



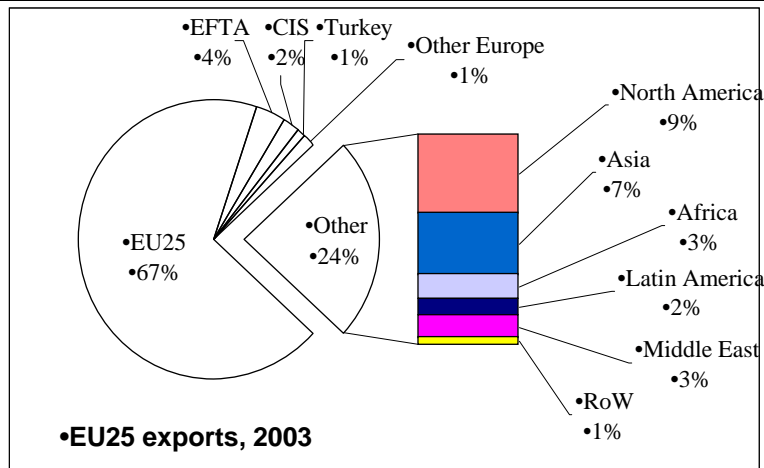
TOPIC 3

EU TRADE POLICY & COMPETITION POLICY

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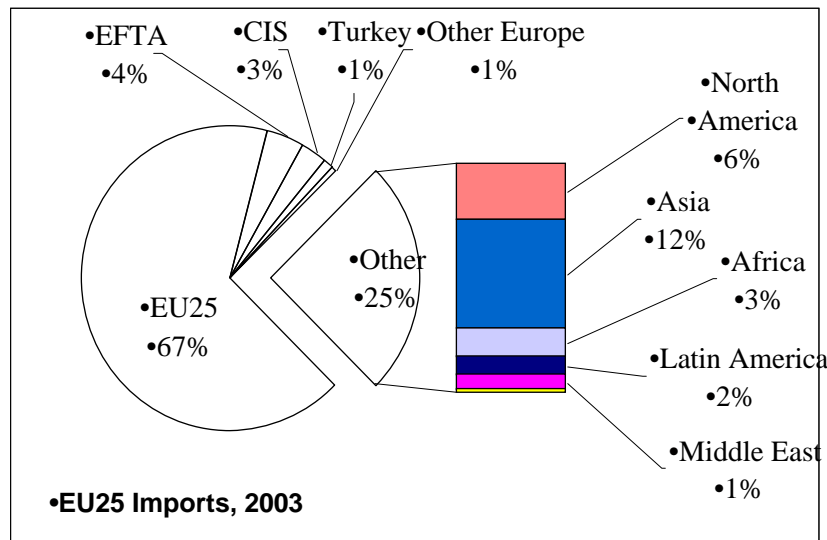
I. Pattern of Trade: Facts



2/3rds EU25 exports are to other EU25 nations.

Add all other European nations, 3/4th of Europe's trade is within Europe..

North America and Asia are the EU25's main markets outside Europe, each accounts less than 1/10th EU exports.



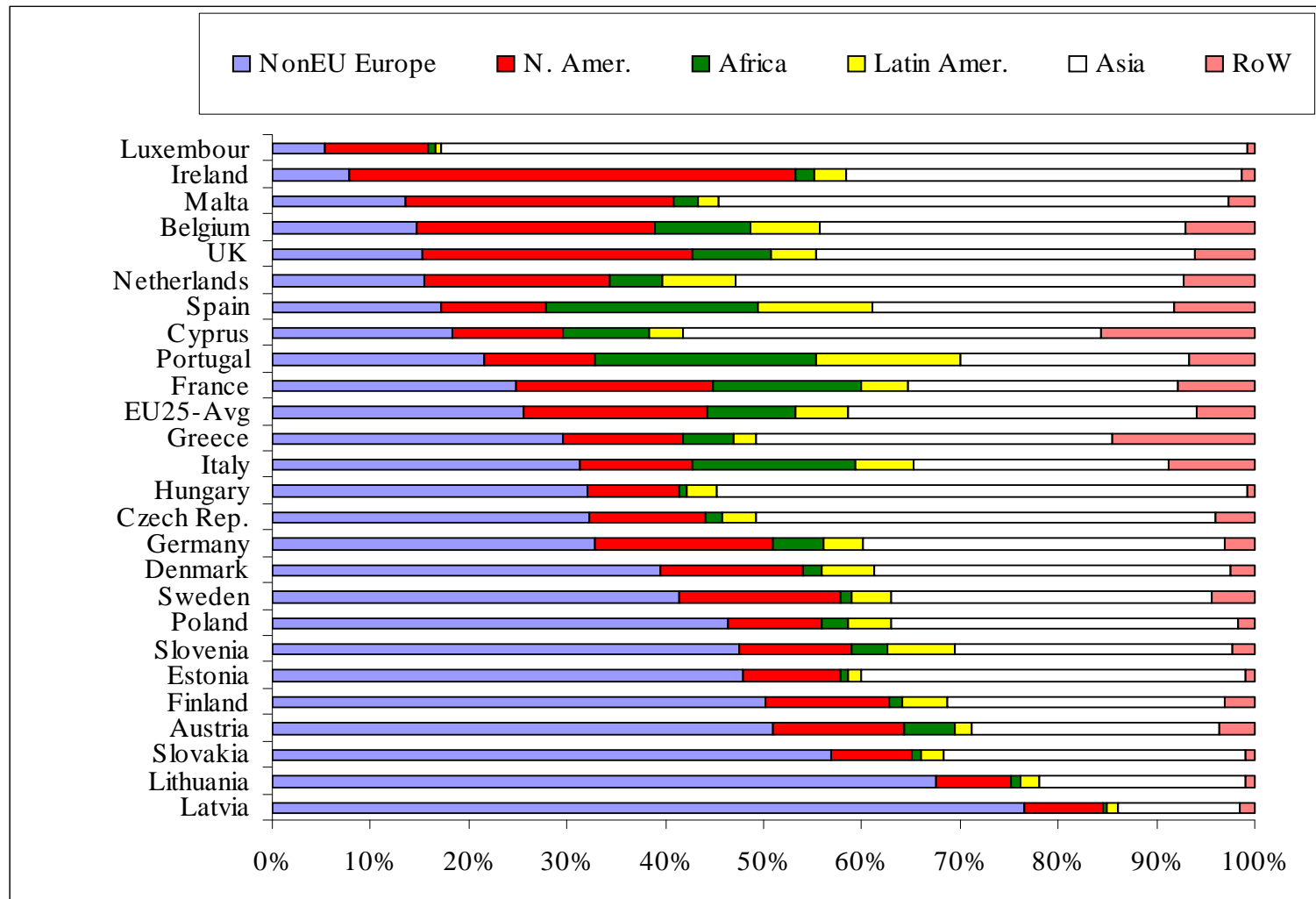
Africa, Latin America and the Middle East are not very important.

