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EUROPEAN ECONOMIC POLICY (FIRST PART)

2° BIEM/BIG

2023-2024 Edition

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European Economic Policy

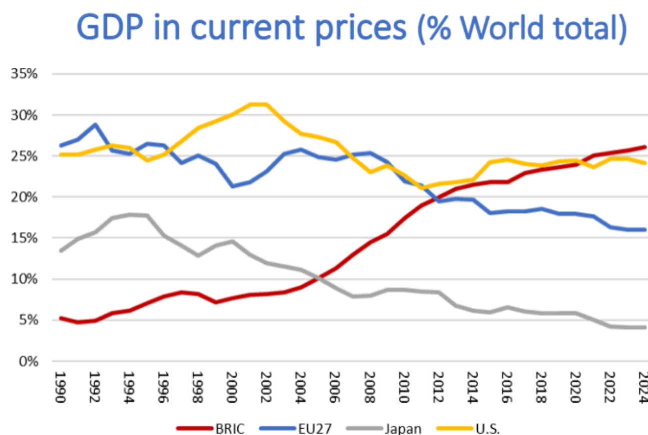
Which are the three main economies in the world?

- China
- Europe
- US

Which is the largest in terms of population? China
and in terms of GDP per capita? US
In the middle stands the EU.

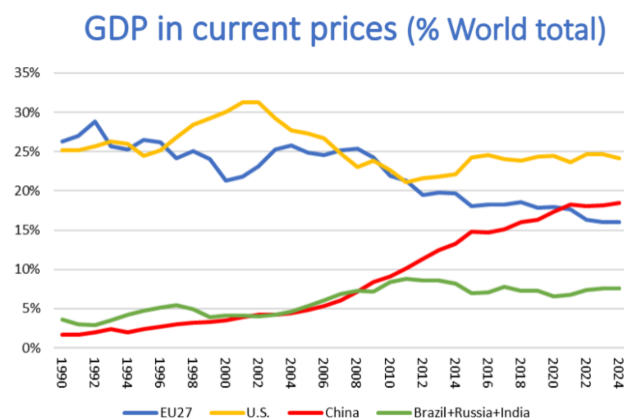
US 26 bl 70k	EU 17 bl 37k	China 19 bl 13k

The graph is telling us that:

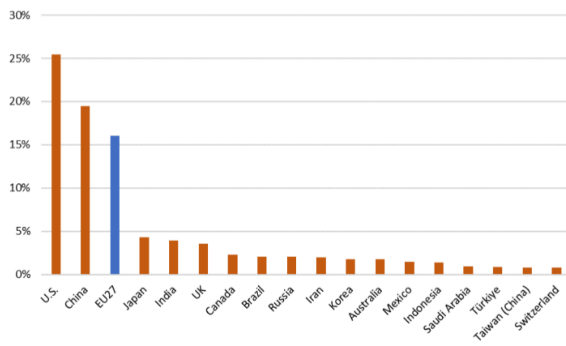


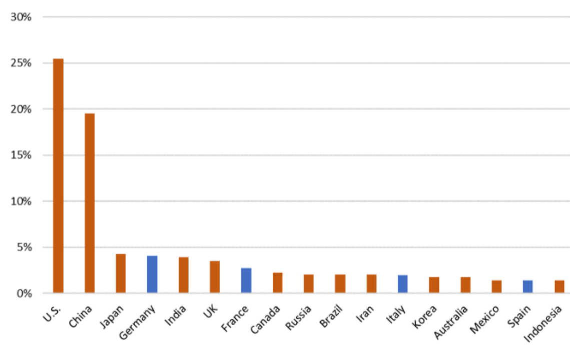
the portion of gdp for each country considering the world gdp and how it changed over time.
BRIC: Brazil, Russia, India and China

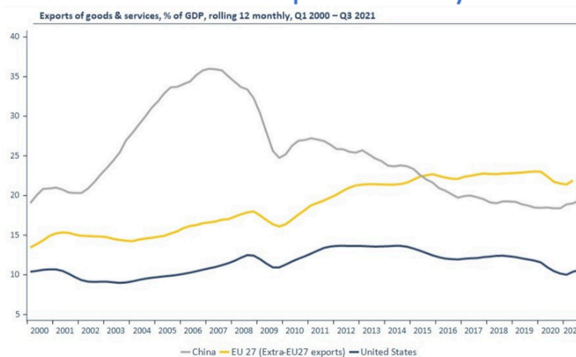
The main takeaway is that Brazil and China had the largest growth in share of gdp compared to the other countries. → The big chunk of increase was due to China.
by disentangling China we get a more accurate reading.



The size of the country matters. If we think of the EU as a purely economic union this is our ideal economic activity.
but by splitting each country by its respective role then the proportion changes. The real share of the world GDP for each country in the EU is much smaller so the negotiating power (regarding contracts and commercial tariffs) changes.







The EU relies on exports, the most exports-heavy economy in the world.
The US and EU have very different percentages of GDP based on exports of goods and services.
This is very striking with respect to what China did in the last 20 years.
In 2000-2001 the dynamic changed for China, when they joined the WTO, world trade organization. It is a group of countries that decided to lower tariffs between them.

The EU in the Global Arena

- The EU accounts today for around **7% of the world population**, but around 22%of world GDP (19% without the UK), similar to the US, and China.
- But it also accounts for **50% of total welfare expenditure** in the world
- The EU generates between 20 to 25% of world trade flows (not including intra-EU trade, in which case the number increases to 35%)
- Through its single currency, the Euro, the overall size of EU financial markets is about 120% of the US one, with 50% of world bank assets

Bottom Line: The EU is one of the three large markets of the world, the largest trading partner, and a key player in financial markets, with the most advanced welfare system and living standards.
Much work is needed to preserve and improve on all this!

EU Development

Widening: increase in number of members	**Deepening**: policy integration

The early steps

At the end of WWII, European leaders wanted to avoid a new similar tragedy ⇒ nationalism had to be defeated by creating something like the United States of Europe.
The U.S. offered financial assistance if countries agreed on a joint programme for economic reconstruction ⇒ **the Marshall Plan (1948):**

As the Cold War got more war-like, West German rearmament became necessary. But strong and independent Germany was a scary thought for many; best to embed an economically and militarily strong West Germany into a supranational Europe.

Two crucial steps (Treaties):

1. ***European Coal and Steel Community***

(Treaty of Paris, 1951): Belgium, France, Germany, Italy, Netherlands and Luxembourg (the 'Six') place their coal and steel sectors under the control of a supranational authority => controlling German rearmament.

2. ***European Economic Community***

(Treaty of Rome, 1957): riding on the success of the ECSC, the Six committed to form a customs union with four fundamental freedoms and common policies.

By the late 60s

EEC 6 = European Economic Community,
members:Belgium, France, Italy,Luxembourg, Netherlands and West Germany.

EFTA 7 = European Free Trade Agreement,
members: Austria,Denmark, Norway, Portugal,Sweden, Switzerland and the United Kingdom.

Evolution to two concentric circles

Falling trade barriers within the EEC and within EFTA lead to discrimination
(e.g., British firms exporting to Germany had to pay tariffs; French exports to Germany were tariff-free).

- The GDP (i.e., potential market size) of the EEC was much larger than that of EFTA, and EEC incomes were growing twice as fast.
- Thus, the EEC was far more attractive to exporters and this led to new political pressure for EFTA nations to join the EEC.
- The UK applied for membership in 1961 and Denmark, Ireland, and Norway also followed since they would otherwise face stronger discrimination (other EFTA nations did not apply because of political reasons).
- Charles De Gaulle stopped UK membership twice in the 60s. Ultimately

Denmark, Ireland, and UK joined in 1973 , while Norwegians said no in a referendum

With the first enlargement (1973), the EEC moved from 6 to 9 members while the EFTA maintained 7 members thanks to the entrance of Iceland and Finland (however much smaller than Denmark and the UK).

The Domino effect and the expansion of the EEC

- Thanks to positive political developments, Greece joined in 1981 (EEC10), Spain and Portugal in 1986 (EEC12).
- Deeper integration in EEC strengthened the 'force for inclusion' in remaining EFTA nations.
- **The European Economic Area (EEA)** initiative was launched in 1989 to extend the European single market of the EEC to remaining EFTA nations. Today, the EEA is made of 27 members of the EU and three of the four member states of the EFTA (Iceland, Liechtenstein and Norway).
- **The fourth enlargement** adds Austria, Finland, Sweden in 1995 and leads to the EC15 (With the Maastricht Treaty, 1993, the EEC was renamed the European Community to reflect that it covered a wider range than economic policy).

The fall of the Berlin Wall and the Soviet Union

At the end of WWII, while the U.S. was providing aids to western Europe under the Marshall Plan, the Soviets had installed left-wing governments in the countries of eastern Europe liberated by the Red Army.

> **The Warsaw Pact** was a collective defence treaty established by the Soviet Union and Albania, Bulgaria, Czechoslovakia, East Germany, Hungary, Poland and Romania. The Warsaw Pact embodied what was referred to as the Eastern bloc, while **NATO** and its member countries represented the Western bloc.

This changes at the end of the 80s:

- End of 1989: democracy in Poland, Hungary, Czechoslovakia; fall of the Berlin wall (built in 1961).
- 3 October 1990: German re-unification.
- End of 1990: independence of Estonia, Latvia and Lithuania;
- End of 1991: the Union of Soviet Socialist Republics (USSR) itself breaks up.

The Cold War ends and, with it, the military division of Europe ends.

Reuniting East and West Europe

At first, no promise of membership but **free trade agreements with promises of deeper integration** and some financial aid.

In June 1993 the European Council set the **Copenhagen criteria** for accession of Central and Eastern European Countries (CEECs):

1. Political stability of institutions that guarantee democracy, the rule of law, human rights and respect for and protection of minorities;
2. A functioning market economy capable of dealing with the competitive pressure and market forces within the Union;
3. Acceptance of the Community 'acquis' (EU law in its entirety) and the ability to take on the obligations of membership.

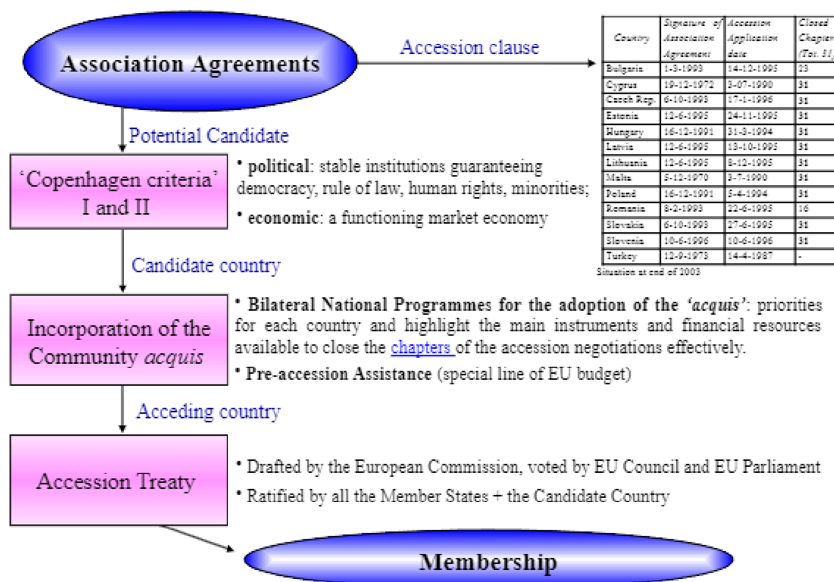
CEEC nations plus Cyprus and Malta joined the EU in 2004 followed by Romania and Bulgaria in 2007.

⇒ The three Copenhagen criteria still apply today.

Becoming a member of the EU

If a country wants to join the EU:

1. The **country must be "European"** (art. 49 TEU) and should sign an Association agreement with an accession clause.
2. The country must send the application that needs to be **approved by the Council of the EU** (unanimity) after consulting the Commission and after receiving the consent of the European Parliament.
3. The country must meet the first two "**Copenhagen criteria**":
    1) political stability of institutions that guarantee democracy, the rule of law, human rights and respect for and protection of minorities;
    2) a functioning market economy capable of dealing with the competitive pressure and market forces within the Union.
4. The country must incorporate the "**Community acquis**", i.e. EU law in its entirety, (the third "Copenhagen criterion") currently divided into 35 different policy fields (chapters) - such as transport, energy, environment - each of which is negotiated separately.
5. **The Accession Treaty,** drafted by the Commission, must be voted by the Council of the EU and the European Parliament, and ratified by all the Member States + the Acceding Country.



