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EU free trade agreements: Outlook and the way forward

The rapidly changing global economy creates new circumstances for EU trade policy. The Covid-19 pandemic and the Russia-Ukraine conflict only accelerated the pace of transformation of global value chains. For several decades, EU free trade agreements (FTAs) have served as an important tool for advancing European economic and geopolitical interests and global trade liberalisation. At the same time, they have also developed as a means of promoting sustainable development and a value-oriented cooperation framework with our partners worldwide. The recent return to a more active pursuit of new trade partnerships by the European Commission is a good moment to evaluate how FTAs fit into the overall trading framework of the EU. This chapter also deliberates how FTAs and EU trade policy could advance the sustainable development agenda and the general prospects for the conclusion of future trade agreements by the EU.

After remaining in suspension due to the Covid-19 pandemic and the ongoing war in Ukraine, the EU trade policy agenda seems to show signals of active revival and a return to the finalisation of free trade agreements (FTAs). This comes after three consecutive years in which EU trade had to tackle severe disruptions to global value chains and geopolitical tensions, which caused the spike in commodity prices and rising protectionist tendencies around the world.

In response, EU member states have turned inward. Trade within the internal market has risen significantly in recent years. At the same time, both external exports and imports fell in 2020 by around 10%. Even with a quick recovery in the following years, the overall trade in goods balance was in deficit by €432 billion in 2022, mainly due to a steep rise in the value of energy imports, which started in 2021 and continued through the next year. The EU still remains one of the three main international traders, faring second to China in exports and to the USA in imports, but the real question remains whether the main global trading trends will allow us to retain this position in the future. The highest imbalance in EU trade ever recorded may serve as a call for an overall evaluation of the state of EU trade policy and its perspectives. As we have observed in 2023, the European Commission's response

was to use geopolitical momentum to advance the free trade agenda and finalise several negotiated FTAs. We are still waiting to see the effectiveness of these efforts; however, this gives us a valuable opportunity to appraise the roles FTAs play in the European economy and speculate on their perspectives.

FTAs in the EU trade policy framework

The role and function of FTAs in the EU trade policy framework rose over time. In the first phase, agreements concerning trade mostly focused on tariff elimination and trade facilitation. The majority of agreements before 2006 were focused on the EU's close neighbours, such as the trade deal with Switzerland (in force since 1973), the customs union with Turkey (1995) or the Euro-Mediterranean Association Agreement. The first FTAs that went beyond this approach were signed with Mexico in 1997 (in force from 2000) and Chile in 2002. However, in general, FTAs were not a main policy tool of the EU, which actively engaged in the multilateral trade liberalisation agenda conducted within the World Trade Organization (WTO). The failure of the Doha negotiating round opened an era of comprehensive FTA agreements, which the EU concluded to advance trade liberalisation, in spite of the halt of multilateral negotiations.

The first agreement of this type was signed with the Republic of Korea in 2010 and was followed by similar documents signed with Canada (2016), Singapore, Japan (2018) and Vietnam (2019). All these agreements are focused not only on tariff elimination for goods, but also on opening service markets, increased access to public procurement, protection of geographical indications and provisions on sustainability. This new approach entailed the assumption that opening of the internal market increases overall volumes of EU trade, promotes access to resources and new markets for our companies, and improves the overall performance of the EU economy.

Currently, the EU has 41 trade agreements, in various forms, signed with 72 countries, making it a worldwide champion of trade liberalisation, as no other single country has more FTAs in place (China is second in number of concluded agreements and Canada in number of trade partners their FTAs cover). It is true that, in many instances, trade liberalisation stemming from the majority of deals brought notable increases in trade volumes and sometimes even considerable balance surpluses. For example, only three years after the entry into force of the EU-Japan FTA, our bilateral trade volumes increased by 12.5% with a €1,768 billion balance surplus on the part of the EU. In the case of trade agreement with Canada, after five years of provisional application, a 30% increase in mutual trade was observed, whereas in the first decade of the functioning of the FTA with the Republic of Korea we noted a 50% increase and our partner's ascent to the position of our third main trading partner in 2020.