The pattern on the import side is very similar:

Rounding off, 3/4ths 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.

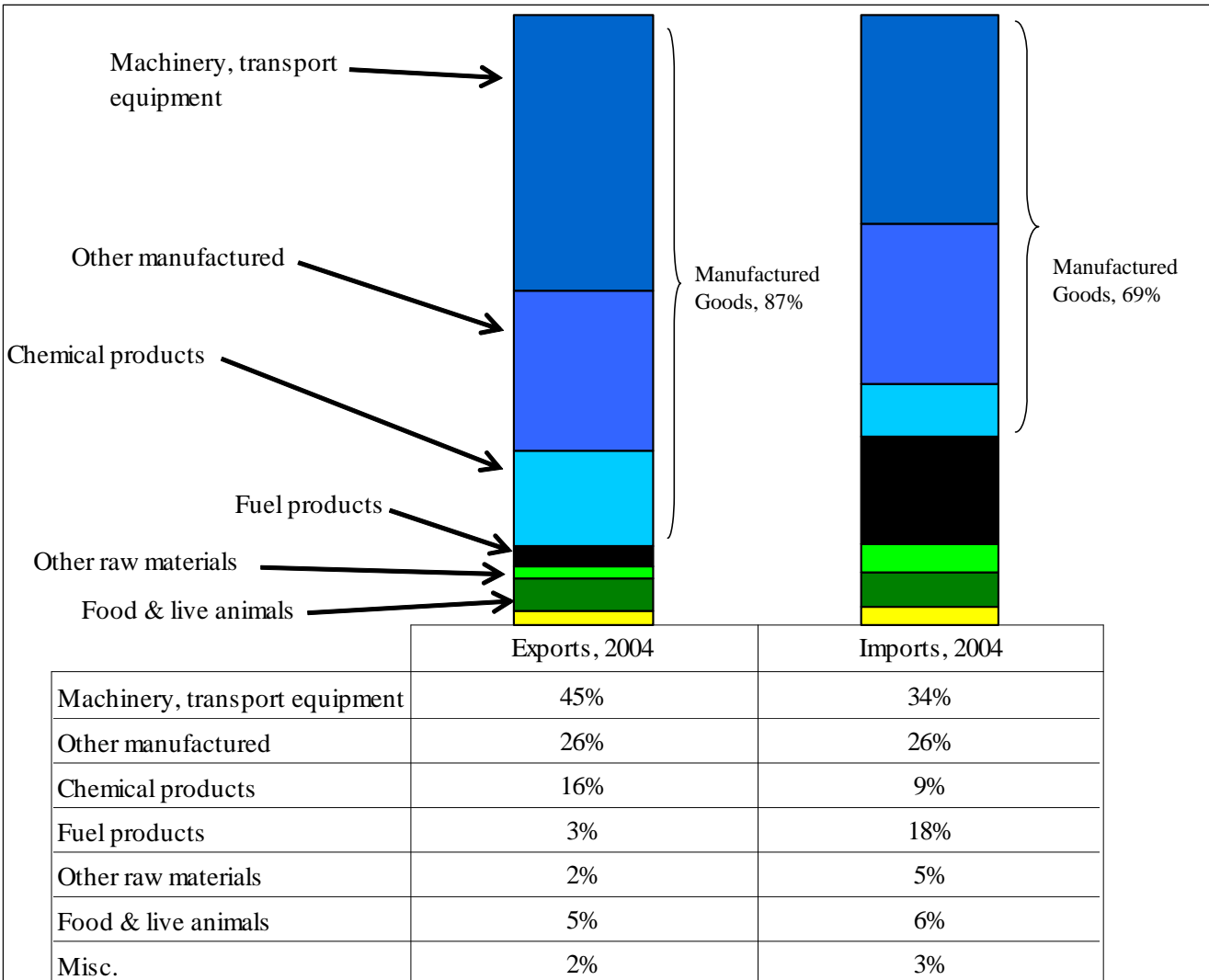


I. Pattern of Trade: Differences among Member States





I. Pattern of Trade: Composition imports & exports



Manufactured goods 90% (half of all exports being machinery and transport equipment).