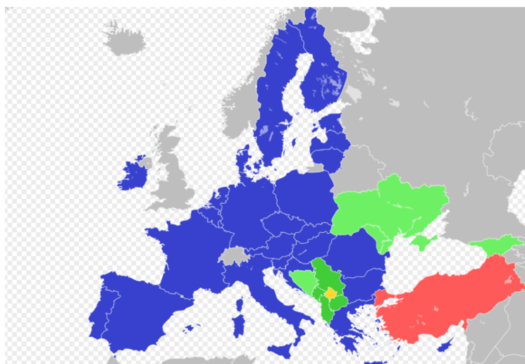
Country	*Signature of Association Agreement*	*Accession Application date*	*Closed Chapters (Tot. 31)*
Bulgaria	1-3-1993	14-12-1995	23
Cyprus	19-12-1972	3-07-1990	31
Czech Rep.	6-10-1993	17-1-1996	31
Estonia	12-6-1995	24-11-1995	31
Hungary	16-12-1991	31-3-1994	31
Latvia	12-6-1995	13-10-1995	31
Lithuania	12-6-1995	8-12-1995	31
Malta	5-12-1970	3-7-1990	31
Poland	16-12-1991	5-4-1994	31
Romania	8-2-1993	22-6-1995	16
Slovakia	6-10-1993	27-6-1995	31
Slovenia	10-6-1996	10-6-1996	31
Turkey	12-9-1973	14-4-1987	-

Situation at end of 2003

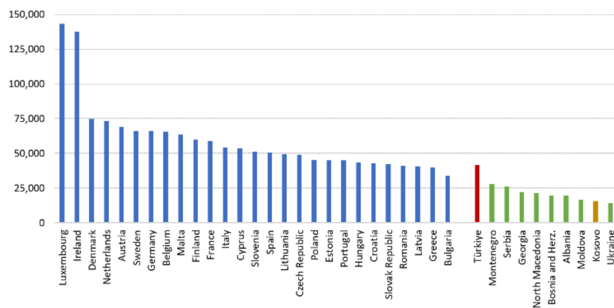
- Throughout the negotiations, the **Commission monitors** the candidate's progress in applying EU legislation and meeting its other commitments, including any benchmark requirements.
- This gives the candidate additional guidance as it assumes the responsibilities of membership, as well as an assurance to current members that the candidate is meeting the conditions for joining.
- The Commission also keeps the EU Council and European Parliament informed throughout the process, through regular reports, strategy papers , and clarifications on conditions for further progress.

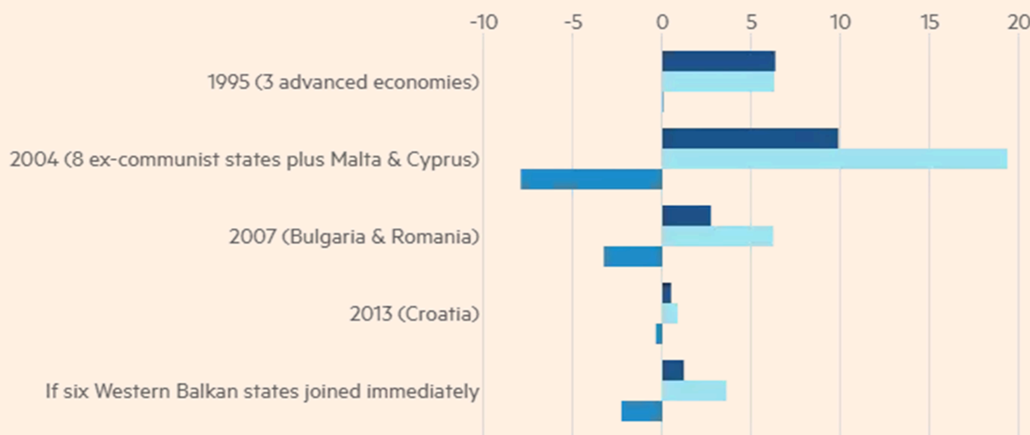
Candidates and Members in the Balkans

Kosovo declared its independence from Serbia in 2008.
The independence has not been recognized by Serbia, and 5/27 EU member states: Cyprus, Greece, Romania, Slovakia and Spain.



Current members
Candidate countries:, Bosnia and Herzegovina, Georgia, Moldova, Ukraine (negotiations not opened yet); Albania, Montenegro, North Macedonia, and Serbia (negotiations already opened).
Türkiye: in 2018 accession negotiations came to a standstill.
Potential candidate (ie, countries that do not yet fulfill the requirements for EU membership): Kosovo





<u>The Big Enlargement after the Cold War (2004)</u>

(…) For many long years we have been preparing the ground for the accession to the European Union of these 10 countries from central and eastern Europe and the Mediterranean.

The negotiations we have conducted, while difficult at times, bear witness to our common commitment to unify our continent and finally to end the artificial division the Iron Curtain imposed on us for more than half a century (Soviet Union collapsed on 1991).

(…) I want to pay tribute to the peoples of Europe who are joining us today. Even in the darkest days of Stalinism, they never lost hope. Since the fall of the Berlin Wall (1989), they have carried out a quiet revolution based on the democratic values that are our common heritage today.

Romano Prodi, President of the European Commission, 1 May 2004

<u>The Enlargement of the EU is not over</u>

The enlargement also deeply changed the institutional working of the European Union, given the higher number of countries / variety of interests / economic development. As such, it required the EU to reform its institutions, ultimately through the **Lisbon Treaty (signed in 2007**, into force in December 2009).

Due to the challenges posed by 2004 enlargement, notwithstanding the commitments made to the countries already in the process, the European Council (December 2006) agreed on considering carefully the EU's capacity to integrate new members: the EU should be more cautious in assuming any new commitments.

The case of Turkiye

Türkiye (population 84 million) is a candidate country. It applied for membership in 1987, and it was declared eligible in 1997 (i.e. it satisfies the political and economic Copenhagen criteria).
Türkiye involvement with the EU goes back to 1959 and includes the Ankara Association Agreement of 1963, for the progressive establishment of a Customs Union, then completed in 1995 => EU and Türkiye have free trade among themselves and share the same structure of tariffs with respect to the rest of the world.
Accession negotiations started in 2005, and in 2018 the Council froze accession negotiations.
The EU has **serious** concerns on the deterioration of democracy, the rule of law, fundamental rights and the independence of the judiciary. However the formal reason is that Türkiye refuses to recognize the Republic of Cyprus and it has not removed all obstacles to the free movement of people (Türkiye continues to apply a discriminatory visa regime against nationals of Cyprus, while it has abolished the short-stay visa requirements for the other 26 Member States) goods, including restrictions on direct transport links with the Republic of Cyprus.

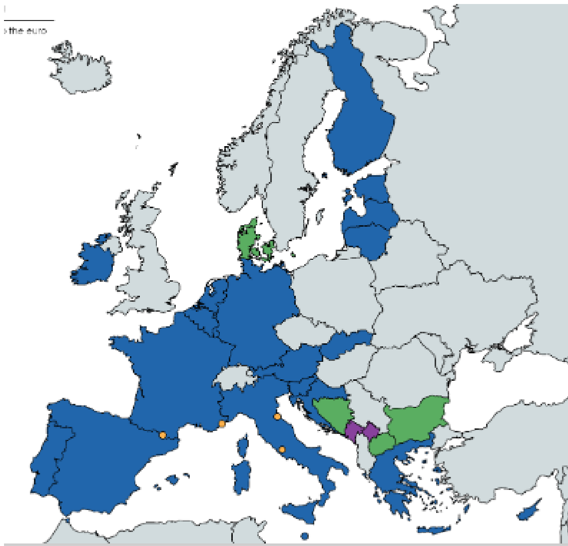
Among other EU concerns (Commission, 2023), there is the refusal to adopt restrictive measures against Russia as the ones adopted by the EU, the rhetoric in support of the terrorist group Hamas following its attacks against Israel on 7 October 2023 is in complete disagreement with the EU approach.

The Case of Ukraine

On 28 February 2022 (4 days after Russia's invasion), **Ukraine sent its application for EU membership.**
On 17 June 2022, the **European Commission** presented its Opinions on the application for EU membership submitted by Ukraine, Georgia and the Republic of Moldova.
Based on the Commission's opinion on the country's application for EU membership, Ukraine was given a European perspective and granted **candidate status on 23 June 2022** by unanimous agreement between the leaders of all 27 EU Member States.
Candidate status was granted on the understanding that **Ukraine takes some key steps** (eg, approval of transparent selection procedure for judges of the Constitutional Court of Ukraine, fight against corruption, anti-money laundering legislation).

On 15 December 2023, the European Council decided to open accession negotiations with Ukraine.
The Commission will monitor the progress and compliance in all areas related to the opening of negotiations and report to the Council by March 2024. The Commission stands ready to start preparatory work, in particular the analytical examination of the acquis (screening) and the preparation of the negotiating framework.

Eurozone



Eurozone member, monetary agreement, unilaterally adopted, currency pegged to the euro

<u>Shengen</u>

EU - Shengen yes, EU - Shengen no, Non EU, Shengen yes

<u>NATO</u>

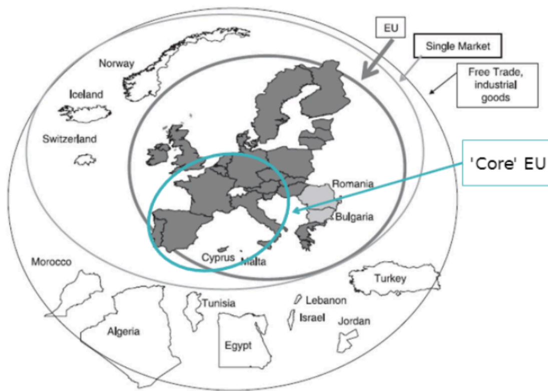
EPC

The European Political Community (EPC) was called by French President Macron after Russia’s invasion of Ukraine in February 2022, to serve as a forum for political dialogue and cooperation on security, stability and prosperity.

The EPC held its inaugural meeting on 6 October 2022 in Prague with the leaders of the EU's 27 Member States and 17 other European countries (eg, Ukraine, Turkey and the UK) focused on the war and the energy crisis.

The next EPC meeting will be in the UK in Spring 2024 (previous meetings in Czech Rep, Moldova and Spain)

Concentric Circles shaping the EU in the future



Deepening (policies at EU level)

The EU only has the **competence conferred** to it by the Treaties, by the member states

Exclusive competence	Shared competence	Supporting competence
The EU has the exclusive rights to legislate and conclude international agreements in: - the **customs union** - Competition - Monetary policy for Eurozone members - conservation of fisheries and other resources	EU and member states share competence in: - Research, tech development and outer space - Development and humanitarian aid Member states can’t exercise competence where EU has done so in: - internal market - Economic, social and	The EU can support, co-ordinate or supplement national policies of member states in: - Tourism - Education - Culture - Administrative co-operation - Human health - Civil protection

under the **Common Fisheries Policy** - Common Commercial Policy	territorial cohesion - Agriculture and fisheries excluding the conservation of marine biological resources - consumer protection - transport - energy - Security and justice, and home affairs	

Deepening: supranational vs. intergovernmental

European Union

Supranational	**Intergovernmental**
- Economic Integration - Justice and home affairs	- Common Foreign and Security policy (national governments maintain string autonomy)

Treaty on European Union (TEU)
Treaty on the functioning of the European Union (TFEU)

The economic integration starts with a **free trade area and customs union**, which the six founding members of the European Economic Community (EEC) had accomplished by 1968, as well as the **gradual build-up of the European Internal Market** based on:

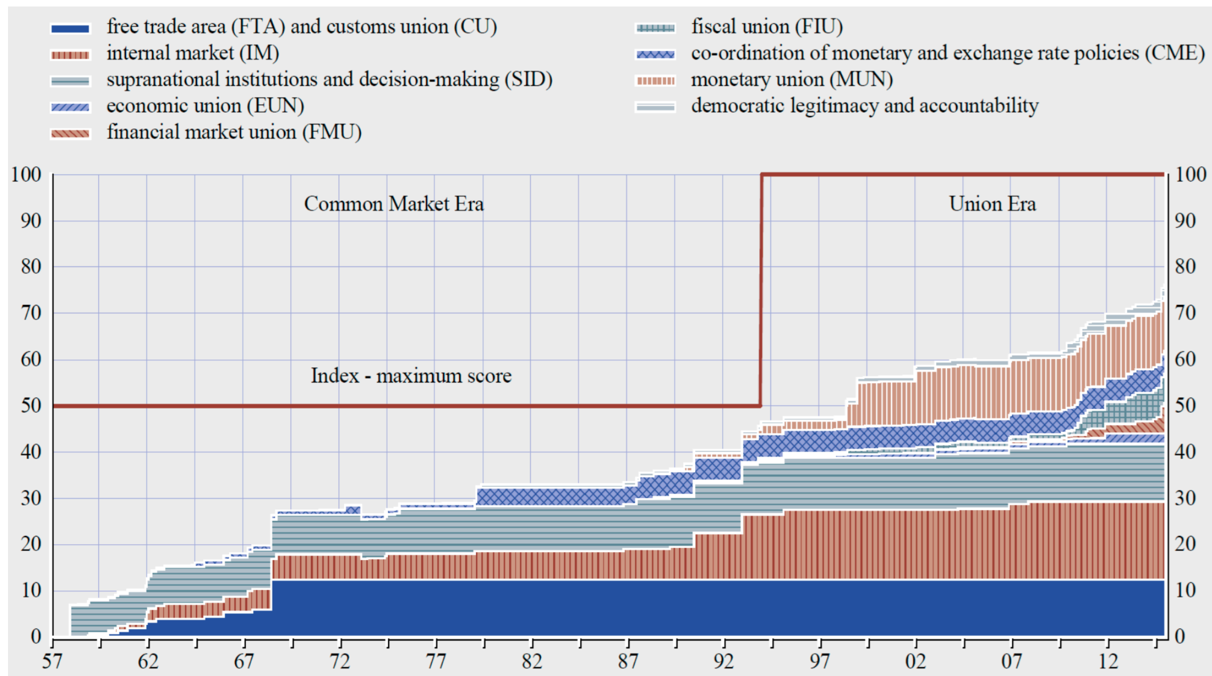
- **Four fundamental freedoms**: free flow of goods, services, workers and capital. In this common/single market, firms and consumers located anywhere in the area would have equal opportunities to sell or buy goods and services throughout the area, and owners of labour and capital should be free to employ their resources in any economic activity anywhere in the area.
- **Common policies where necessary:** the EU acts only within the limits of the competences that EU countries have conferred upon it in the Treaties; thus competences not conferred on the EU by the Treaties thus remain with countries (Social policies, welfare, taxation remain in the hands of national governments).
- **Common rules:** the development of a body of law harmonising rules and procedures throughout the area.