Extra-EU trade is responsible for the existence of 38 million jobs in the EU, as the European Commission stated in 2019, which means an 11 million increase over the previous decade. This is an important reference point, although we need be mindful that intra-EU trade is

1.6 times as high as external trade.¹ Additionally, out of 27 member states, only Ireland and Greece rely more on trade with third countries than on trade with EU partners (the average rate of extra-EU trade per member state stands at 40%).² Furthermore, FTAs in place are responsible for only 35% of all extra EU trade (with close neighbour FTAs representing around 20.9%). Trade with our two main partners, China and the US, represents almost a similar volume and is without an FTA in place.

It is hard to predict whether new trade agreements will be able to increase this ratio, as concluding trade agreements has become a challenging task for the European Commission. Considering this, it is worth asking whether we should focus so much attention into developing new trade agreements and whether FTAs play additional roles, which go beyond simple trade in goods.

Additional roles of EU FTAs

The increasing complexity of global economic relations and emerging shifts in the geopolitical landscape impose additional roles for the EU's FTAs. With the halt of the trade liberalisation negotiations within the WTO and the blockage of its dispute settlement system, modern FTAs concluded by the EU work as a substitute in these fields. A typical comprehensive deal the EU concludes usually lifts well over 90% of existing tariffs between parties and introduces a bilateral dispute settlement mechanism. These provisions work on top of regular obligations of contracting parties that stem from their WTO membership, such as the most-favoured-nation treatment or being subjected to the Dispute Settlement Body rulings.

The example of EU-Ukraine trade relations proves that this duality increases, rather than distorts, the means of resolving disputes between parties. Arbitration of the Ukrainian export ban on unprocessed wood was resolved via bilateral consultation and an expert panel ruling based on provisions of the Deep and Comprehensive Free Trade Agreement (DCFTA), while the latest dispute on the ban of imports of Ukrainian cereals to several EU member states has been addressed by Kyiv at the WTO. However, the main game changer in the field of arbitration has been the extension of a mandatory dispute settlement over trade and sustainable development (TSD) chapters, which also play an important role in EU trade policy and are highly characteristic of the European FTA model.

The TSD chapters were a novelty introduced in the second generation of EU FTAs concluded during the last two decades. They play a crucial role in our trade policy as a means of advancing sustainable development, and protection of the environment and human rights across the globe. Aside from those more general goals, the TSD provisions were supposed to address the negative influences of increased trade over the environment and work against a race to the bottom on how workers and the environment are treated

1 Rueda-Cantuche, J.M., P. Piñero and Z. Kutlina-Dimitrova (2021) "EU exports to the world: Effects on employment". Publications Office of the European Union, EUR 30875 EN.
 2 "DG trade statistical guide". Publications Office of the European Union, August 2021.

internationally. For these reasons, the new generation of EU trade agreements includes obligations on the implementation of core international labour conventions and key environmental agreements, promotion of fair trade, and sustainable use of resources and energy consumption, as well as obligations to combat climate change. Important complementary measures also include mandatory consultations with stakeholders affected by the functioning of the agreements and the delivery of sustainability impact assessments of the FTA.

However, these provisions, although an integral part of the agreement, usually do not hold the same position as other parts of the text, as TSD chapters are not safeguarded by a sanctions mechanism in the event of non-compliance. Only recently, in the Trade and Cooperation Agreement between the EU and the UK we have seen the introduction of a sanctions mechanism, which is also binding for the sustainability provisions of the deal. In the case of the other ten agreements that include a TSD chapter, disputes over these provisions are addressed by bilateral consultations rather than a fully-fledged dispute settlement.