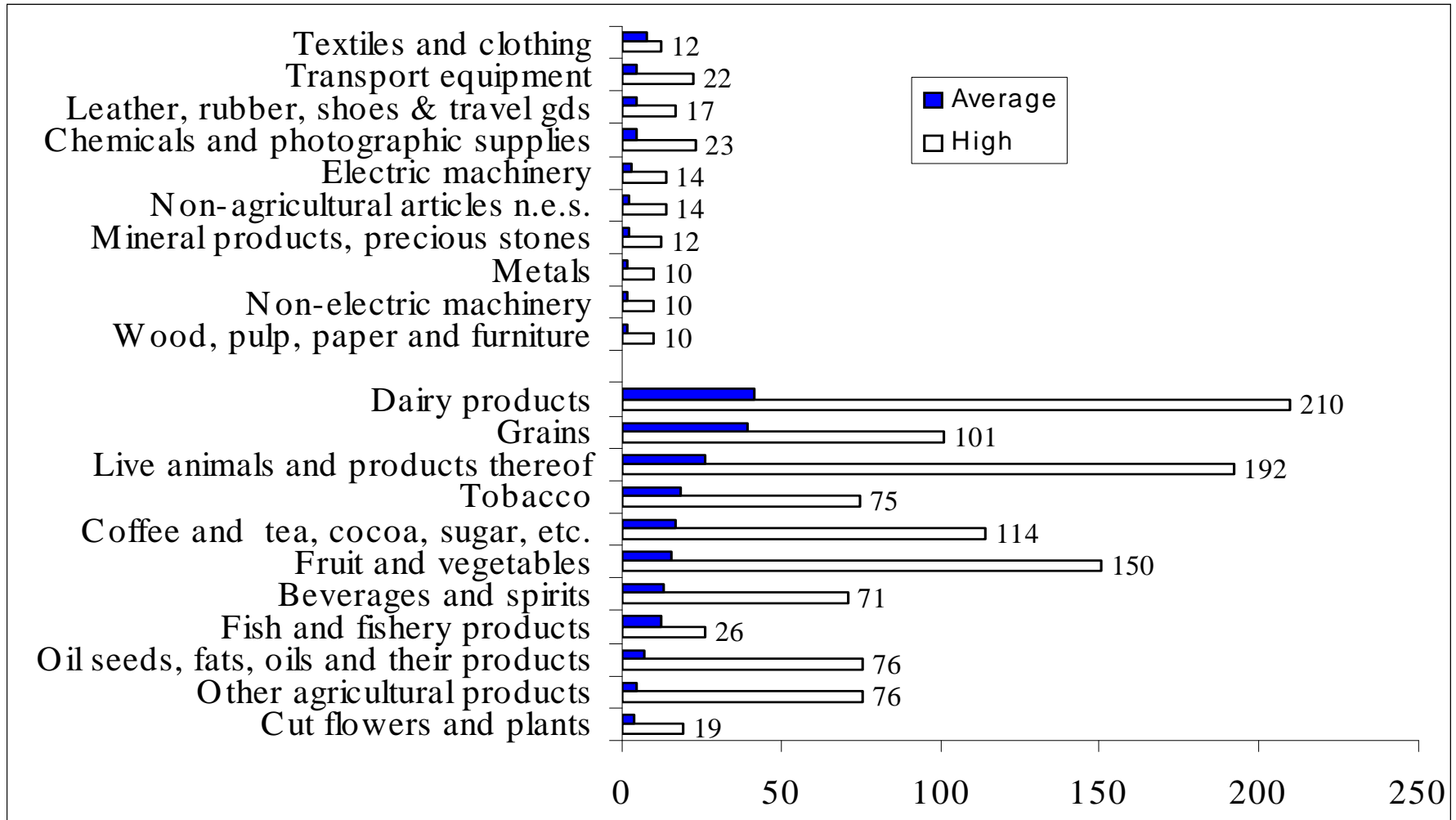
Import side, 2/3rds on manufactured goods.

EU25 is a big importer of fuel.

Other types of goods play a relatively minor part in the EU's trade.



I. Pattern of Trade: Common External tariff





II. Institutions

- Trade policy is an exclusive competency of EU.
Customs Union requires agreement.
- Trade in goods: Commission has responsibility for negotiating, Council of Ministers sets “Directives for Negotiation.”
Peter Mandelson (Trade Commissioner).
Council accepts/rejects final deal by QMV.
- Commission in charge of surveillance and enforcement of 3rd nation commitments to EU.
Trade disputes with US, China, etc.



II. Institutions

World trade negotiations involve far more than trade in goods.

TRIPs, Services, TBTs, trade facilitation, etc.

Rome Treaty only gave Commission power over trade in goods.

Treaty of Nice (& Amsterdam) extended Commission's authority to some aspects of Services trade and TRIPs, & made QMV the rule in Council on such matters.

“Parallelism” -> if the issue would be subject to QMV in Single Market considerations, it's subject to QMV on trade matters.

Constitutional Treaty expanded Commission authority to include FDI & more role of Parliament.



II. Institutions

WTO allows members to raise tariffs to:
Counter 'unfair' trade practices, e.g.

- Antidumping
- subsidies

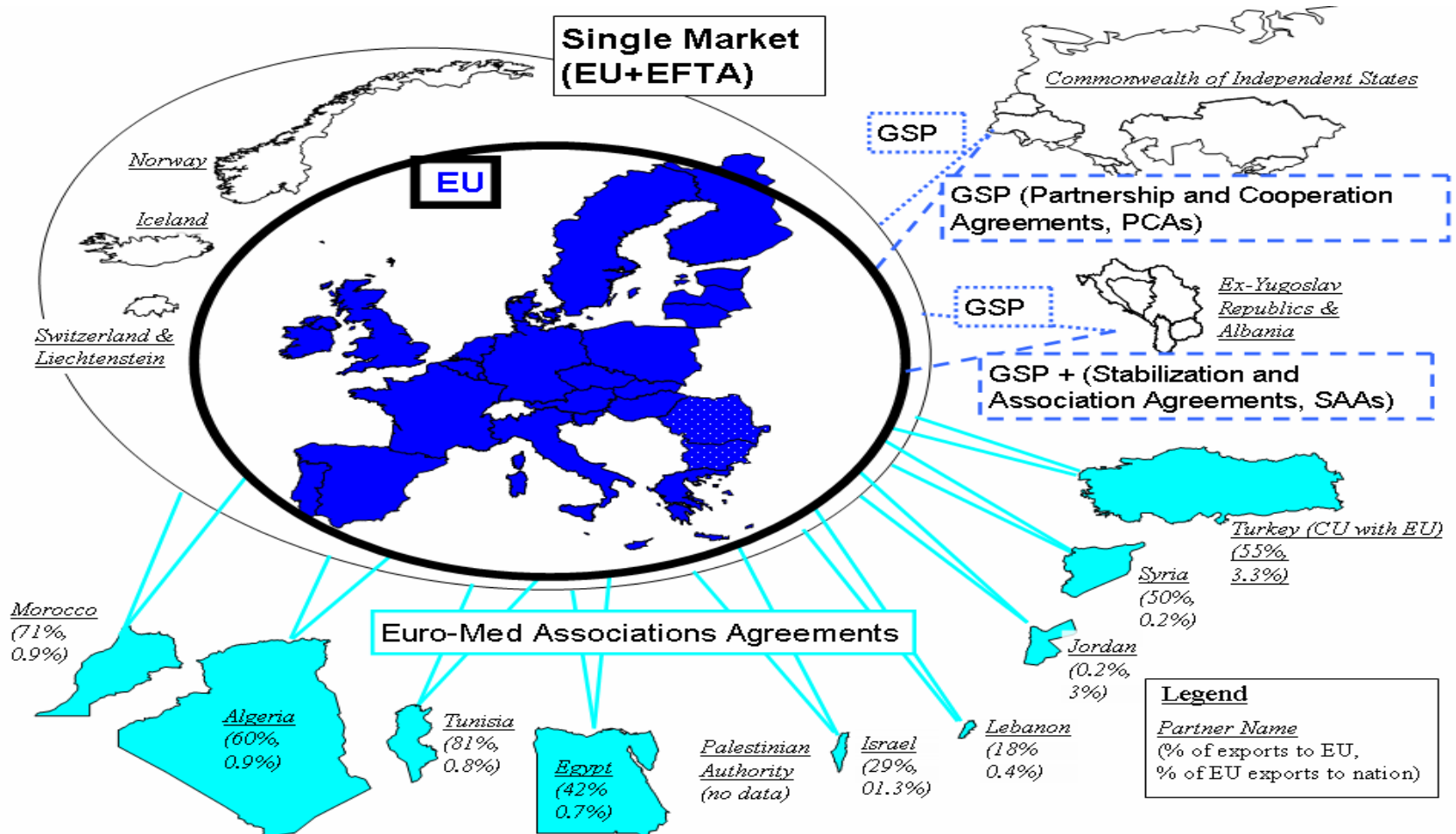
Provide temporary protection “safeguards.”