During these years, **some degree of coordination** of, for instance, monetary and exchange rate policies was also set up alongside a number of institutions, laws and decision-making processes.
Given the final goal of a **fully-fledged common market**, this process was not too far from being completed in the early 1990s, though additional work needed (and still needs) to be done to complete the Internal Market.

The Union Era is characterized by the **Economic and Monetary Union (EMU) and the single currency, the euro.**
However, the initial version of EMU, despite including some mechanisms for the coordination of national economic policies, proved **unable to cope with the shocks** emanating from the global crisis and even contributed to endogenously creating some of the **preconditions for the euro area crisis.**

A paper published in 2015 presents a quantitative index of EU integration since the 1950s. It is articulated along two overarching periods of institutional integration:

1. The **"Common Market Era",** from 1958 (when the Treaty of Rome entered into force) until 1993 (when the Treaty of Maastricht entered into force);
2. The **"Union Era"** from 1993 to 2014.



The graph summarises the deepening of the European integration project.

The brown line is the maximum score achievable if all objectives of the Common Market Era and of the Union Era were fully accomplished: it is 50 from 1958 to 1993 and 100 (50 + 50) thereafter.

⇒ The Graph is telling us that there is a positive trend for the increase in integration, so the deepening dimension is increasing.

We got to almost 80% of integration in the Union Era.

Custom Union => never stopped these reforms

Fiscal Union => there were periodos in which it was somehow shaky

2009 - Credit Crisis

2012 - Debt Crisis

Next Generation EU: 750 bl of resources to be redistributed, partially for free, partially debit. This is a strong step forward in integration and cooperation.

Integration always increased by a lot after each crisis.

The Omitted Elements (left at national level)

The EU is about single market, single currency, common policies (e.g., trade, competition, agriculture, currency ..), but..

- **Social policy** (welfare, health, education, labour market regulation, pensions) and **taxation** are mostly **national** policies apart from the framework, not the rates, of indirect taxation: the Value-Added Tax (VAT).

Harmonization in those fields is politically difficult. EU nations have very different sensitivities on what types of social policies and taxes should be dictated by the government.

However, is a top-down harmonization necessary?

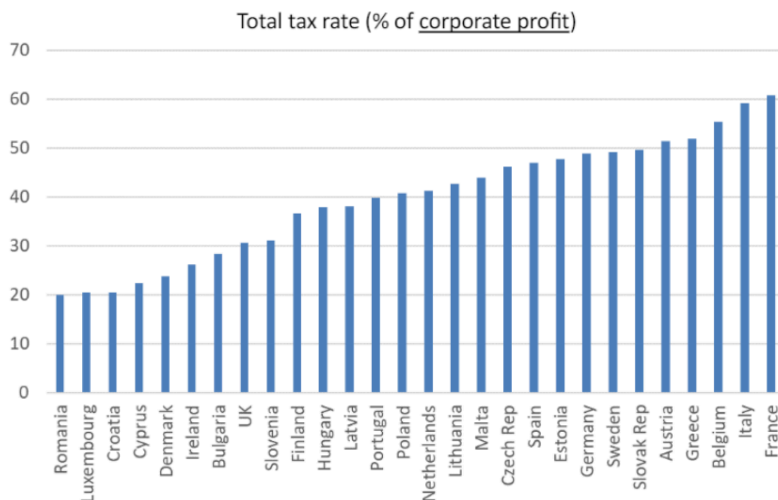
It could be efficient to have a single body managing all the taxes in the union, but taxes are a powerful tool for consensus for politics in the countries.

This could also be applied to the question of a common European defence and security policy.

> In low-tax countries workers will enjoy a higher net salary compared to high-tax countries.
> Since low-tax countries are also low-welfare countries, workers need to buy, with their net salary, services that are not provided by the government (education, health, transportation…).
> *National wages would adjust to offset any unfair advantage. =》* ***automatic modifier***
> *Wages adjust to the expectations of people, while taxes are more difficult to amend since they are laws. People will expect a higher wage to compensate for the non existent services.*

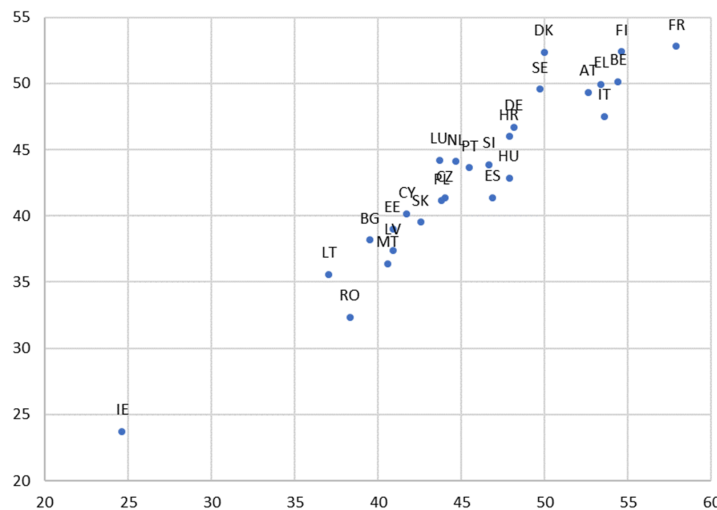
The VAT

is a consumption tax assessed on the value added in each production stage of a good or service. Every business along the value chain receives a tax credit for the VAT already paid. The end consumer does not, making it a tax on final consumption.
EU law only requires that the standard VAT rate must be at least 15% and the reduced rate at least 5% (usually for foodstuffs).
Actual rates applied vary between EU countries and between certain types of products.
=> there was no agreement for a maximum level of VAT



the taxes on corporate profit are very different in different EU countries.

y = Tax revenue(%GDP)



x = Government Expenditure (%of GDP)

There are countries that spend more than what they raise in taxes, All countries below the 45* line. There is direct correlation between these variables.
Different models in EU but consistency between taxes (input) and expenditures (output) at national level.

The Key principles of the EU

Though the powers of the EU have expanded (deepening), the aim of the EU is not to intervene in every field. The exercise of EU competences is subject to three fundamental principles:

1) **The principle of conferral**: the EU may only act within the limits of the competences conferred upon it by the EU countries in the Treaties to attain the objectives provided therein.

2) **The principle of subsidiarity:** in the area of its non-exclusive competences, the EU may act only if the objective of a proposed action cannot be sufficiently achieved by the EU countries, but could be better achieved at EU level (put it another way: the EU does not take action, unless it is more effective and efficient than action taken at national, regional or local level). => for example during the pandemic

Ex. **The EU has responsibility when transport is of transnational nature**, like the setting up of common infrastructures and transport corridors (TEN-T) and the harmonization of technical and administrative standards among Member States.

Urban transport (e.g., regulation of taxis) is in the hands of national and local authorities.

The **Court of Justice of the EU (CJEU)** ruled that **Uber should be classified as a taxi service and not a digital platform.**
Uber directly offers a transport service, and without the Uber app, the drivers would not be able to offer that service. Uber has a decisive influence over the price.
So, for example, Uberpop is banned in Italy, Germany and France, but it works in Czech Republic, Estonia and Poland.

3) **The principle of proportionality:** the content and scope of EU action may not go beyond what is necessary to achieve the objectives of the Treaties.

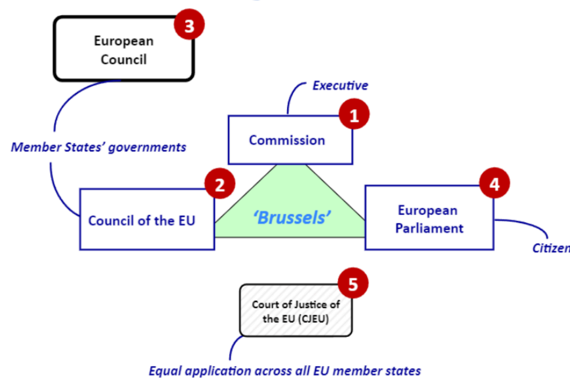
EU Institutions

European States created and want to be part of the EU to manage some policies together.

There are many EU institutions but the core ones involved in the legislative process are 5:

- **the European Commission;**
- **the Council of the EU;**
- **the European Council;**
- **the European Parliament;**
- **Court of Justice of the European Union (CJEU).**

Other important EU institutions are, among others: the **European Central Bank (ECB)**, responsible for monetary policy in the Euro area), the **EU Court of Auditors** (that oversees the correct execution of the EU budget).



The European Council confers the power to the institutions, and the European Parliament and Council of the EU vote on matters. They also give confidence to the Commission.

The European Commission

The Commission can be seen as the **executive-bureaucratic arm** of the EU. Has a key role in managing EU finances: collection of revenues, proposal of yearly EU budget and administration.
Promotes the **general interest of European integration**, in light of the Treaties.
Develops proposals for new laws and policies: "**powers of initiation**".
Oversees the execution of adopted laws and policies (e.g. the Commission can take to the Court of Justice any member state, corporation or individual that acts against the EU law)
President of the Commission => Represents the EU in international organisations like the **World Trade Organization (WTO)**.

The College of Commissioners is made of 27 members, one for each country.
Each commissioner is responsible for a different area of policy (e.g. environment, trade, competition, regional policy, external relations…)
The College serves a five year term. Each commissioner comes from a different country so negotiations for certain roles are strong.
The College is headed by a **President**, currently **Ursula von der Leyen**, the former Germany's Federal Minister.

- The President of the Commission:
- Distributes portfolios among Commissioners
- Sets the agenda of the Commission and chairs the meetings
- Can launch major new policies
- Represents the Commission when dealing with other EU institutions or national governments

The Council of the European Union

Consists of **national government ministers**, who meet in 10 different "councils" (configurations), depending on the topic under discussion.

One of the most important configurations is the "**General Affairs**", bringing together all the EU foreign affairs ministers to discuss issues related to internal EU affairs, sensitive policies and new laws, preparing the meetings of Heads of State and Government (European Council).

The "**Economic and Financial Affairs Council**" (Ecofin) brings together the economics and finance ministers.

- The relevant EU Commissioner also attends the meetings.

The frequency varies depending on the configuration, from once per month (Ecofin…) to once every six months (Agriculture…).

Extraordinary meetings, beyond the agenda of the Presidency, can be set should the need arise.

The **Presidency** is held in turn by each member state for a period of 6 months (changes in January and July every year), now **Belgium** (the official website)

Together with the Parliament, the **Council of the EU is a key decision-making actor**. It discusses, amends and approves (or not) new laws which are proposed by the Commission.
=> it has the power to approve or discard new regulations.

The Council deliberates with:

- **Simple majority**: for procedural issues.
- **Qualified Majority Vote (QMV)**: most common mode. To be successful, a proposal must win a double majority of at least 55% of member states (15/27) and 65% of the total population.
- **Reverse Qualified Majority Voting (RQMV):** Decisions on most sanctions under the Excessive Deficit Procedure (fines for national governments) are deemed to be approved by the Council of the EU unless a qualified majority of Member States overturns them.
- **Reverse Reinforced Qualified Majority:** At least 72% of MS (20/27) representing at least 65% of the EU population are needed to object to the Delegated Act: ie, non-legislative acts adopted that serve to amend or supplement the non-essential elements of the legislation (eg, EU Taxonomy: indexes that measure if an activity is sustainable or not and is permitted or not in the EU).
- **Unanimity**: only needed for changes in the Treaties, matters of political sensitivity (eg, taxation, the multiannual financial framework - MFF) or if the Council wants to change a Commission proposal against the opinion of the Commission.

