macro-economic benefits. However, these gains could have been substantially larger if the removal of most of the remaining cross-border barriers was achieved (page 1). In particular, the initial expectations that the Internal Market would serve as a catalyst for creating a more dynamic, innovative and competitive economy at the world level have not been met. Various reasons for this are identified, namely: the slow and sometimes incomplete implementation of directives, the inadequacy of some instruments, the persistence of barriers to cross-border trade and investment, particularly in services, and the slow development of an Internal Market for knowledge. Building on the evidence and analysis provided, the paper concludes with eight suggestions to guide the design of policymaking for the Internal Market in the 21st century.
>
> It is time to see what, in the years ahead, the EU should do to improve efficiency, i.e. its ability to induce European and foreign investment.

In the Commission's Single Market Act II we find:[7]

> A lot has been achieved: from 1992 to 2008 the Single Market has generated an extra 2.77 million jobs in the EU and an additional 2.13% in GDP. For European consumers the Single Market means more choice at lower prices—a 70% reduction in mobile phone costs is but one example.

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5 http://aei.pitt.edu/3813/1/3813.pdf.

6 Fabienne Ilzkovitz, Adriaan Dierx, Viktoria Kovacs and Nuno Sousa, *Steps towards a deeper economic integration: the Internal Market in the 21st century. A contribution to the Single Market Review,* Directorate-General for Economic and Financial Affairs, European Commission, Brussels, Economic Papers, N° 271 January 2007: http://ec.europa.eu/economy_finance/index_en.htm.

7 European Commission, *Single Market Act II*, p.4: http://ec.europa.eu/internal_market/smact/docs/single-market-act2_en.pdf.

> For citizens, the Single Market has given them the capacity to travel freely, to settle and work where they wish. For young people it has opened up the opportunity to study abroad—more than 2.5 million students have seized this opportunity in the last 25 years. For the 23 million companies in the EU the Single Market has opened access to 500 million consumers. The message is clear, the evidence is there: a strong, deep and integrated Single Market creates growth, generates jobs and offers opportunities for European citizens which were not there 20 years ago.

The single market is, therefore, the great asset created by European integration, and its most beautiful product. Without the single market, the single currency, as well as the Schengen system, would not make sense, even a programme like Erasmus would not work. In short, the EU would not be conceivable without the single market.

Its value is given by the intra-EU flow of goods and services, plus the flow of investments between member states: in essence, the total value of trade and intra-EU investment. Graphic 0.1 shows these values. In 2007, the last year before the crisis, the size of the single market touched 4,123 billion, amounting to the sum of the GDPs of Germany and Italy, equal to 32% of EU GDP. In 2014, the value of the single market reached (the last year for which all data are available) the level of 4,200 billion euro. This value corresponds to the sum of the GDPs of Germany, Spain, Estonia, Latvia, Lithuania and Malta of the same year, equal to 32% of EU GDP.

It is worthwhile to notice two more things.

First, the value of the single market has already surpassed the pre-crisis level. Second, this result is due to the dynamic of services and goods, while intra-EU direct investments are still lagging behind. These trends reconfirm the central role of the single market as a factor of growth, especially as far as services are concerned.

The centrality of the single market is reaffirmed in the conclusions of the European Council of 26-27 June 2014, first among five priorities:[8]