The various WTO articles on these require a procedure; in EU the Commission is in charge of these procedures, but the final decision is subject to QMV approval of the Council.



III. EU External Trade Policy

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





III. EU External Trade Policy

1. European-Mediterranean area:

West, Central and East Europe = Single market in industrial goods;
EU + EEA + Swiss bilateral agreements

Euro-Med Association Agreements: Morocco, Algeria, Tunisia, Egypt, Israel, the Palestinian Authority, Lebanon, Jordan, Syria and Turkey.
Asymmetric (EU cuts its tariffs faster) FTAs in manufactures, by 2010.

Turkey unilaterally in Customs Union in manufactures.

Asymmetric dependence (e.g. 70% of Morocco's exports to EU, but <1% of EU to Morocco)

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



III. EU External Trade Policy

•2. 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.

Stabilisation and Association Agreements (SAAs).

- Former Yugoslavian states.
- Croatia has started membership; others likely to follow.



III. EU External Trade Policy

- 3. Preferential agreements with former colonies
- Colonial preferences conflicted with Common External Tariff
 - EU made exception for these nations to avoid imposing new tariffs; signed “unilateral PTAs”

“ACP nations” (Africa, Caribbean & Pacific);

the new agreement = Lomé Convention.

Duty-free but subject to quota for sensitive items (sugar, banana).

These didn't help ACP nations (Asian success w/o preferences).

- When Lomé Convention renewed in 2000, the EU and the ACP nations agreed to modernise the deal.
- Cotonou Agreement; eventually reciprocal free trade.



IV. Generalization System of Preferences

- EU grants GSP to almost all poor nations.
- General GSP.
- “Super-GSP” more generous on market access.
- ‘Everything but Arms’ for least developed nations.
- On paper, EBA grants zero-tariff access all goods, except arms and munitions.
 - Goods in which these nations’ are most competitive are excluded
 - Tariffs on bananas, rice and sugar are to come down only in the future.
 - Exports quantities are limited by bilateral quotas.
- 49 nations qualify for EBA in principle in 2005.



V. Non-regional FTAs & Non-preferential trade

Non-regional FTAs agreement

Mexico, Chile, and South Africa, done.

Ongoing with Mercosur, & the Gulf Cooperation Council
(Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE).

Non-preferential trade

About 1/3 EU imports are not granted some sort of
preferential treatment (US, Japan, etc.).

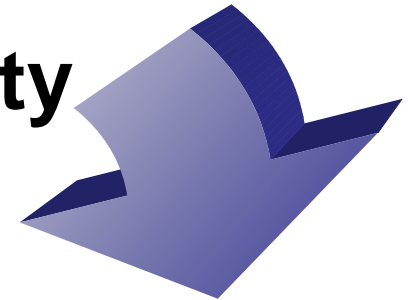


VI. Individual attitudes towards globalisation

Globalization



**Economic
insecurity**



**Demand for
Social welfare**

**Reduction in opposition
to globalization**



**Social
welfare**





VI. Individual attitudes towards globalisation

Attitudes toward globalization

Individual Interests

Labour market
concerns

Ideology &
National identity

General
globalization effects

National &
regional concerns



VI. Individual attitudes towards globalisation

- Stolper-Samuelson Model

Assumptions:

- *Two factors of production (K and L).*
- *Used for the production of final goods.*
- *Capital intensive or labor intensive goods.*
- *Capital-abundant or labor-abundant countries.*
- *Technologies are the same across countries.*



VI. Individual attitudes towards globalisation

Results of the model

- *Trade affects prices, wages and rents.*
- *Trade is nationally advantageous.*

- *Capital abundant countries will export capital intensive goods.*

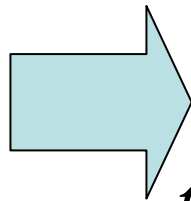


VI. Individual attitudes towards globalisation

- Stolper-Samuelson Theorem

If the price of the capital-intensive good rise, then the price of the capital, the factor used intensively in that industry, will rise, while the wage rate paid to labor will fall.

Inference



A movement to free trade will cause the real return of a country's relatively abundant factor to rise, while the real return of the country's relatively scarce factor will fall.



VI. Individual attitudes towards globalisation

- **Example**

Support to globalization in the EU.

Data from the European Commission 2003.

6778 individuals from the EU



VI. Individual attitudes towards globalisation

Support globalization	Countries	Regions
Gender	-0.0071	-0.0073
Age	-0.0191***	-0.0189***
Age squared	0.0002***	0.0002***
Skill	-0.0348***	-0.0238***
Skill* skill area	0.0017***	0.0011
Employee	-0.0790	-0.0765
Manual worker	-0.1421**	-0.1330**
Non-active	-0.0621	-0.0593
Urban area	0.0308	0.0404
Rural area	0.0761**	0.0842**



VI. Individual attitudes towards globalisation

Support globalization	Low-skill	High skill
Gender	0.0818**	-0.1073***
Age	-0.0234***	-0.0160**
Age squared	0.0002***	0.0002***
Skill	-0.0097***	0.0045
Employee	-0.0302	-0.1568**
Manual worker	0.0059	-0.3096***
Non-active	-0.0269	-0.1204
Urban area	0.0732	-0.0176
Rural area	0.1270**	0.0109



VI. Individual attitudes towards globalisation

ISSP 2003: “National Identity II”. Ordinal probit

¿Should your country limit imports?