The European Council

It consists of the **Heads of State or Government of the EU member states** (eg, Olaf Scholz, Emmanuel Macron, Giorgia Meloni, Pedro Sánchez, Viktor Orbán) plus the President of the EU Commission.

- It meets at least two times per year, normally in December and June.
- It is not one of the EU's legislating institutions, so it does not negotiate or adopt EU laws like the Council of the EU (made of national ministers).

However, because of the principle of conferral, it is the **European Council that sets the EU's policy agenda**, traditionally by adopting **'conclusions'** during meetings that identify issues of concern and actions to take. They are *opinions* on concerns and actions to take.

The European Council has a **President**, currently the former **Belgium's PM Charles Michel,** elected by the European Council with a qualified majority, for two years and a half (renewable once). This is different from the Presidency of the Council of the EU.

For instance, in the conclusions of the meeting held on 15 December 2016:
"Europeans must take greater responsibility for their security. [....] The European Council welcomes the Commission's proposals on the European Defence Action Plan as its contribution to developing European security and defence policy, stressing the importance of fully involving Member States, and calls on all relevant actors to take work forward. The Council is invited to rapidly examine the related Commission proposals. [....] The Commission is also invited to make proposals in the first semester of 2017 for the establishment of a European Defence Fund including a window on the joint development of capabilities commonly agreed by the Member States."

=> intention to go forward with a common defence and security policy and call to action to the Commission and Parliament. The EU wants to put together resources for security and make the countries see the benefits in forming a common front.
In 2016 the President of the US was Trump.
Why? In March 2016 then GOP presidential front-runner Donald Trump questioned NATO's relevance.
In 2017, the **Permanent Structured Cooperation (PESCO)** was established by 25 EU members (Denmark and Malta opted-out). PESCO aims to deepen defence cooperation to deliver the required capabilities to also undertake the most demanding missions and thereby provide an improved security to EU citizens.

European Council ≠ Council of the EU ≠ Council of Europe

European Council

- Meeting of 27 EU member states leaders (heads of state and government).
- It is an institution of the EU.
- It does not negotiate or adopt EU laws.
- It defines the EU's overall political direction and priorities, traditionally by adopting conclusions.
- The European Council usually decides by consensus (i.e. no member opposes the adoption).
- The President is elected by the European Council by a qualified majority.

Council of the EU

- Meeting of 27 EU national government ministers grouped by policy area.
- It is an institution of the EU.
- It negotiates and adopts EU laws. In most cases, the Council decides together with the European Parliament through the ordinary legislative procedure.
- Depending on the issue under discussion, it takes its decisions by: simple majority, qualified majority or unanimity.
- The presidency of the Council is assigned to a member state that changes every six months.

Council of Europe

- International organisation, based in Strasbourg, which was created in 1949 and now includes 46 European countries.
- It is **not** an institution of the EU.
- Set up to promote democracy, human rights and the rule of law.
- Home to the European Convention on Human Rights and the European Court of Human Rights – among many other things.

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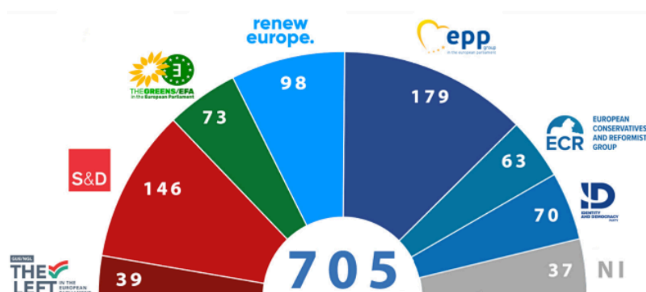
The European Parliament

Besides the Council of the EU, the European Parliament is the other decision maker of the EU.
It is the only EU institution whose members are directly elected by citizens of the member states.
It has a single chamber with **705 me.mbers (MEPs)** elected for 5 years (renewable) in common European elections.
Each country gets a number of seats according to a "***degressive proportionality principle***", i.e. per capita deputies are lower for larger countries .
Germany has the highest number (96) of Members while Malta, Cyprus, Estonia, Luxembourg have the lowest (6).

	Population	MEP allocation with pure proportionality	Actual MEP allocation with degressive proportionality	MEPs/pop
Germany (DE)	83 million	166	96	**1.16**
Malta (MT)	0.5 million	1	6	**12**
DE/MT ratio	*166*	*166*	*16*	

The European Parliament works through **permanent and ad-hoc Parliamentary Committees**: e.g. environment, transport and tourism, budget etc.
The Members of the European Parliament (MEPs) sit in political groups – they are not organised by nationality, but by **political affiliation.**



There are currently **7 political groups** in the European Parliament. Some Members do not belong to any political group and

are known as non-attached Members (Non-Inscrits).

The seats of the European Parliament

Formally, European Parliament's offices are located in three different countries (Protocol n. 6 of the TFEU):

- Administrative headquarters are in **Luxembourg**.
- Parliamentary committees, where laws are instructed / amended, meet in **Brussels** for two-three weeks every month.
- However ordinary plenary sessions, where formal laws are approved, take place in **Strasbourg** for 3-4 days every month, which means that deputies and staff have to move there temporarily.

Very inefficient and costly arrangement… Kind of "history joke" and certainly a good example of compromises within the EU. An Agreement was not found.

The Court of Justice of the EU (CJEU)

Ensures that national and European laws meet the terms and spirit of EU Treaties.
Ensures that EU law is equally, fairly and consistently applied in all member states.
=> it is the highest level of judiciary in the EU. It is able to address disputes between countries, people or firms and competition law.

It does so by:

- Ruling on the "constitutionality" of EU law
- Giving opinions to national courts about EU law
- Making judgments in disputes involving EU institutions, member states, individuals and corporations.

The CJEU is divided into **2 courts:**
Court of Justice: it deals with requests for preliminary rulings from national courts, certain actions for annulment and appeals.
General Court: it rules on actions for annulment brought by individuals, companies and, in some cases, EU governments. In practice, this means that this court deals mainly with competition law, State aid, trade, agriculture, trade marks.

The EU Law: the principles

One of the most unusual and important things about the EU is its **supranational legal system**. By the standards of every other international organisation in the world, the EU legal system is extremely supranational.
Main principles:

- **direct effect**: EU law can create rights which EU citizens can rely upon when they go before their domestic courts, can create rights for citizens before the rights are inscribed in the national legislation;
- **primacy**: Community law has the final say (e.g., highest German court can be overruled) so that it cannot be altered by national, regional or local laws in any member state;
- **autonomy**: system is independent of members' legal orders.

Nowadays on average some **70%** of all the laws in place in a given Member State derive directly or indirectly from the EU.
When it comes to business law the figure is even higher… You better get to know it!

The EU law: Tools

- **Treaties** are the *"primary" source of European Union law*. They define the aims of the EU, the roles and competencies of the EU institutions. The EU can only act within the competences granted to it through these treaties and amendment to the treaties requires the agreement and ratification of every signatory member according to national procedures.

"Secondary" sources of EU law are:

- **Regulations**: the most powerful form of EU "secondary" law, immediately binding for every member state.
- **Directives**: define mandatory goals, but the legislative actions for implementing these goals are left to the member states (normally with a time deadline and the obligation to report to the Commission).
- **Decisions**: also binding, but very specific in their application, normally referring to single member states, institutions or companies.
- **Recommendations** and opinions: have no binding force, usually they provide interpretations for the application of regulations, directives and decisions.

TEU. Objectives and tools

⇒ Based on the **principle of conferral and proportionality**

1. The Union's aim is to promote peace, its values and the well-being of its peoples.
2. The Union shall offer its citizens an area of freedom, security and justice without internal frontiers, in which the free movement of persons is ensured in conjunction with appropriate measures with respect to external border controls, asylum, immigration and the prevention and combating of crime.
3. The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.
It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child.
It shall promote economic, social and territorial cohesion, and solidarity among Member States.
It shall respect its rich cultural and linguistic diversity, and shall ensure that Europe's cultural heritage is safeguarded and enhanced.
4. The Union shall establish an economic and monetary union whose currency is the euro.
5. In its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights, in particular the rights of the child, as well as to the strict observance and the development of international law, including respect for the principles of the United Nations Charter.
6. The Union shall pursue its objectives by appropriate means commensurate with the competences which are conferred upon it in the Treaties.

EU Decision Making

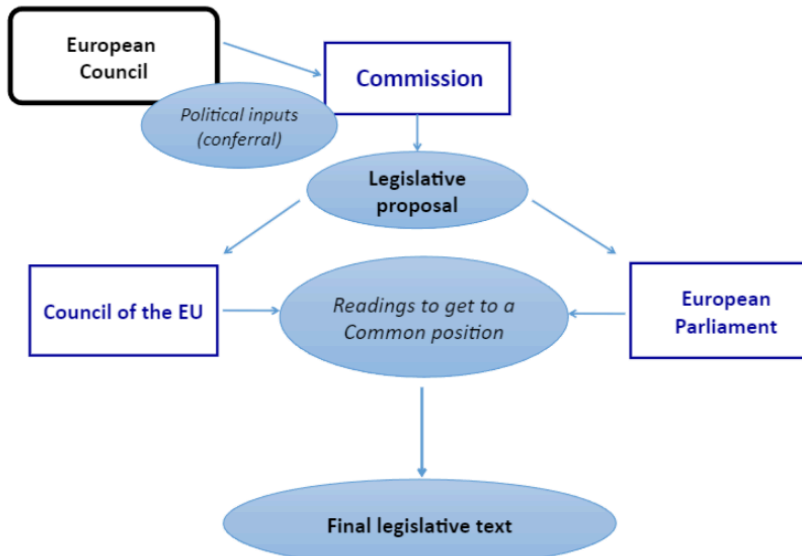
Decision making in the EU takes place by means of various legislative procedures that involve EU Institutions.

The **ordinary legislative procedure** is the default procedure. Before the Treaty of Lisbon (2009) the ordinary legislative procedure was named

Co-decision procedure.

The essential characteristic of the ordinary legislative procedure is that **both the Council of Ministers as well as the European Parliament have a deciding vote** in the legislative process, and both institutions may amend a proposal (to know more about the ordinary legislative procedure), the law is bounced back and forth until it is approved.

When the Treaties indicate otherwise, other legislative procedures are used such as the

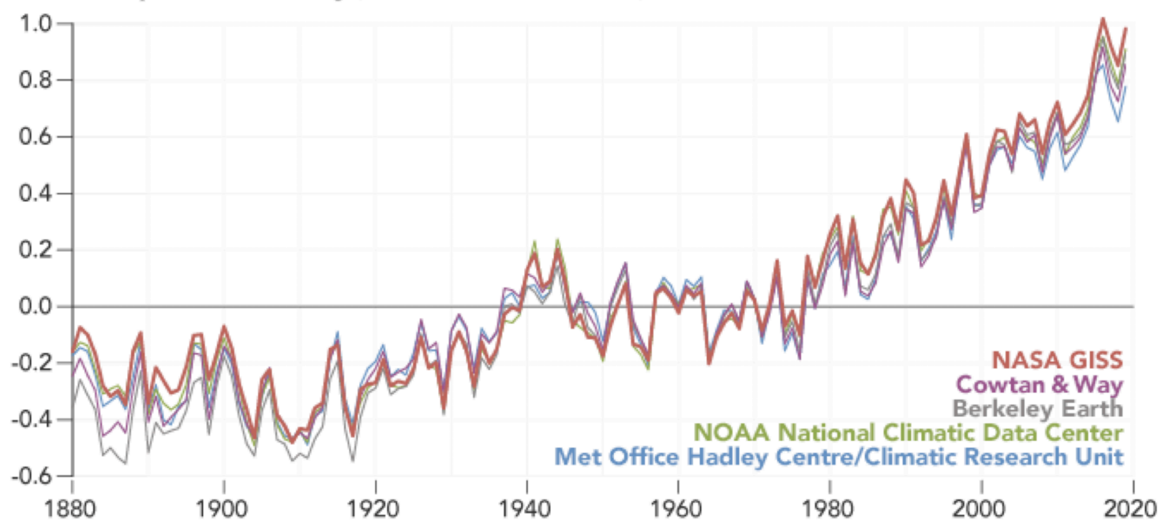


Assent procedure: this procedure is used for matters where the member states retain a larger degree of control. The word assent refers to the role the European Parliament plays in the procedure: it has to approve or disapprove a proposal, but cannot amend it. The last word belongs to the Council of the EU.