Nonetheless, we cannot say that this system is fully ineffective. In 2018, the EU requested formal consultations with the government of the Republic of Korea regarding the implementation of the sustainable development commitments under the EU-Korea trade agreement. Since 2011, the Republic of Korea has failed to ratify several International Labour Organization (ILO) conventions on freedom of association and the right to collective bargaining and on child and forced labour. As a result of the work of a panel of experts, the Republic of Korea has decided to ratify ILO core conventions concerning the freedom of association and amend its national legal framework accordingly.³ This was a great success on part of the EU. However, this result was achieved with a trading partner that was ready to abide by the panel recommendations and willing to honour its sustainability commitments. In the case of a less like-minded partner, the implementation of TSD provisions, as well as possible bilateral consultations, are often only formal in nature and do not address real shortcomings and improve the situation on the ground. One of the main tasks of the chief enforcement trade officer, a position created in DG Trade in 2020, is to influence and induce our partners to abide by the rules of sustainability stemming from our trade agreements. At the same time, a review process on the effectiveness of our TSD approach has been launched by the Commission.

As a result, in June 2022, the European Commission declared a new TSD action plan detailing 20 tasks to be undertaken to ensure that EU FTAs deliver for the environment and sustainable development.⁴ Among the many reform proposals, we should note leveraging the role of FTAs for increased sustainability, setting up clear sustainability benchmarks for trade deals, increasing the role of sustainability impact assessments, strengthening the role of the Domestic Advisory Groups in the control and evaluation of the trade agreement and its

3 Han, J. S. (2021) "The EU-Korea labour dispute: A critical analysis of the EU's approach". *European Foreign Affairs Review*, 4(26): 531-552. DOI: 10.54648/eerr2021041

4 "The power of trade partnerships: Together for green and just economic growth". European Commission, 22 June 2022.

sustainability provisions, and increasing the general enforceability of the TSD chapters. Due to clear pressure from the European Parliament, and notably the S&D Group, the Commission eventually added a sanctions mechanism as a last resort to a TSD reform checklist.

We can already see this new approach fully implemented in the latest FTA signed with New Zealand in 2023, with an ambitious TSD chapter and a sanctions mechanism in place. We should expect that the improved methodology for the creation and application of TSD chapters is reflected in the ongoing revision of existing FTAs and applied whenever possible in new trade agreements.

The reform of sustainability provisions in our FTAs, as well as recurring criticism of how TSD chapters are actually implemented by our trading partners, raises the question of the overall fitness of this measure to address the degradation of the environment and breaches of human and labour rights. It is clear that the adoption of sustainability elements in a trade agreement is easiest with like-minded partners, who share both the same values and a common legal framework, whereas in the case of trade negotiations with partners in Asia, Africa and Latin America, the addition of a sustainability chapter is an element of an overall negotiation with clear trade-offs for both parties. Therefore, it is no surprise that the final provisions of the TSD chapter do not achieve our most progressive expectations in most instances. This should not stop us from stressing the need to advocate for ambitious TSD provisions whenever possible. At the same time, we should accept that there are limitations to the role TSD chapters can play in addressing environmental and human rights challenges connected with international trade.

In effect, what we observe is a clear trend towards achieving goals of sustainable development by means of unilateral legislative measures of the EU. The deforestation or conflict minerals regulations are just a few sectoral examples of this approach. However, the recent game changers in this field are the Carbon Border Adjustment Mechanism, the Corporate Sustainability Due Diligence Directive and the regulation on products derived from forced labour (anti-forced-labour regulation). All of them introduce mechanisms embedded in EU law dedicated to the enforcement of sustainability. They are vital for the achievement of our main goals and enforcement of our values. On the other hand, it is already clear that they will influence our trade relations globally, as many partners, especially in the developing world, perceive them as hidden forms of protectionism. Considerable work needs to be delivered by EU institutions to counter such sentiments in the coming years.

Geopolitical function of FTAs

When analysing various functions of EU FTAs, one cannot overlook strategic considerations to engage in this type of economic cooperation. Increased trade volumes strengthen political relationships between partners and open new economic opportunities. Quite often, the development of economic relations follows an existing political connection or interest.