1 Totally agree

2 Agree

3 NA

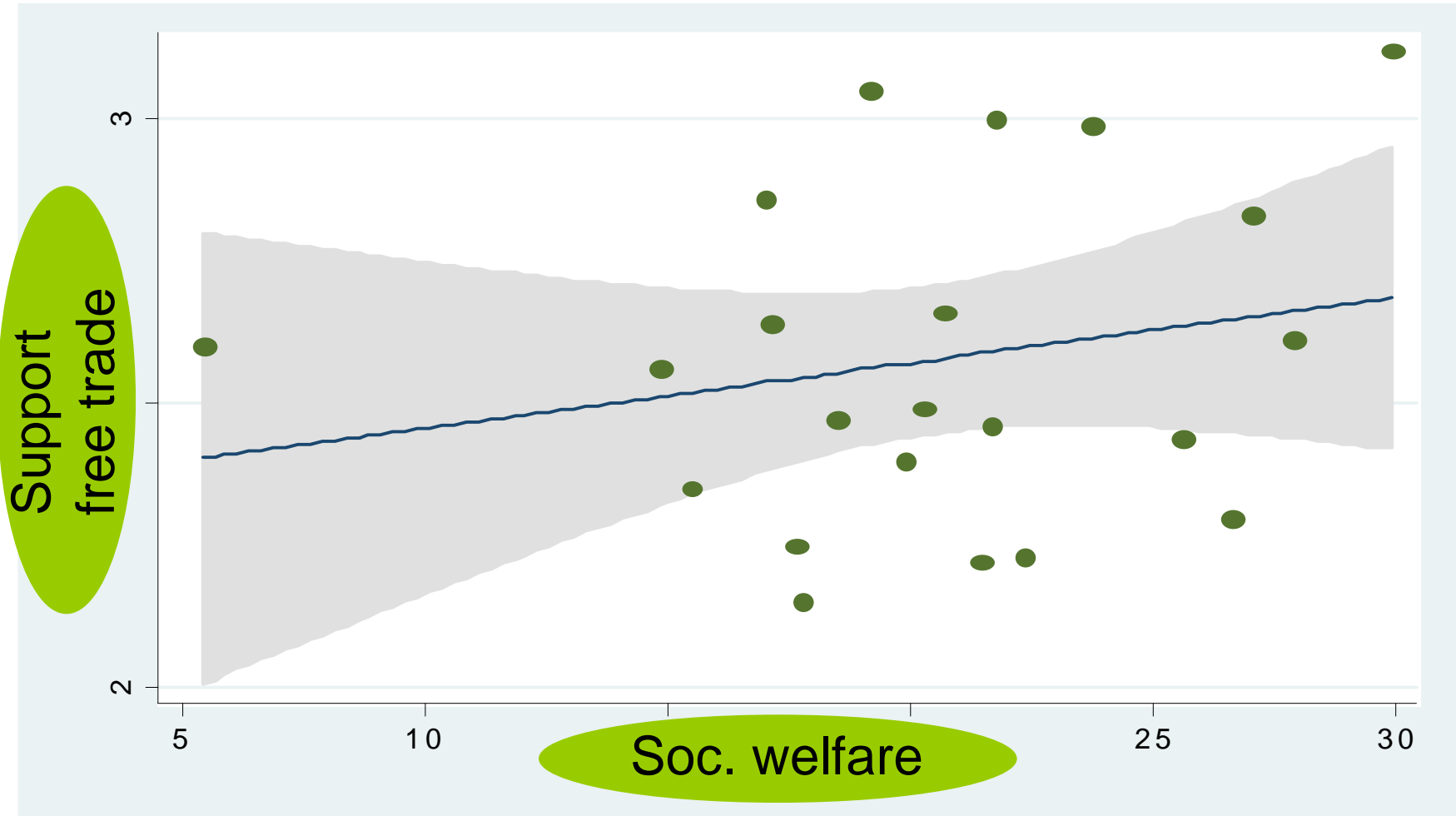
4 Disagree

5 Totally disagree

	Country model	Regional model
Skill	-0,04**	-0,03**
Skill*country skill	0,01**	
Skill*regional skill		0,01**



VI. Individual attitudes towards globalisation





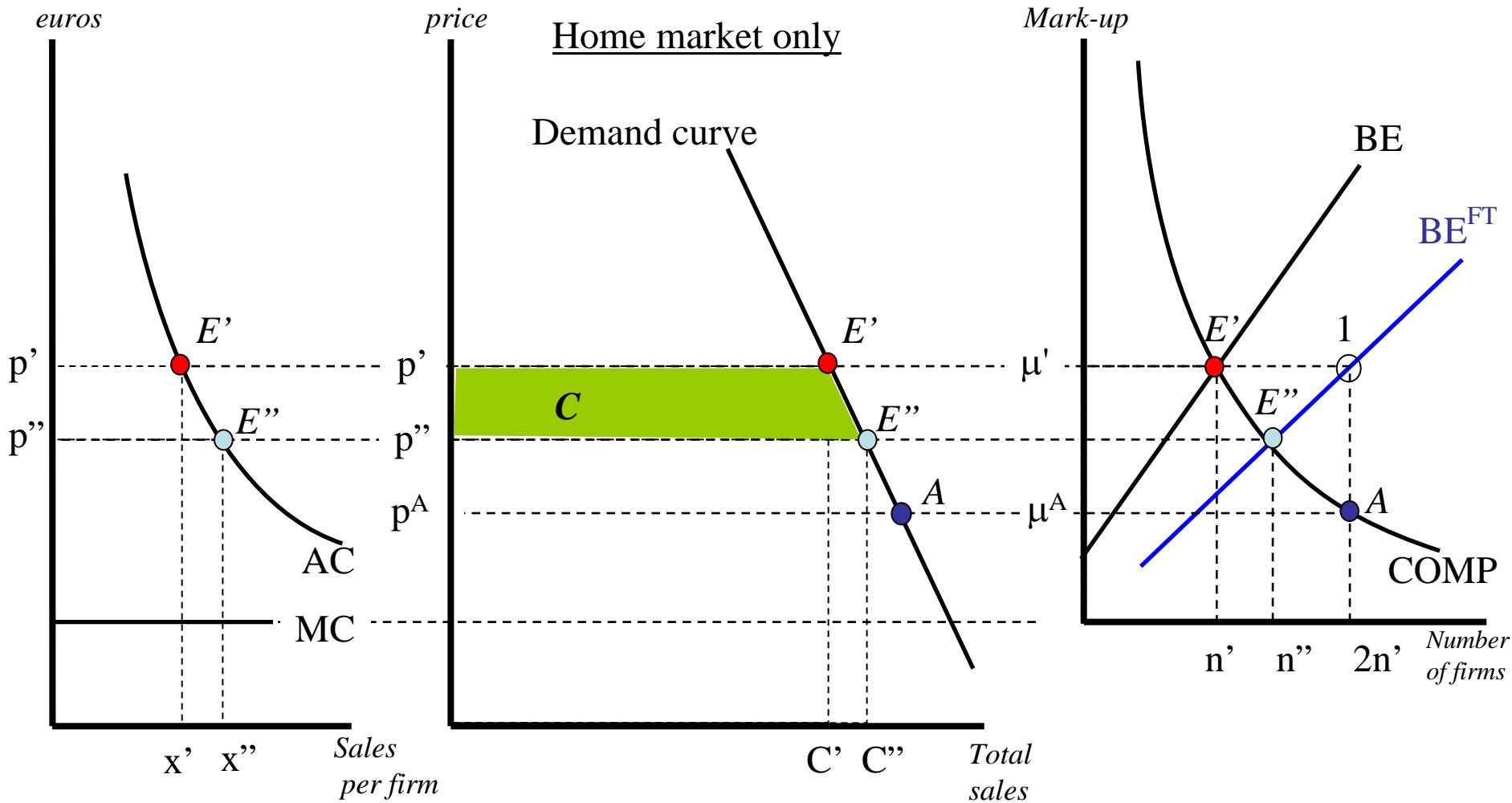
VII. EU Competition and state aid policy