The EU Green Deal

1951 - 1980 average taken as point of reference from before globalisation

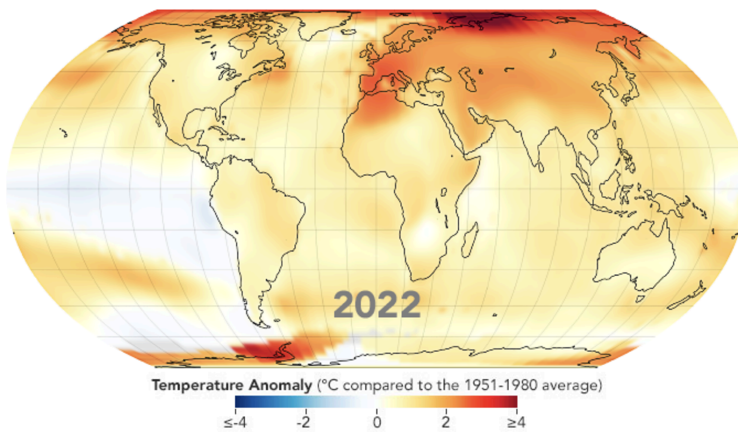
Independently of the measure, the temperature is increasing



A screenshot of the change in temperature worldwide.

It is possible to do research of these topics with detailed data by region (NASA)

Average temperature has not been increasing everywhere.



In 2022, glaciers in the European Alps lost more ice than ever before.
Last year, 3.2 cubic km of ice were lost, representing a decrease in volume of 6.2% in 2021.
This was caused by low winter snowfall, summer heatwaves and deposits blown in of Saharan dust, which absorbs more heat and accelerates melting.
=> **Melting Ice is not the only consequence**

- Sea levels are expected to rise and large parts of several major cities are likely to be at risk of inundation.
- Hurricanes and other storms are likely to become stronger.
- Floods and droughts will become more common. Yet some regions are experiencing more severe drought, increasing the risk of wildfires, lost crops, and drinking water shortages.
- Less freshwater will be available, since glaciers store about three-quarters of the world's freshwater.
- Some diseases will spread, such as mosquito-borne malaria. Dengue will also spread to northern regions.
- Ecosystems will continue to change: Some species will move farther north or become more successful; others, such as polar bears, won't be able to adapt and could become extinct.

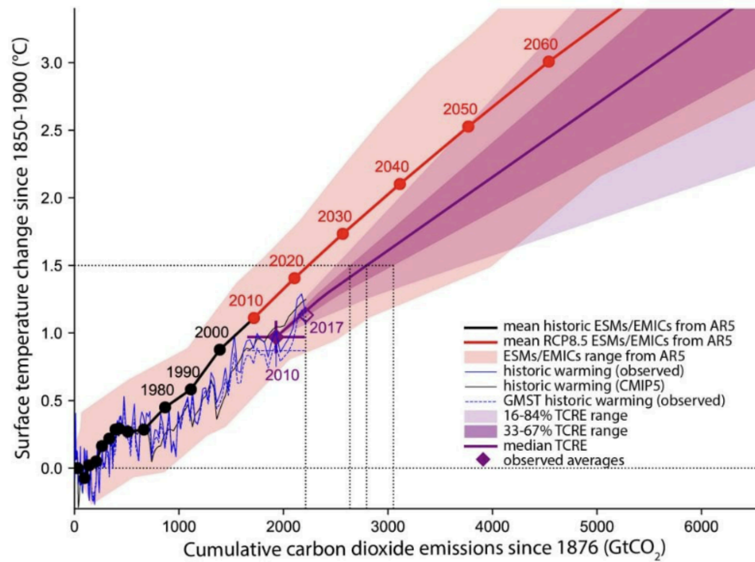
In Europe: a geographical North–South divide, with countries in South impacted more by global warming than those in northern Europe.

Many Main Cities around the world will suffer the effect of rising sea levels

- Jakarta
- Venice
- Tokyo etc

Anthropogenic Climate Change

Temperature changes from 1850–1900 versus cumulative CO_2 emissions since 1st January 1876.



The 2021 IPCC report shows that "*emissions of greenhouse gases from human activities are responsible for approximately 1.1°C of warming since 1850-1900, and finds that averaged over the next 20 years, global temperature is expected to reach or exceed 1.5°C of warming. This assessment is based on improved observational datasets to assess historical warming, as well progress in scientific understanding of the response of the climate system to human-caused greenhouse gas emissions.*"

There are some countries that are the main contributors of CO2 emissions in the world

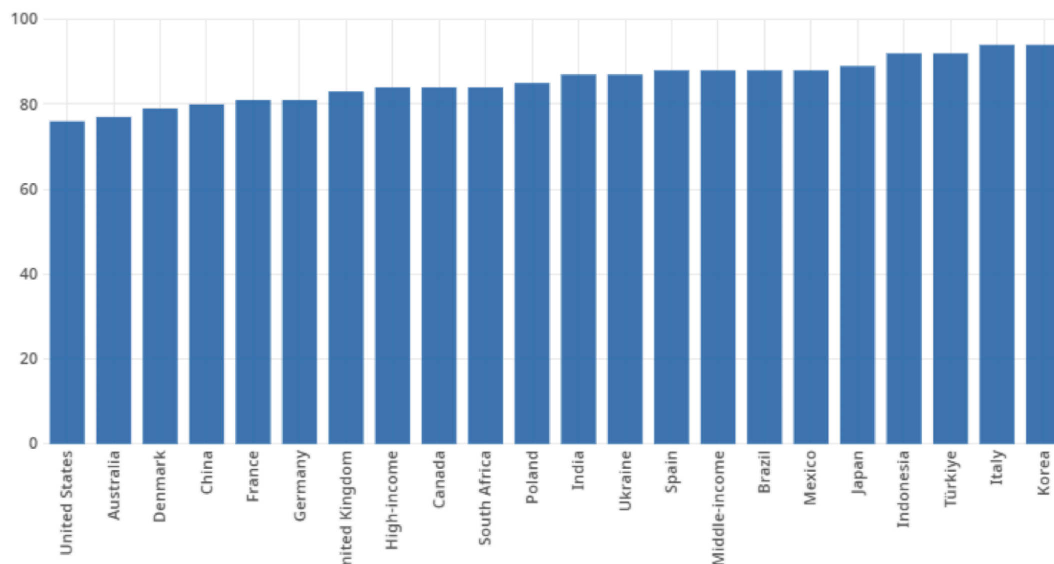
- China
- Other Developing Countries

Developing countries are not developing with green objectives in mind.
Some countries which are now developed might have polluted more in the past.
=> the per capita emissions are very different from aggregated emissions, the biggest polluter is the US.
China is gradually increasing its per capita pollution.
This is an important political issue since developing countries would have to slow their development down in order to pollute less.
=> in developing countries the waste is managed by burning everything, there is no infrastructure to recycle. They also receive all waste washing ashore on their seasides.
The disposal of waste is not properly managed.

Public opinion strongly supports measures against climate change

Climate change is an important problem

Average public support in countries, in %



Note: The figure shows the share of respondents who somewhat or strongly agree that "Climate change is an important problem" and that their country "should take measures to fight climate change.
In high-income countries the samples are nationally representative along the dimensions of gender, age, income, region, and area of residence (urban vs rural). In middle-income countries, the samples are online representative. Comparisons across the two groups should be done with caution.
Source: Fighting Climate Change: International Attitudes toward Climate Policies

1) Adaptation – **adapting to life in a changing climate – involves adjusting to actual or expected future climate.** The goal is to reduce our risks from the harmful effects of climate change (like sea-level rise, more intense extreme weather events, or food insecurity).

=> MOSE in Venice
=> Smart Tunnels : when it does not rain, cars can flow through. When it rains heavily the tunnel acts as drainage and guides the water away from cities, pastures etc.

2) Mitigation – **reducing climate change – involves reducing the flow of heat-trapping greenhouse gases into the atmosphere**, either by reducing sources of these gases (for example, the burning of fossil fuels for electricity, heat, or transport) or enhancing the "sinks" that accumulate and store these gases (such as the oceans, forests, and soil)
=> policies needed!

The 2030 Agenda for Sustainable Development was adopted by all United Nations Member States in 2015.
It is drafted around **17 Sustainable Development Goals (SDGs), "which are an urgent call for action by all countries** - developed and developing - in a global partnership."
"They recognize that ending poverty and other deprivations must go hand-in-hand with strategies that improve health and education, reduce inequality, and spur economic growth – all while tackling climate change and working to preserve our oceans and forests."

=> every proposal from the Commission also highlights which ones of the 17 Goals are tackled by the policy

Ursula Von Der Leyen: *Europe was the first continent to declare to be climate neutral in 2050, and now we are the very first ones to put a concrete roadmap on the table. Europe walks the talk on climate policies through innovation, investment and social compensation.*

The EU Green Deal

December 2019: the new Von der Leyen Commission adopts the "**European Green Deal**" : a sustainable growth strategy and a contribution to tackling climate change
Final goal: **climate neutrality** (zero net carbon emission) by 2050
Intermediate goal 2030: reduction of net greenhouse gas emissions by at least 55% with respect to 1990 values => July 2021: adoption of "Fit for 55" package
Instruments : a "**European Climate Law**" and more than 50 specific actions
=> nowadays this objective does not seem attainable.

Video: it is aimed at convincing investors to invest in green technologies and energy transition. They want to change the expectations of people and companies so that they trust and cooperate with the new policies.

Jan 2020: The European Green Deal Investment Plan was presented together with the Just Transition mechanism (social policies to safeguard workers, e.g. of "brown" industries, during the transition) => it is inevitable that some other industries will suffer during the transition

Mar 2020: **The European Industrial Strategy** was adopted transition to green+digital economy
Mar 2020: Circular Economy action plan adopted (more on next slide) => want to change the way we think about production cycle and waste disposal. The aim is to have production, distribution, consumption, reuse, recycling and so on.

May 2020: Farm to fork strategy towards a more sustainable EU food system adopted by the Commission; **EU Biodiversity Strategy** presented
July 2020: EU Strategy for Energy System Integration & Hydrogen Strategy supporting alternatives to fossil fuels
July 2020: Taxonomy for sustainable activities into force list of environmentally sustainable economic activities to avoid mislabeling and green washing

The Circular Economy Action Plan

The economic system we live in is mostly linear: products get designed, made and/ or assembled, employed in the value chain towards the production of final goods in case they are intermediate products, and finally they are consumed by final users, who then produce waste related to the product itself or at least to its packaging.

"*The circular economy is a model of production and consumption, which involves sharing, leasing, reusing, repairing, refurbishing and recycling existing materials and products as long as possible. In this way, the life cycle of products is extended.In practice, it implies reducing waste to a minimum. When a product reaches the end of its life, its materials are kept within the economy wherever possible thanks to recycling. These can be productively used again and again, thereby creating further value*."

The New Circular Economy Action Plan was proposed in early March 2020, five years after the first action plan on Circular Economy launched by the EU. The pillars of the plan are the following:

• **Make sustainable products** the norm in the EU: ensure that products placed on the EU market are designed to last longer, are easier to reuse, repair and recycle, and incorporate as much as possible recycled material instead of primary raw material;

• **Empower consumers**: consumers will have access to reliable information on issues such as the reparability and durability of products to help them make environmentally sustainable choices. Consumers will benefit from a true "Right to Repair";

• **Focus on the sectors that use the most resources and where the potential for circularity is high**: the Commission will launch concrete actions on: - electronics and ICT - batteries and vehicles - packaging - plastics - textiles - construction and buildings -food
=> sustain sectors that offer big opportunities for circular economy

• **Ensure less waste:** the focus will be on avoiding +waste altogether and transforming it into high-quality secondary resources

The European Climate Law

The Climate Law is the juridical basis of the Green Deal and entered into force on 29 July 2021. It includes:

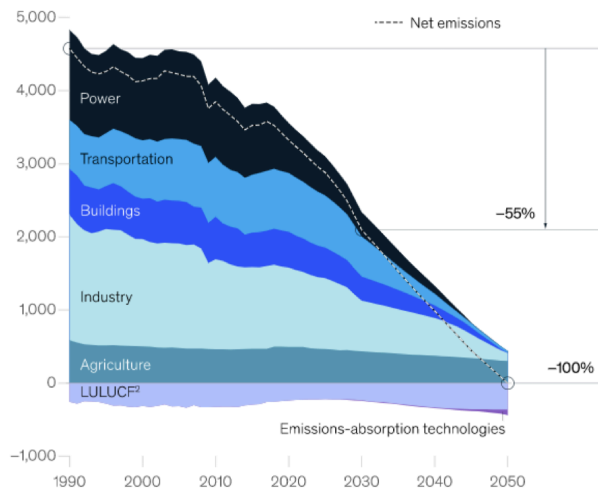
- a legal objective for the Union to reach climate neutrality by 2050 an ambitious 2030 climate target of at least 55% reduction of net emissions of greenhouse gases as compared to 1990, with clarity on the contribution of emission reductions and removals
- recognition of the need to enhance the EU's carbon sink through a more ambitious LULUCF (Land Use, Land-Use Change, and Forestry) regulation, for which the Commission made a proposal in July 2021 and which entered into force in May 2023

=> many agricultural products do not take into account the type of soil and conditions solely aimed at increasing productivity

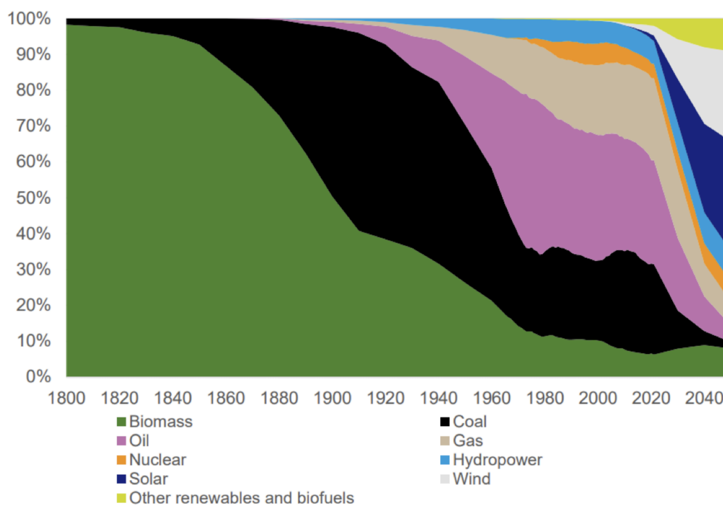
- a process for setting a 2040 climate target, taking into account an indicative greenhouse gas budget for 2030-2050 to be published by the Commission

- a commitment to negative emissions after 2050
- the establishment of European Scientific Advisory Board on Climate Change, that will provide independent scientific advice
- stronger provisions on adaptation to climate change
- strong coherence across Union policies with the climate neutrality objective
- a commitment to engage with sectors to prepare sector-specific roadmaps charting the path to climate neutrality in different areas of the economy

How emissions are allocated:



The main sectors that need energy transition are industries and transport.