It is no surprise that the first FTAs the EU concluded in history were signed with its close neighbours, underlining not only actual trade flows and volumes but also political and social

connections. The same logic applied to the partnership and association agreements with countries in the Balkans and the Eastern Partnership. The DCFTAs concluded with Georgia or Moldova play minor roles in economic terms, but carry high geopolitical importance. In the most prominent example of Ukraine, the FTA facilitated a general shift of external trade of the country and reorientation from the East to the West in about five years since its provisional application.⁵

One can conclude that the first batch of ‘new generation’ FTAs with the Republic of Korea, Singapore, Japan and Canada were also an emanation of a geopolitical direction to connect economically with a set of like-minded international partners, achieving two goals at the same time: increasing trade; and deepening political relations. A similar thing could be said of the most ambitious bilateral trade liberalisation attempt yet, which was the Transatlantic Trade and Investment Partnership (TTIP) between the US and the EU. However, in this case, the economic gains, estimated at over €200 billion increase in bilateral trade volumes, could not outweigh internal opposition on both sides of the Atlantic and the negotiations came to a complete halt three years after they started. As some promoters of the deal claimed, the TTIP was supposed to create a new economic powerhouse bloc, which could uphold Western economic dominance over the rest of the world. The failure of the negotiations on this deal only confirmed that we are entering a new era of global economic order, where national interests of the main competing blocs determine the pace and level of further trade liberalisation.

From the longer-term perspective, the large and affluent EU market is deemed to gradually lose its global significance due to unfavourable demographic and strategic trends. Without proper access to resources (most critical raw materials are located outside the EU) and insufficient access to growing markets in Africa, Asia and Latin America, European companies may face hurdles from global competition. This trend is further reinforced by an increasing technological race between the main superpowers, as well as growing export restrictions and distortions in the functioning of global value chains.

The Covid-19 pandemic and the outbreak of the Russia-Ukraine conflict have distinctively marked the end of the era of fully open markets and ‘just in time’ production models. In effect, what we observe is a growing tendency for reindustrialisation and reshuffling of the concept of value chains with ‘smart shoring’ or ‘near-shoring’ as the new key paradigm.

The Chips Act, the Critical Raw Materials Act, and a series of new defence measures on subsidies, public procurement and coercive actions are perfect examples of adjustment to the new realities the current ‘geopolitical’ European Commission faces. Consequently, what we observed in recent years was the further development of three main trading and economic centres (US, EU and China), which trade with each other heavily and compete at the same time. This triangle of economic reliance and competition functions in the trade policy sphere as well. The race towards new FTA agreements is a simple extension of the rivalry over new markets and access to resources.

5 Dabrowski M., M. Dominguéz-Jiménez and G. Zachmann (2020) “Ukraine: Trade reorientation from Russia to the EU”. Bruegel Blog, 13 July.

It was no coincidence that, in response to a ‘no limit’ cooperation between Russia and China, the European Commission returned to FTA negotiations with India last year, which had been frozen since 2013. The talks on a new trade agreement have clear geopolitical goals: to woo India away from Russia; to connect with a giant market, which will probably surpass the EU in global GDP creation by 2050; and to counter new trade developments in Asia. In January 2022, the Regional Comprehensive Economic Partnership was established, with China, Japan, the Republic of Korea, Australia, New Zealand and the Association of Southeast Asian Nations (ASEAN) member states as signatories. This overarching trade liberalisation agreement is said to bring most benefits to its largest economies. This deal may also bring benefits to the EU, which is connected by an FTA to such trading hubs as South Korea, Singapore and Vietnam, but without new economic partnerships, the EU’s trading position in the region may weaken considerably over time.