- Exclusive competency of EU; Commission controls.
- 2 aspects: mergers & anti-competitive behaviour.
- Look at justification for putting competition policy at the EU level.
 - Spillovers (negative effects of one Member's subsidies on other Members' industry).
 - Need belief in 'fair play' if integration is to maintain its political support.
 - Witness recent 'protectionist' tendency of Member States to prevent foreign takeovers.



II. Market Size and Scale Effects

No-trade-to-free-trade integration





VII. EU Competition and state aid policy

- Integration: no-trade-to-free-trade: BE curve shifts out (to point 1).
- Defragmentation:
 - PRE typical firm has 100% sales at home, 0% abroad; POST: 50-50 .
- Pro-competitive effect:
 - Equilibrium moves from E' to A: Firms losing money (below BE),
 - Pro-competitive effect = markup falls, and short-run price impact p' to p^A .
- 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.



VII. EU Competition and state aid policy

- 2 immediate questions
 - “As the number of firms falls, isn’t there a tendency for the remaining firms to collude in order to keep prices high?”
 - “Since industrial restructuring can be politically painful, isn’t there a danger that governments will try to keep money-losing firms in business via subsidies and other policies?”
- The answer to both questions is “Yes”.



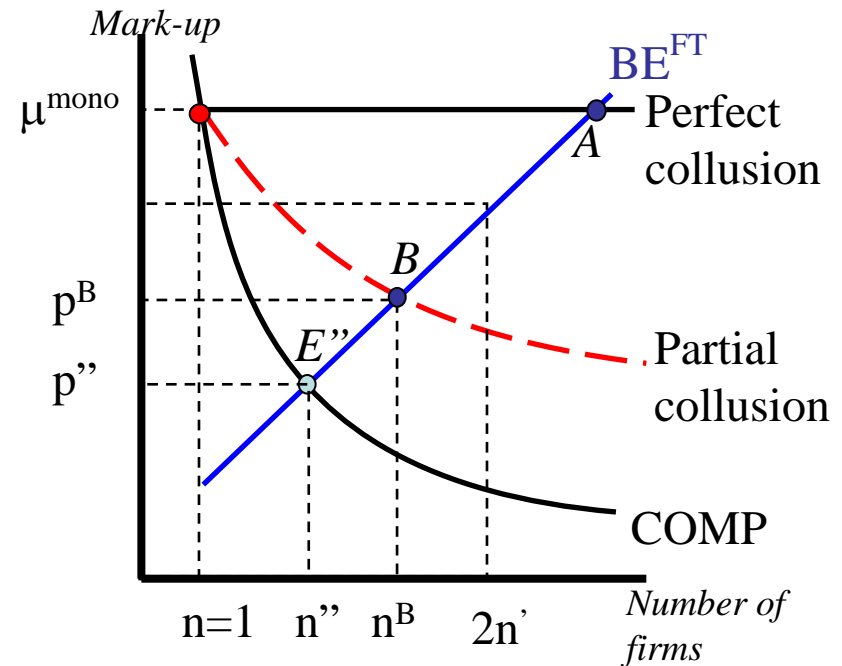
VII. EU Competition and state aid policy

- Collusion is a real concern in Europe.
 - dangers of collusion rise as the number of firms falls.
- Collusion in the BE-COMP diagram.
 - COMP curve is for ‘normal’, non-collusive competition
 - Firms do not coordinate prices or sales.
- Other extreme is ‘perfect collusion’.
 - Firms coordinate prices and sales perfectly.
 - Perfect collusion is where firms charge monopoly price and split the sales among themselves.