The first industrial revolution is linked with the advent of coal. Although coal was still marginal at the beginning of the 19th century (but already dominant in the UK), it conquered the world in less than six decades.
Coal was supplanted by hydrocarbons, which are strongly associated with the second industrial revolution with the emergence of cars and airplanes.
Renewables – including the oldest, such as hydropower – now account for 13.5% of the world's primary energy supply. According to the IEA (2022), under the net-zero scenario, they are expected to exceed 30% of total primary energy supply by 2030.

=> **The green transition presents a major opportunity for European industry by creating markets for clean technologies and products.**
These new proposals will have an impact across entire value chains in sectors such as energy and transport, and construction and renovation, helping create sustainable, local jobs across Europe.

Security: EU is very dependent on the US
Energy: Almost Completely dependent on Russia
Markets: Gets all intermediate goods, input, raw materials from China
=> EU must diversify in the next few years

RePowerEU Plan

Following Russia's invasion of Ukraine, the European Commission is implementing its REPowerEU Plan (May 2022).

Its purposes are:
To secure affordable energy supplies
To save energy
To produce clean energy
To diversify European energy supplies

The forecast of the budget is 7 years by 7 years

Transition Costs will be very high

The Social Climate Fund will mobilise EUR 72.2 billion for the period 2025-2032 to:

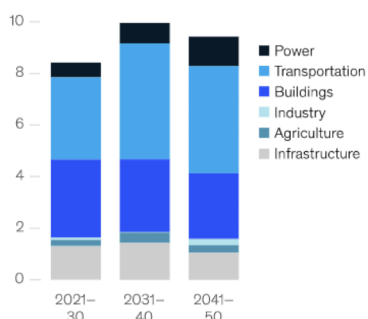
Support households, transport users, and micro-enterprises affected by the impact of the new ETS (Emissions Trading System)	Support investments in energy efficiency and renovation of buildings, clean heating and cooling	Provide direct income support for vulnerable households	Help finance zero- and low-emission mobility

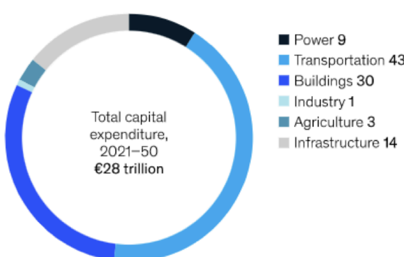
The Future Generation EU money will be distributed:

€520 bn of additional investments every year until 2030, plus €210 bn by 2027 to reduce energy dependence
=> Until 2030 = €5 Trl

But estimates of consulting agencies are not aligned:

Reaching net zero would require an estimated €28 trillion in investments over the next 30 years.

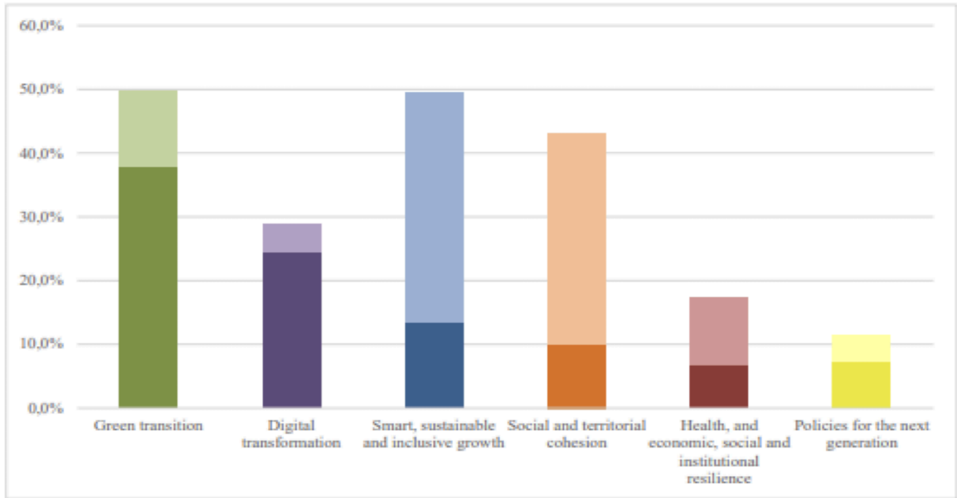




McKinsey & Company

=> the EU is going to support the demand for the new market for at least the next 30 years so it becomes efficient/convenient to invest

Figure 3: Share of RRF funds contributing to each policy pillar

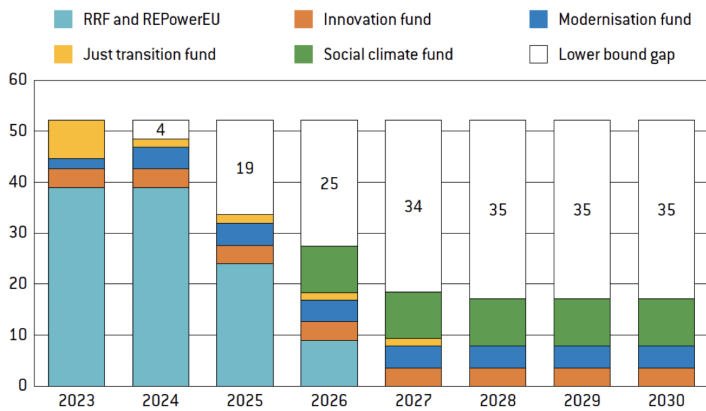


Legend: The darker-coloured parts of the columns represent those measures which have been tagged and assigned to the pillar as primary policy area, while the lighter-coloured parts represent measures tagged as secondary policy area.

Long-term budget (2021-2027) of €1.074 trillion:
At least 30% of EU budget 2021-2027 will be spent on climate-related action, the highest share of the largest European budget ever

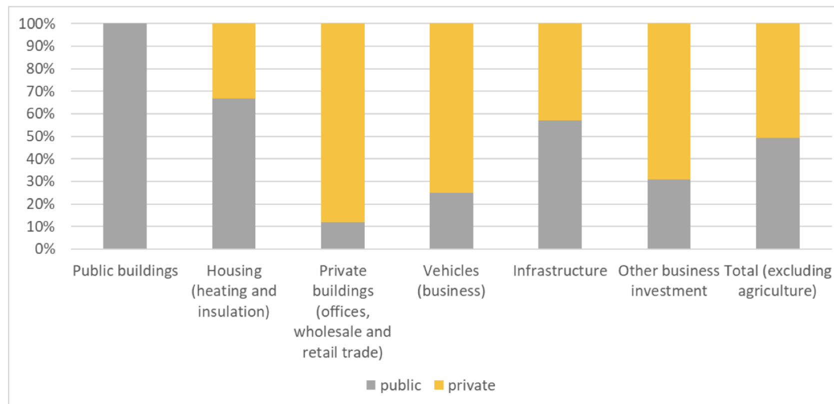
Next Generation EU (2021-26), temporary recovery instrument of €750 billion

Figure 4: EU climate grants: the sharp post-RRF decline (€ billions)



Source: Bruegel based on the European Commission (2020a) and Baccianti (2023). Note: All numbers are in current prices. The split of RRF and REPowerEU funding by year was done using Carrión Álvarez's estimates (2020).

Member States have developed own individual Recovery and Resilience plans, each of which will include minimum 37% climate expenditure



The Emissions Law:

The Commission will review and propose legislation to:

Reinforce and expand the EU Emissions Trading System (inc. buildings and road transport, possibly aviation and maritime)

Update the Effort Sharing Regulation

Strengthen the Land Use, Land Use Change and Forestry (LULUCF) Regulation

Revise Energy Efficiency + Renewable Energy Directives

Launch a “Renovation Wave”

Tighten CO2 emissions performance standards for cars and vans plus the rules on fluorinated greenhouse gases

Revise Border Carbon Adjustment Mechanism + Energy Taxation Directive

Emissions Trading System

For its climate action, the EU set up the emissions trading system (ETS) in 2005, the world's first and major international 'cap and trade' scheme.

The EU sets a cap on how much CO2 heavy industry and power stations can emit. Within the cap, firms receive emission allowances (auctioned and/or for free).

If a firm emits more, then it needs to buy allowances from another firm.

If a firm emits less, then it can keep allowances for future needs or sell them to another firm in short of allowances.

The limit on the total number of allowances available ensures that they have a value.

After each year a company must surrender enough allowances to cover all its emissions, otherwise heavy fines are imposed.

Trading brings flexibility that ensures emissions are cut where it costs least to do so.

Currently, the sectors covered are: electricity generation, energy-intensive industries such as refineries, aluminium and steel mills.

=> polluting agents will move to other countries in order to be able to pollute more, that is why the EU is pushing for internationally expand the market for Carbon Permits.

Maritime and Aviation sectors

EU international emissions from navigation and aviation have grown by more than 50% since 1990
The Commission proposes to reduce the free allocation of allowances in the aviation sector, increasing the effectiveness of the carbon price signal
Fresh political consideration will be given to the international aspects of the EU ETS, taxation and fuel policies for aviation and maritime
Our ambition is to one day include international emissions from aviation and navigation into the EU ETS

Covers almost 60% of EU greenhouse gas emissions
Includes buildings, transport, agriculture (non-CO2), waste, F-gases, other smaller sectors outside ETS
Breaks down the EU target of -30% for non-ETS sectors by 2030 into Member State targets
Member State targets will be enhanced to match those of the 2030 Climate Target Plan
Possible extension of EU ETS to buildings and transport will have commensurate effects for this Regulation

Private Transportation

To cover road transport by emissions trading from 2026, putting a price on pollution, stimulating cleaner fuel use To extend carbon pricing to the maritime sector, and set targets for major ports to serve vessels with onshore power	To introduce carbon pricing for the aviation sector and to promote sustainable aviation fuels	The Commission also promotes the growth of the market for zero and low emissions vehicles by ensuring that the citizens have the infrastructure they need to charge them

Decarbonising the energy system

Reducing greenhouse gas emissions by at least 55% by 2030 requires higher shares of renewable energy in electricity production and greater energy efficiency.

40% new renewable energy target for 2030	36-39% new energy efficiency target for final and primary energy consumption

The Commission also proposed to align the minimum tax rates for heating and transport with our climate objectives, while mitigating the social impact and supporting vulnerable citizens.

Buildings

Renovation is key for reducing the energy consumption of buildings, for bringing down emissions and for reducing energy bills. In addition, renovation generates employment and economic growth.

The new Social Climate Fund, funded by revenues from emissions trading in road transport and buildings, will provide financial support to citizens, in particular the vulnerable households, to invest in renovation or heating systems and ensure a fair transition..
=> buildings account for 40% of energy consumption and 36% of energy related greenhouse gas emissions

Trade and price of carbon

On 1 October 2023, the EU's Carbon Border Adjustment Mechanism (CBAM) entered into application in its transitional phase to contrast the so-called 'carbon leakage'.

Carbon leakage: occurs when firms based in the EU move carbon-intensive production abroad to countries where less stringent climate policies are in place than in the EU, or when EU products get replaced by more carbon-intensive imports.

Topics in International Trade Theory

The rationale for economic integration among countries

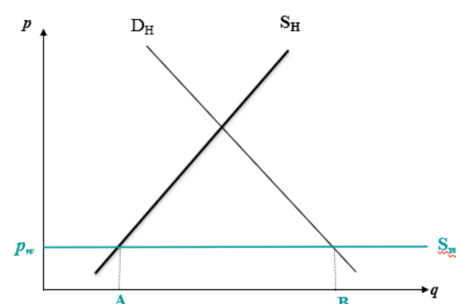
The theory of economic integration studies how intermediate situations between pure protectionism and free trade affect efficiency in the use of resources for every country.