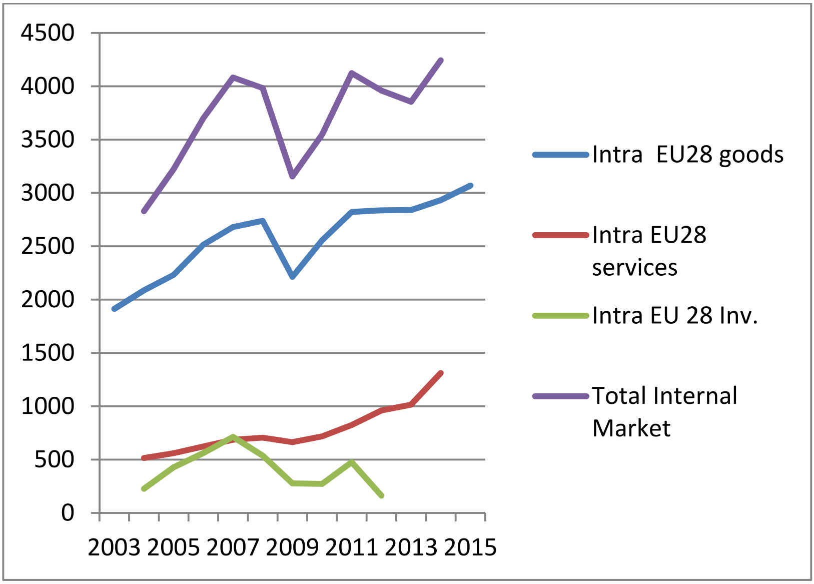
> Therefore, the priorities we set for the Union for the next five years are to:
> - fully exploit the potential of the single market in all its dimensions: by completing the internal market in products and services; by completing the digital single market by 2015;
> - promote a climate of entrepreneurship and job creation […];
> - invest and prepare our economies for the future: by addressing overdue investment needs in transport, energy and telecom infrastructure as

[8] European Council 26/27 June 2014 Conclusions: http://data.consilium.europa.eu/doc/document/ST-79-2014-INIT/en/pdf.

well as in energy efficiency, innovation and research, skills, education and innovation; […];

- reinforce the global attractiveness of the Union as a place of production and investment […] and complete negotiations on international trade agreements, in a spirit of mutual and reciprocal benefit and transparency, including TTIP, by 2015;
- make the Economic and Monetary Union a more solid and resilient factor of stability and growth […].

Graphic 0.1. Single European Market (in million euros)



Source: Eurostat

In these documents the single market has the place it deserves. However, in the priorities put on display by politicians this happens a lot less. As already pointed out the expression "single market" is almost entirely absent from the political language of many European leaders. Their greater benchmark remains public spending, public investment and especially the anti-rigor policies. Flexibility in public accounts is invoked as the tool having the greater impact to make the recession dry up.

The road map to fully exploit the potential for growth is clearly identified in the above-mentioned Single Market Act II, identifying four pillars around which to develop a set of key actions:[9]

> The four drivers for new growth put forward in this Communication are:
> 1. Developing fully integrated networks in the Single Market;
> 2. Fostering the mobility of citizens and businesses across borders;
> 3. Supporting the digital economy across Europe;
> 4. Strengthening social entrepreneurship, cohesion and consumer confidence.

For the purposes of this introductory chapter it is important to highlight the liberal character of the Single Market Act II, namely the conformity of its actions with the principles of a free market economy.[10]

1. Network industries introduce competition in traditionally protected sectors where enterprises are considered as national champions (champions in losing money in a liberal perspective). Network industries provide services that citizens use every day from transport to energy. The single market in transport and energy offers consumers a real choice, while operators are free to propose their services "anywhere, anytime and to any customer on an equal basis". Since its inception, the single market has triggered significant advancements in network industries such as transport and energy. However much still needs to be done, particularly in transports by rail and sea; in electricity and gas. Consumers and businesses still pay too many extra prices derived from fragmented and inefficient markets. Still too many “rent-seekers” (privileged State, or State-protected, operators) operating in these areas, penalize the consumers purchasing capacity and business competitiveness. The actions identified by the Commission to introduce or expand the competition are:

- Open domestic rail passenger services to operators from another Member State to improve the quality and cost efficiency of rail passenger services;
- Establish a true Single Market for maritime transport;
- Accelerate the implementation of the Single European Sky;
- Improve the implementation and enforcement of the third energy package and make cross-border markets that benefit consumers a reality;

[9] European Commission (2012) p. 5.
[10] The quoted expressions in this paragraph refer to the *Single Market Act II*.

2. The mobility of people and businesses is another key element of the single market:

> The Commission will continue to work towards its vision of a Single Market where citizens, workers and businesses are free to move cross-border whenever and wherever they want to and without unjustified restrictions imposed by divergent national rules and regulations. Mobility is a precondition for the Single Market to deliver on its potential, be it social, cultural, political or economic.