VII. EU Competition and state aid policy

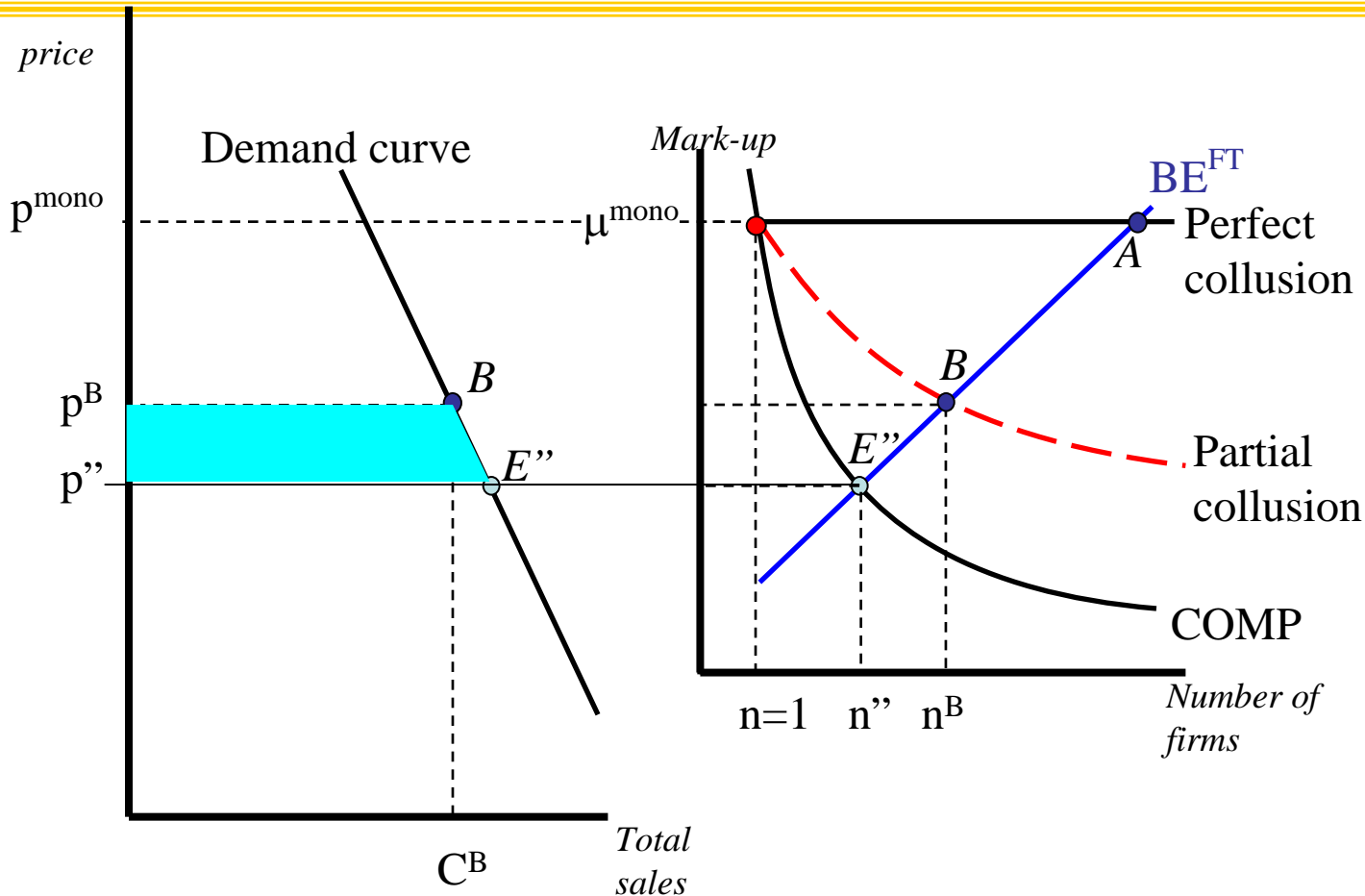
- Collusion will not in the end raise firm's profits to above-normal levels.
 - Industrial consolidation proceeds as usual, but only to n^B . Point B Zero profits earned by all.
- prices higher, $p^B > p''$, smaller firms, higher average cost.





VII. EU Competition and state aid policy

- The welfare cost of collusion (versus no collusion).
 - four-sided area marked by p^B , p'' , E'' and B.





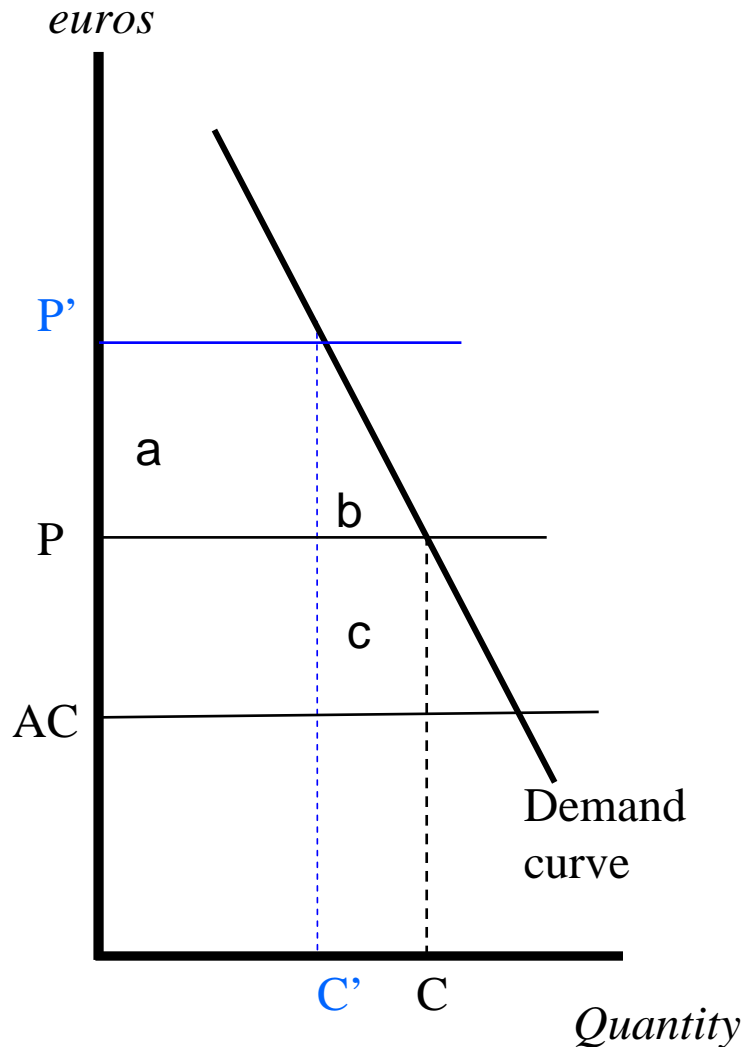
VII. EU Competition and state aid policy

- 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.



VII. EU Competition and state aid policy

a) Economic of cartels



- Suppose price without cartel would be P .
- Cartel raises price to P' .
- $\Delta CS = -a - b$; 'ripoff'
- $\Delta PS = +a - c$
- Net welfare = $-b - c$;
"technical inefficiency"



VII. EU Competition and state aid policy

a) Economic of cartels

- In 2001, Commission fined 8 companies for vitamins cartels
 - vitamins A, E, B1, B2, B5, B6, C, D3, Biotin, Folic acid, Beta Carotene and carotinoids
- The European vitamins market is worth almost a billion euros a year.
- The firms fixed prices, allocated sales quotas, agreed on and implemented price increases and issued price announcements in according to agreed procedures.
- They set up a mechanism to monitor and enforce their agreements and participated in regular meetings to implement their plans.
- Hoffman-La Roche of Switzerland (cartel ringleader) received the largest fine (462m euros); BASF and Merck (Germany), Aventis SA (France), Solvay Pharmaceuticals (the Netherlands), Daiichi Pharmaceutical, Esai and Takeda Chemical Industries (Japan).