Free Trade: no restriction to import and export	**Protectionism:** - tariff/custom duties - Quantitative restrictions (quotas) - Standards/regulations	**Full protection:** Autarky is the highest level of protectionism (no imports allowed) as it leads to the closed-economy equilibrium

Demand and Supply

DH = domestic demand in H maximum price for each unit of the good that consumers in H are willing to pay

SH = domestic supply in H minimum price at which producers in H are willing to sell each unit of the good



Hypotheses

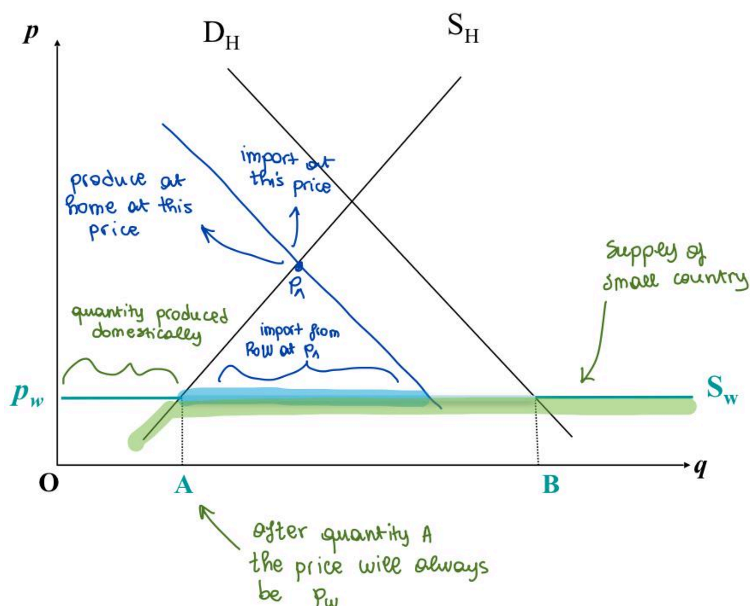
Consider one country H and one homogeneous good, produced both at home as well as somewhere else in the world

- perfect competition
- insignificant transport costs
- upward sloping domestic supply SH
- **world supply Sw perfectly elastic at price Pw** =>***small country hypothesis:*** whatever quantity we demand, the rest of the world will keep asking the same price, not a big share of the market demand

Free Trade

OA = Domestic supply
OB = Domestic demand
AB = Imports from RoW

If I am allowed to trade, where is production going to be? ⇒ you produce domestically until you reach the price of the rest of the world



Protectionism

We can distinguish three main tools through which protectionism can be implemented:

1. **Tariffs** (specific or ad valorem)
2. **Quotas** (= quantitative restrictions, e.g. to imports)
3. **Non-Tariff Barriers (NTBs)**, e.g. safety standards

1) Tariffs

A tariff can be calculated according to two main formulas:

Ad valorem: **Th = Pw (1 + t)**

eg, If Pw = 40 EUR and t = 20% -> TH = 40 EUR (1 + 0.20) = 48 EUR

Specific: **Th = Pw + T**

eg, If Pw = 40 EUR and T = 8 EUR -> TH = 40 + 8 = 48 EUR

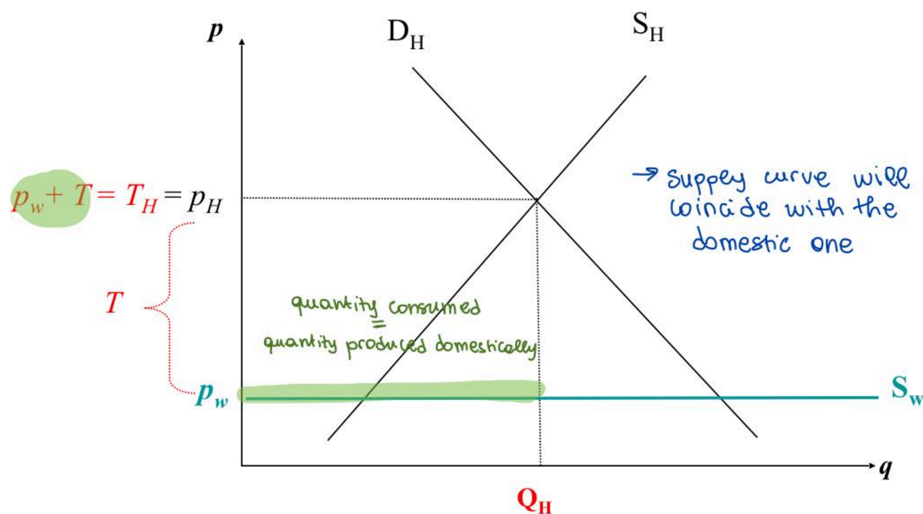
⇒ Th is always price after tariffs

We will mostly consider SPECIFIC tariffs in this set of slides.

Autarky – prohibitive tariff

Ph = price in autarky

- Pw + T = pH; T is the "prohibitive" (specific) tariff ⇒ price that brings the country in autarky equilibrium
- Qh = Domestic supply = Domestic demand => autarky
- There are no imports from the rest of the world

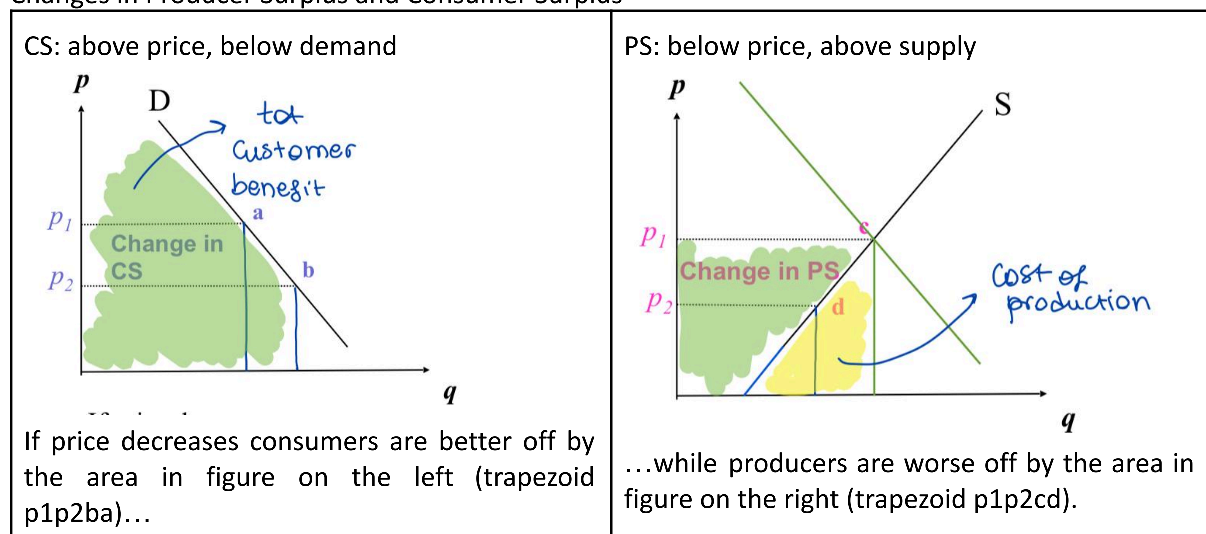


Autarky vs Free Trade

⇒ what situation makes consumers better off? What is best for producers?

⇒ we must evaluate agents' welfare

Changes in Producer Surplus and Consumer Surplus



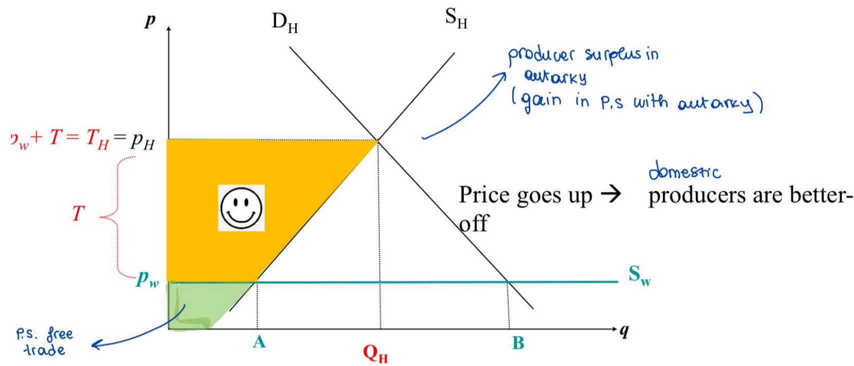
CS: above price, below demand	PS: below price, above supply
If price decreases consumers are better off by the area in figure on the left (trapezoid p1p2ba)…	…while producers are worse off by the area in figure on the right (trapezoid p1p2cd).

Net gain = difference between Change in CS and Change in PS

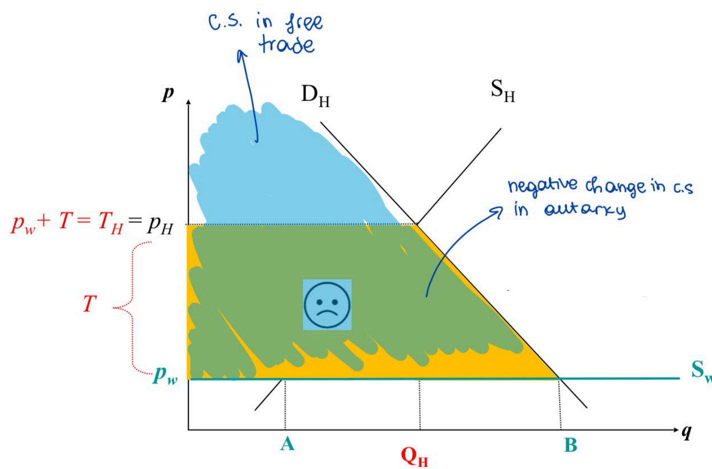
Note: in case the government is involved (tariff revenues), we have to take into account that too!

From Free trade to Autarky

1) **change in PS:**

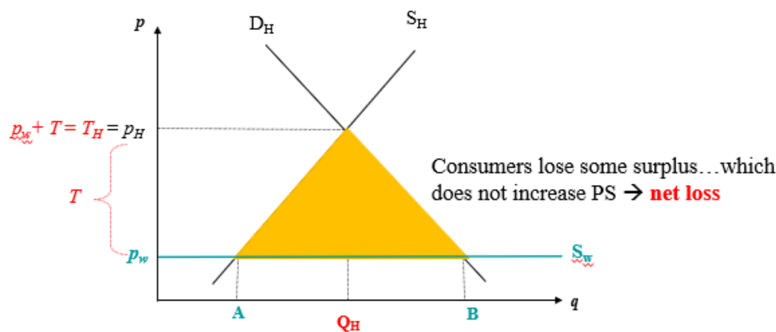


2) **Change in CS:**



⇒ price goes up and consumers are worse off

3) **Change in total welfare:**



with respect to CS in free trade

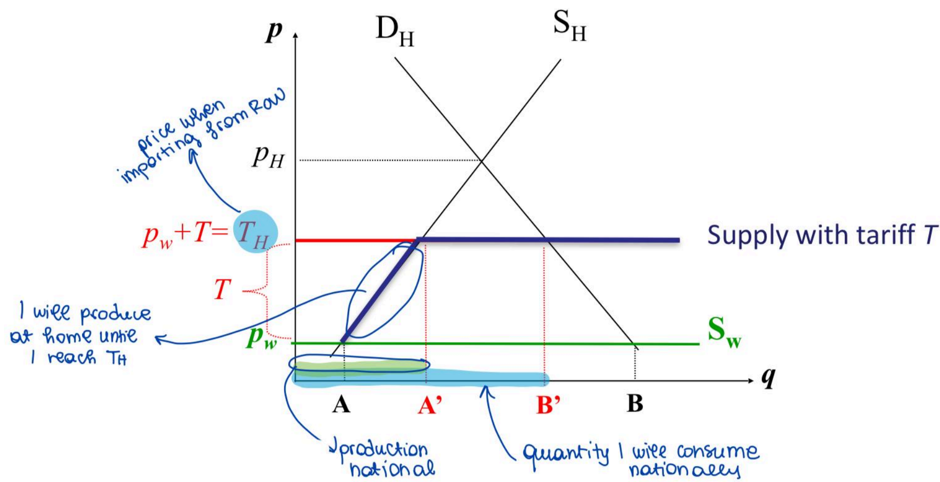
Non-Prohibitive tariff

⇒ not autarky ⇒ PROTECTIONISM

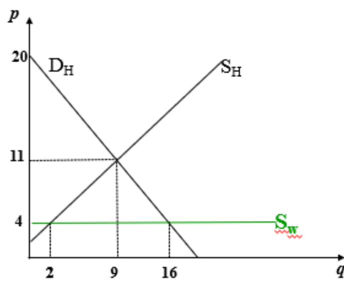
TH=Pw+T (*specific* tariff T) or TH=pw (1+ t) (*ad valorem* tariff t)

OA' = Domestic supply; OB' = Domestic demand;

A'B' = imports from the rest of the world => smaller than AB



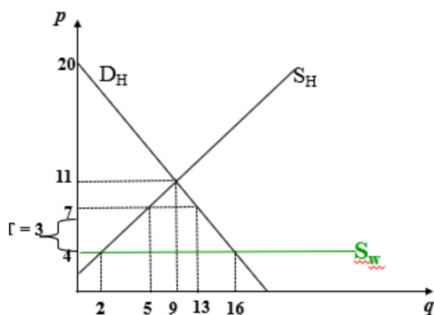
A numerical example



Suppose that the demand curve in country H, Dh, is q= 20-p, while the inverse supply curve Sh is q=p-2.