Here we provide some examples. The "business environment" is essential for the development of entrepreneurship. The carrot of profits and the stick of bankruptcy are indispensable ingredients of the market. More possibilities must be made available to the honest entrepreneur who had the courage to attempt an innovation that has subsequently failed. Unfortunately, in too many member states the legislation is less tolerant of the entrepreneur who has failed.

> Europe needs modern insolvency laws that help basically sound companies to survive, encourage entrepreneurs to take reasonable risks and permit creditors to lend on more favourable terms. A modern insolvency law allows entrepreneurs to get a second chance and ensures speedy procedures of high quality in the interest of both debtors and creditors.

The "business environment" can be improved through common procedures and rules in terms of taxation. As the Commission proposes, it is not the harmonization of rates, but the procedures and rules for the payment of VAT. Even today, the fact that each Member State applies different regulations implies extra costs for businesses, an unnecessary administrative burden that reduces competitiveness.

3. The Internet economy is increasingly crucial for economic development. The Internet, to provide an example, can increase by 10% the productivity of small and medium enterprises. Europe is seriously lagging behind its competitors in the exploitation of the potential of the Internet. McKinsey has elaborated an indicator to evaluate the capability of a single country in four fundamental aspects of the Internet: human capital, financial capital, and infrastructure and business environment. These reveal the European delay. The United States is at an altitude of 76, followed by Sweden at 67, but then the picture gets worse: United Kingdom 54, France and Germany 51, and Italy 31. This is a delay that the implementation of the actions foreseen by the Commission aims to fill.

These include the improvement of payment and delivery services and better access to high-speed broadband:

> A 10% increase in broadband penetration can result in a 1-1.5% increase in GDP annually and 1.5% labour productivity gains […]. Yet despite the progress made, the EU is still suffering from underinvestment in the deployment of high-speed broadband networks across the Single Market.

4. The social market economy is a liberal concept. The TEU (article 3) stipulates that the EU shall endeavour to establish “a highly competitive social market economy". In the Single Market Act II, the call to the social market economy is in consonance with the need for “market surveillance”, which is required in a single market where goods circulate freely between member states. Market surveillance does not mean intervention in the market. Rather it evokes the Einaudian concept of a Member State which lays down certain rules and then watches (the plumes of the “carabinieri” hats hovering in the market, in the famous example) their application.

> Market surveillance should enable unsafe or otherwise harmful products to be identified and kept or taken off the market and dishonest and criminal operators to be punished. It should also act as a powerful deterrent.