Similarly, the delayed finalisation of the EU-Mercosur Association Agreement puts a question mark over the EU’s ability to act in its strategic interest. The deal, which has been negotiated for 20 years, is set to bind together the two largest economic blocs in the world in a connection of not only economic but also political significance. However, with the persisting doubts about sustainability issues connected to deforestation, agricultural production and labour rights raised by some member states in the EU and increasing impatience of Mercosur countries, the finalisation of the agreement is at a crossroads. It seems we remain in a narrow window of opportunity to conclude the deal before the end of the current political term in Europe. The failure to seal it may deliver a serious blow to the concept of EU strategic autonomy and reinforce existing preferences in the Mercosur countries to conclude an FTA agreement with China instead.

Possible ways forward

The latest geopolitical and economic developments gradually reformulate the organisation of the global economy with some distinctive traits. The consensus around the concept of ongoing global liberalisation of trade is gone. We currently observe a reformulation of globalisation, which more often means regionalisation, a drive towards the defence of national interests and an increasing technological and industrial race. This does not mean a clear withdrawal from open trade and international cooperation; nonetheless, autonomous trade measures are on the rise as the race for access to resources and markets increases. In this environment, EU trade policy will be used more often to increase EU strategic autonomy and support our industrial and climate policy. FTA negotiations may play an important role in this process. Conversely, other means of trade policy may increase their significance in reaching our economic and political goals.

In geopolitical terms, concluding free trade and association agreements with key partners around the world allows the EU to increase its global position, reinforce political relations, and influence and be more efficient in its economic competition with China and the US. Modernised FTAs also allow multiple issues, ranging from trade and procurement through to protection

of intellectual property rights and addressing sustainable development and human rights, to be tackled comprehensively. However, the comprehensive character of these agreements also puts a heavy toll on the negotiating process. With multiple issues to agree and often diverging interests within the EU, finalising FTAs has become challenging in recent years.

The conclusion of trade agreements with the Mercosur bloc, India and Australia is of crucial strategic importance to the EU; these would increase its political and economic autonomy. However, in each of those cases, a quick finalisation is not certain. Recently, negotiations of the FTA with Australia have ceased just before the expected finalisation, due to increased demands on access to the EU agricultural market. In the case of India, provisions on sustainability and public procurement may stand in the way of striking a quick deal, and it seems that only the Mercosur agreement stands a chance of being finalised before the end of this legislative term. The EU is still capable of moving ahead with the trade liberalisation agenda, as the conclusions of agreements with New Zealand and Kenya show. However, we all wait for an agreement that could match the Comprehensive Economic and Trade Agreement (CETA) with Canada in terms of size and significance.

It is probable that, with a slowdown in the adoption of overarching FTAs, the Commission may settle on a more adjusted approach, in which sector-specific bilateral agreements will complement FTAs with selected partners. The recently concluded sustainable investment facilitation agreement with Angola, the EU-Japan deal on data flows or the EU-Canada strategic partnership on raw materials are just a few examples of this concept.

The future of the EU's TSD agenda will most likely be advanced by a two-pronged approach. On the one hand, we should expect the ongoing revision and reform of existing TSD chapters. For instance, the reopening of negotiations on a comprehensive agreement with Switzerland delivers a great opportunity to put forward sustainability provisions, which are absent from this over 50-year-old agreement and do not match the ambitions of both parties in this respect. However, with the possible limitation of the role of new FTAs in the European trade policy mix, internal EU provisions on sustainability are expected to play a more important role in the advancement of our sustainable agenda. We have to be mindful though that imposing unilateral measures may come at a cost to our bilateral relations with partners in the developing world.

We have to make sure that, similarly to trade liberalisation, our sustainable development agenda is not limited to the enforcement of our own convictions but becomes part of a broader trade and development package, which is appealing to our partners. We shall see in the coming months and years whether EU FTAs will still play an instrumental role from this respect.

Negotiations and conclusions of FTAs remain one of the most important tools of EU trade and foreign policy, second only to the enlargement policy. The new political and economic developments around the globe force adjustments to our strategies and tactics, hence imposing new tasks for our trade policy. Providing strategic autonomy, advancing our development agenda and reinforcing the green transformation will all rely on our actions in this field. The way in which we conclude FTAs and association agreements will be an important expression of this new trend.