VII. EU Competition and state aid policy

b) Exclusive territories

- More common anti-competitive practice is ‘exclusive territories’.
- Nintendo example; high prices in Germany vs UK.
 - Germany’s inelastic demand meant Nintendo wanted to charge a higher price than in UK.
 - Normally Single Market limits this sort of price discrimination (arbitrage by firms).
- Nintendo implemented a system that prevented arbitrage within the EU (illegal).
 - European Commission fined Nintendo and the 7 distributors 168 million euros.



VII. EU Competition and state aid policy

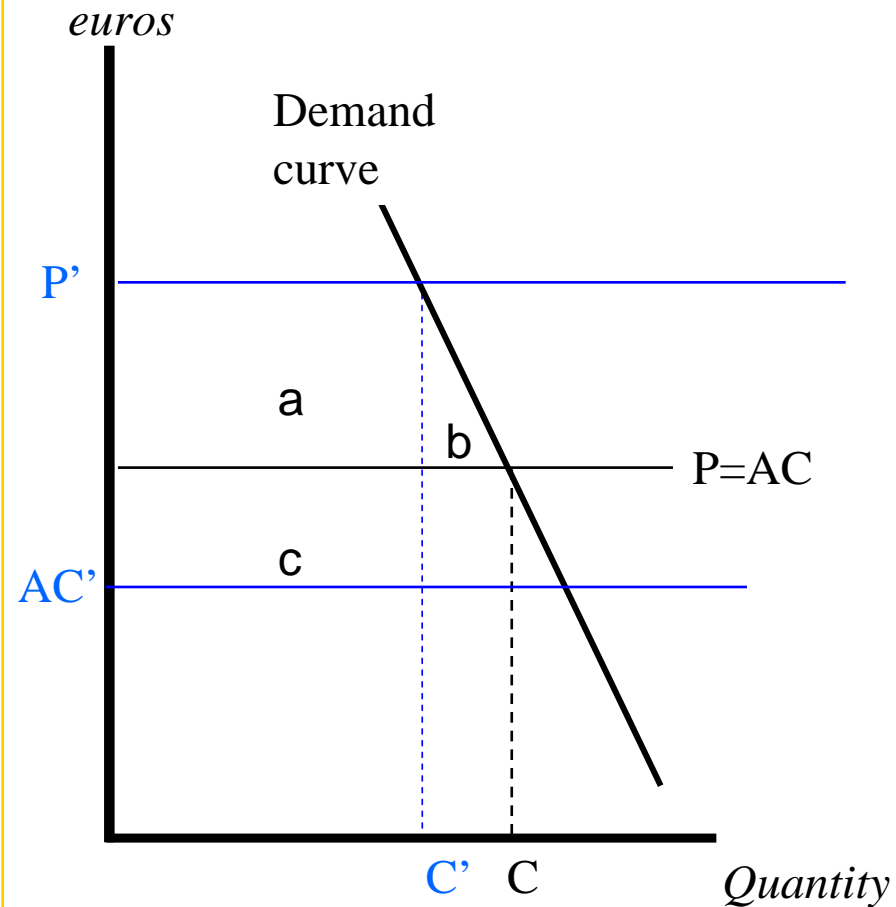
c) abuse of dominant position

- Firms that are lucky or possess excellent products can establish very strong positions in their market.
- Not a problem, per se:
 - position may reflect superior products and/or efficiency,
 - e.g. Google's triumph.
- However dominance may tempt firm to extract extra profits from suppliers or customers.
- Or arrange the market to shield itself from future competitors.
- Illegal under EU law 'abuse of dominant position.'
- e.g. Microsoft with media software:
 - Charge high price of Word, etc. where the competition has been driven out of biz (WordPerfect, etc.), but give for free all software where there is still competition.



VII. EU Competition and state aid policy d) merger control

- Initially $P=AC$.
- Merger implies lower AC to AC' , but raises the price to P' .
- $\Delta CS = -a - b$; 'ripoff'.
- $\Delta PS = +a + c$.
- Net welfare = $-b + c$; ambiguous, 'efficiency defence'.
- Laissez-faire; if free entry then eventually P driven down to AC' .

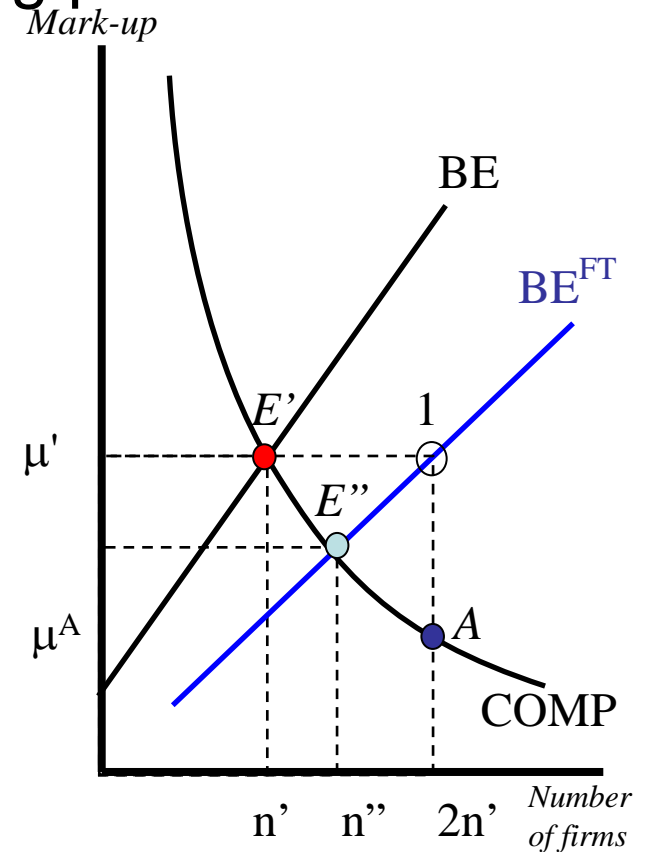




VII. EU Competition and state aid policy

e) State aid: restructuring prevention

- Consider subsidies that prevent restructuring.
- Specifically, each government makes annual payments to all firms exactly equal to their losses:
 - i.e. all $2n'$ firms in Figure 6-9 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.





VII. EU Competition and state aid policy

e) State aid: 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 liberalisation.



VII. EU Competition and state aid policy

EU policy on State aid

- 1957 Treaty of Rome bans state aid that provides firms with an unfair advantage and thus distorts competition.
- EU founders considered this so important that they empowered the Commission with enforcement.