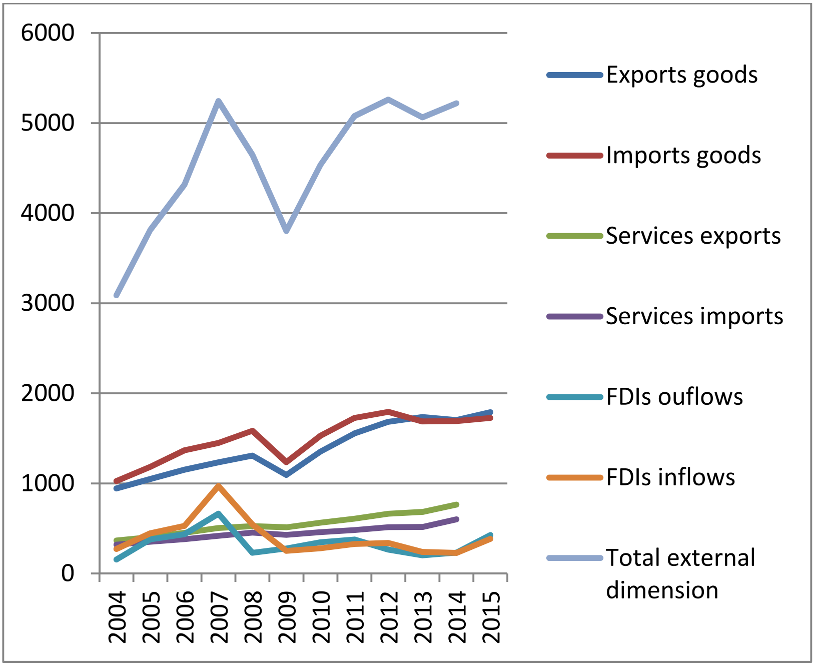
3. The Common Commercial Policy

The Common Commercial Policy is the second major asset of the EU: free trade means economic development; it has never been as true as it is today. The general objective of an EU trade policy is to improve the terms of trade for European companies. In terms of foreign trade, the EU certainly continues to be affected by the original sin of the CAP. In agriculture protectionism still prevails.

Graphic 0.2 shows the values of the external dimension of the EU and of its components: exports and imports of goods and services and foreign investment inflows and outflows.

The performance of the total curve and that of the individual series reveal two realities. The first, a structural feature, is the huge external dimension of the EU: above 5000 billion euros. In terms of GDP it is roughly the sum of Germany and France in 2013. The second and most important indication is that the pre-crisis levels have not been only recovered, but exceeded.

Graphic 0.2. External dimension of the EU (million euro)



Source: Eurostat

In the years of the Great Recession the EU economic open trade stance, a combination of multilateral, bilateral and unilateral dimensions, has represented a security net. In years when the domestic demand is particularly weak, foreign trade becomes the main source of growth.

> The contribution of external demand to economic growth is bound to increase in future, as 90% of global economic growth in the next 10-15 years is expected to be generated outside Europe, a third of it in China alone. To be sustainable, economic recovery will need to be consolidated through stronger links with the new centers of global growth.[11]

[11] European Commission, *Trade, Growth and Jobs,* 2013: http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_151052.pdf. The quoted expressions in this paragraph refer to this document.

The EU is a major exporter and importer in the world. It is also the largest foreign investor and the largest recipient of foreign investment from the rest of the world.

It is in the typological variety of existing trade agreements and negotiations, where we find a mixture of innovation and innovation in tradition, that it is worthwhile highlighting.

Firstly, the concept of the European Economic Area is innovative. Today the most significant example of the application of the EEA concept is Norway, Switzerland and Iceland. However, the EEA could turn out to be an interesting evolutionary possibility for the current relations between the EU and Turkey, a country with which a Customs Union Treaty has been enforced. The European Economic Area could be a viable instrument for other countries, too. The EEA is an instrument which offers a country the possibility of full market integration without all of the other tough requirements and obligations of membership. This is the advantage. The cost is that the partner country does not have a say in the decisions taken by the Council of the EU on the single market. It just has to accept them. We will come back to this point in the next section while discussing Brexit.

The so-called "deep and comprehensive free trade agreements" are innovative in tradition, far beyond the traditional concept of the free trade area. DCFTAs go beyond business, to enter the political sphere, as well as culture and cooperation. The one with Ukraine in 2014 is the latest example. This is an innovation that does not have other examples in the world, being peculiar to the deep and wide process of integration of the EU: a process with an inbuilt capability to look beyond national interests. This point deserves a few more comments.

The single market and the common commercial policy are two sides of the same coin. They could not exist separately. The one implies the other. The common commercial policy exists because of the existence of the single market. The two are mighty growth engines that must work in harmony. Furthermore, when faced with a crisis they can help each other.

The progressive creation of the internal market and its subsequent enlargement to twenty-eight countries has allowed companies to develop a European chain of value. In manufacturing, the final product contains more and more intermediate inputs which are the results of imports from other member states, as well as from the rest of the world. There is no doubt that the single market has facilitated the formation of this European chain of value. The exports of a given member state contain value created in other member states,

> A German export very often incorporates value created in the Czech Republic, Belgium or Poland. The distribution of jobs created by exports reflects this. For every two jobs created in a Member State where exports are counted, one job is created elsewhere in the EU.[12]

As this is the context what guidelines in the short to medium and long term should the EU's trade policy follow? In general terms, it should continue the liberal orientation of its three dimensions, but especially the bilateral one. Trade liberalization is a powerful structural reform. This is because they create stronger ties between member states making their growth more sustainable and their economy more competitive and improving the quality of their domestic and exportable supply. Trade liberalization is a powerful vehicle for the diffusion of innovations, as it helps a country to find the most convenient productive specialization, thus enhancing its productivity.

The *in fieri* agreement with the United States could lead to an economic gain for the EU of 120 billion euros annually once it is fully operational (2027), while the one with Japan would trigger a 0.34% increase of European GDP as well as advance trade negotiations with the other 16 partners, including Canada, Singapore, China (an agreement on investment), Malaysia, Thailand, Vietnam and Mercosur.

4. Brexit, SEM and Trade Policy

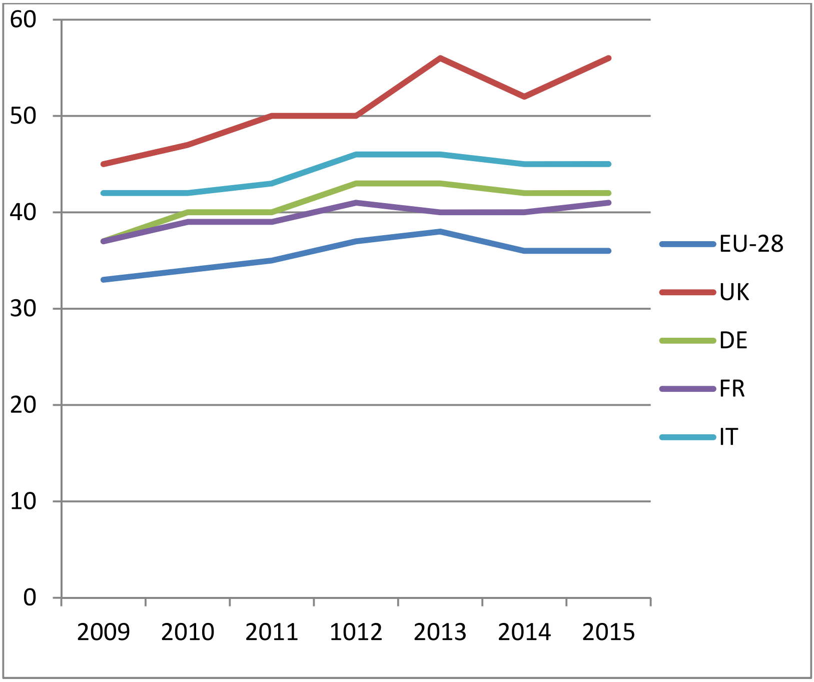
The debate and concerns about Brexit focus around two main issues: the single market and trade policy. Graphic 0.3 allows us to perceive the relative position of the UK for extra EU-28 exports. The mirror image of this figure is the relative position of the UK within the single market.

UK exports are more concentrated on the rest of the world than on the single market. Furthermore, this is an ascending trend. Actually this is a general trend in the EU which is shared by its biggest economies, but it is clearly more accentuated for the British economy.

The shift from the single market towards the external markets is linked to two factors. The first is the “preference for bilateralism” which has more and more characterized the EU trade policy since the beginning of the new century; the second is the higher rate of growth of emerging market economies like China or India.

[12] Vide supra.

Graphic 0.3. Extra EU-28 Exports of goods as a percentage of total exports



Source: Eurostat

As a consequence of Brexit, the UK will have to renegotiate all bilateral trade agreements in which it is presently participating as an EU Member State. This will be true for both implemented agreements and under negotiation agreements. It is sufficient to have a look at the list of EU agreements to understand the magnitude of this task. Below we provide a few examples.[13]

- *Europe.* A Customs Union Treaty has been in force with Turkey since 1995. Negotiations for a Deep and Comprehensive Free Trade Area (DCFTA) have been concluded with Ukraine (2012), Georgia (2014) and Moldova (2014);

[13] The whole list of the EU bilateral agreements is available at: http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf .

- *North America*. The Comprehensive Economic and Trade Agreement (CETA) with Canada was signed on 30 October 2016. The negotiating directives were obtained in April 2009;
- Negotiations have been under way with the United States since 2013, while a Global Agreement with Mexico has been operating since 1997;
- *South America*. The EU-Colombia/Peru FTA has been applied since August 2013. Negotiations with Ecuador were competed in July 2014 and officially re-launched with Mercosur in May 2010. An Association Agreement has been operating with Chile since 2005;
- *East Asia*. Negotiations with Singapore and Malaysia were launched in 2010, with Vietnam in June 2012 and with Thailand in March 2013. Negotiations for an FTA with the Philippines were launched in December 2015. The corresponding negotiation directives were obtained in 2007;
- Trade negotiations with Japan started in November 2012;
- Negotiations with India for an ambitious and broad-based FTA were launched in June 2007. An FTA has been in operation with South Korea since 2011. Negotiations for an EU-China investment agreement were launched in November 2013;
- *Africa*. The EU has established a network of Association Agreements which include reciprocal FTAs with eight countries of the region (all except Libya and Syria). Trade liberalization with South Africa was completed in 2012. In October 2016 five southern African countries: Botswana, Lesotho, Namibia, South Africa and Swaziland, started a new chapter in their bilateral relations with the EU with the entry into effect of their Economic Partnership Agreement (EPA).

The charter at page 24 provides a general view of the state of EU trade agreements.

In the optic of Brexit and the consequent need for the UK to negotiate new trade agreements it is worthwhile to underline two issues.

First, we can consider the length of this process. Years of negotiation, roughly from five to ten, are generally needed to find an agreement for an FTA. There is no reason to think that this period could be shorter for the UK in respect of its experience of the EU. Although the time span will be shorter between the signing of the agreement and its entry into force, it is particularly long for the EU due to the fact that international agreements have to go through the ratification process of member states' parliaments.

In any case this time, however long or short it proves to be, there will be a cost to the UK in terms of GDP.

Second, we can consider the terms of the agreements. In this respect the crucial question is: “will the UK have enough strength to obtain the same conditions that the EU has been able to negotiate?” It is an open question that we leave to the reader. We just notice that the EU is the biggest trading block and that will continue even after Brexit. As far as the conditions of the agreements are concerned, the differential in respect to the ones negotiated by the EU will represent the cost that the UK will have to bear. This second cost, unlike the first which is temporary, is a long term one, thus representing a permanent loss to the UK.

We can however think of a third cost, not specifically affecting the EU or the UK, but addressing the effectiveness of bilateralism, consequently hampering the efficiency of the global economy. Presently (2017) the UK’s external economic dimension is the second largest in the EU. Its share in the total of the EU’s export and import of goods and services is around 13%. It will be a (new) big player in the international economic arena. The presence of such a big player will further complicate the “spaghetti bowl” of regional trade agreements. As a consequence, discriminations within world trade will rise; global growth could thus be negatively affected.

The UK is the biggest recipient, within the EU, in terms of FDI inflows and stock, with amounts that are respectively just below 50 billion euros (10% of the total EU inflows) and 1.500 billion euros (19% of the total EU stock) in 2014. About 50% of the stock of FDIs in the UK comes from the EU, and one-third of all the acquisitions of UK companies by overseas buyers between 2010 and 2015 have involved EU purchasers. This attractiveness will be eroded by Brexit, at least for that share which is absolutely majoritarian of FDI inflows and stock linked to the SEM. The UK financial sector is doomed to suffer major harms, as it will lose passporting rights. Actually, under EU passporting rules, a firm located in the SEM has a right to set up branches or conduct cross-border business across the EU without the need for additional local authorization. UK-based firms are the most active in using them, accounting for about 75% of passporting activities in the EU. Brexit could cause the loss of passporting rights, determining a significant disturbance to UK-based firms and to their customers.

The centrality of the SEM in the whole process of European integration is highlighted by the fact that the UK premier Theresa May, just after taking office in July 2016, expressed the wish to remain in the SEM, as far as goods, services and capital are concerned, but keeping the