Equilibrium quantity and prices in H in this case would be, Qh=9 and Ph=11

If the world price of the considered good is Pw=4 and country H adopts a free trade policy, then the total demand of consumers in country H will increase to 16 (by solving q=20-p with p=4), with a domestic production of 2 (by solving q=4-2) and imports 14, the difference between total demand and domestic supply.



Suppose now that country H, in order to stimulate local production, decides to apply a specific tariff T=3.

We will have that the final price of the imported good faced by the consumers in H will increase, and notably we will have Th= Pw+T=7. The higher price of the imported good will receive total demand to q=13 of which 5 (q=7-2) will be produced locally while 8 will be imported.

If a specific tariff T=7 is set, then Th=Pw +T=11 =Ph and so all the resulting total demand of 9 will be served by domestic production, with no imports from the rest of the world: T=7 would thus be a prohibitive tariff.

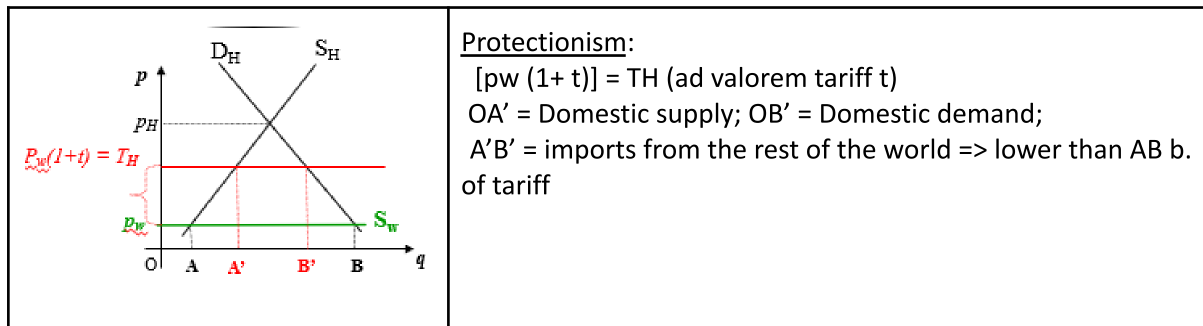
Recap: The 'classic' theory of economic integration, Free trade vs Autarky

Hypotheses

- consider one country H and one homogeneous good
- perfect competition in goods and factor markets
- insignificant transport costs and balanced current account
- upward sloping domestic supply SH
- pH = internal equilibrium price of country H; pw = world prices < pH
- World supply Sw (perfectly elastic => small country hypothesis)

Free Trade:	Autarky:

• OA = Domestic supply • OB = Domestic demand • AB = Imports from RoW	• Pw + T = TH = pH ; T is the "prohibitive" (specific) tariff • OQH = Domestic supply = Domestic demand ⇒ There are no imports from the rest of the world



Protectionism:
[pw (1+ t)] = TH (ad valorem tariff t)
OA' = Domestic supply; OB' = Domestic demand;
A'B' = imports from the rest of the world => lower than AB b. of tariff

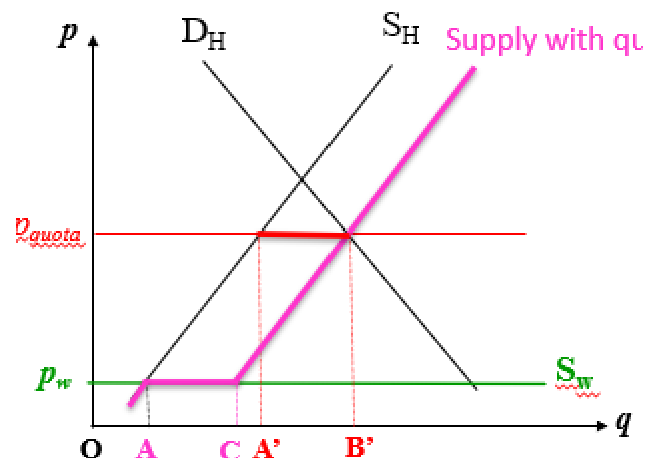
2) Quotas

An import quota is a **quantitative restriction** on the amount of goods that may be imported. The aim is usually to protect domestic producers.

Normally, the domestic government issues licenses: only the agents (individual or firms) who hold those licenses can import a maximum amount of the goods subject to the policy.

In the Free Trade Equilibrium:

- The equilibrium price is pw
- The quantity consumed is OB
- The quantity domestically produced is OA
- The imported quantity is AB



If we introduce a quota:
Consider an import quota of an amount AC:
The supply faced by consumers becomes the pink line.

- The equilibrium price is Pquota
- The quantity consumed is OB'
- The quantity domestically produced is OA'
- The imported quantity is A'B' = AC

Pquota > Pw the domestic price is higher under the quota
OB' < OB home consumers consume less under the quota
OA' > OA home producers supply more under the quota
A'B' < AB imports decrease if a quota is in place

⇒ a quantity restriction affects prices!!
Notice: an import quota raises the domestic price of the imported goods. Why?

At the price pw, the demand exceeds domestic supply plus imports, when imports are limited by a quota
→ the price increases until the market clears! This happens at Pquota
→ a quota raises the domestic price, *similarly to what a tariff would do*

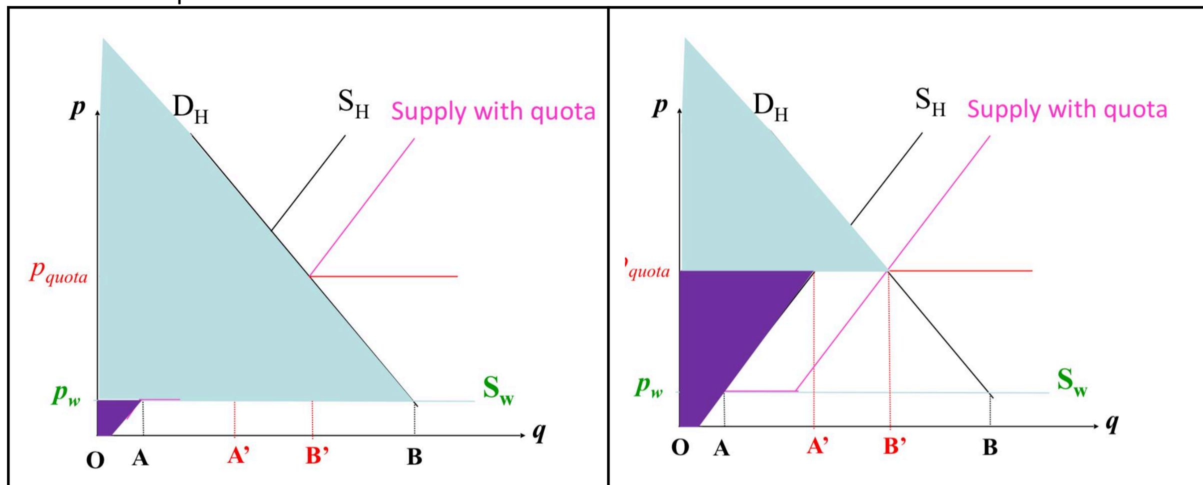
Tariff-quota equivalence
There would be an equivalent effect on price, consumption and production if instead the government had imposed a tariff of an amount

t = Pquota – Pw

→For every quota, there is an equivalent tariff (Baghwati, 1965)

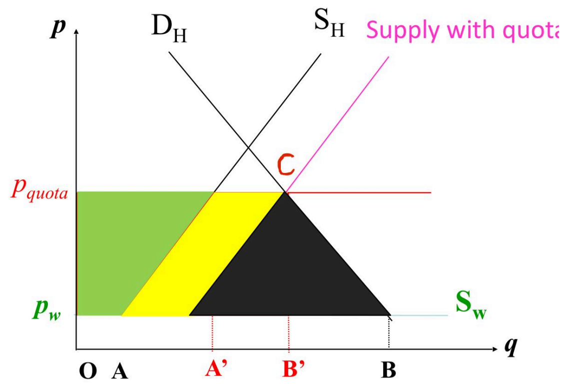
→**Notice: this is true only under specific assumptions (perfect competition required!)**
→**Notice** an important difference between tariffs and quotas: **the government does not raise revenues under a quota!**

Welfare, CS and PS under a quota:
Free trade vs quota:



Welfare changes:
If an import quota is introduced, we see:
- a **loss in consumer surplus: Area: Pquota,C,B,Pw**
- a **gain in producer surplus**
- a gain for those who can buy at pw and resell at Pquota > Pw (quota rents ⇒ not to the government, but to same chosen industries)

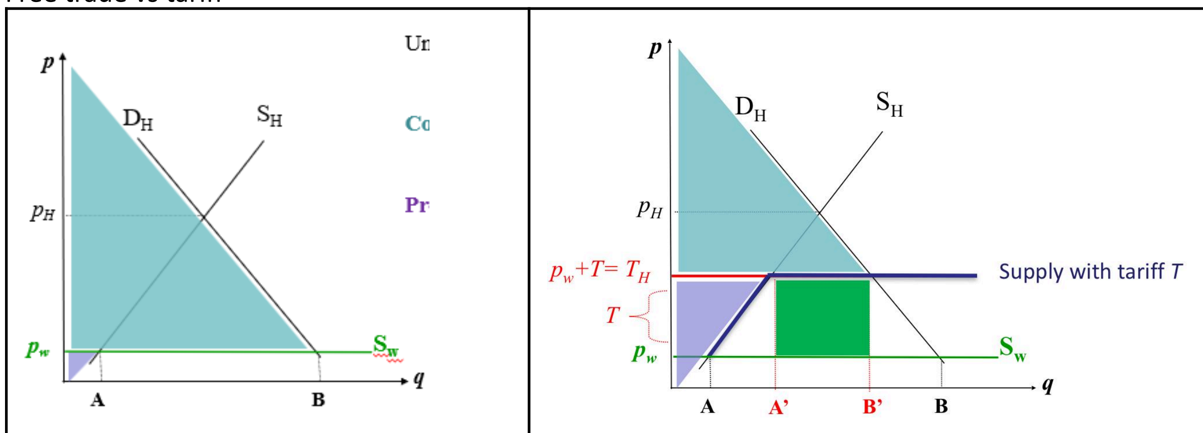
There is a **deadweight loss:** some surplus (that was for consumers in free trade) that just disappears!



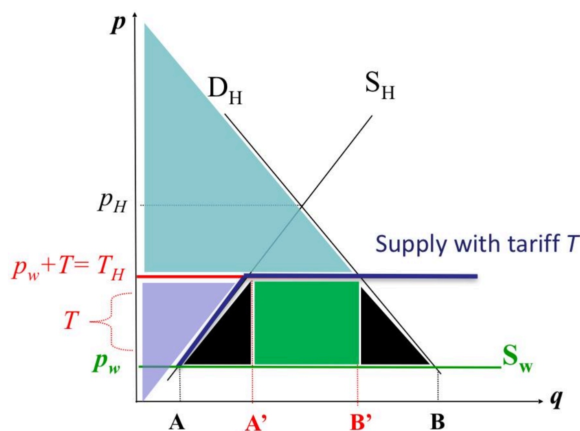
What about the government? ⇒ **nothing happens! There are no government revenues!** (different in case of tariffs)

Welfare change under tariffs

Free trade vs tariff



Change in total welfare:



Consumer surplus

Producer surplus

Tariff revenue (for government)

- A loss in CS
- A gain in PS
- A gain for the Government

⇒ **Net effect: a deadweight loss** as some surplus disappears (from consumers in free trade)

Ex. US quota on sugar, largest imported commodity subject to quota.

The UD Department of Agriculture established annual quota limits. The US Trade Representative (ustr) allocates the country quantitative limits and US customs and border protection implements the sugar quotas. ⇒ the US is an important producer of sugarbeet and corn, while sugarcane is mostly grown in Brazil. US Importing a quota on sugar, so that the production of alternative goods(or domestic alternative goods) is protected such as corn. In fact, the majority of the world corn production is in the US.

3) Non-Tariff Barriers

- *Non-Tariff Barriers* are determined by the set of rules that each country imposes to regulate industrial production methods, safety standards, environment, consumer protection, etc.
- **Sanitary and phytosanitary measures** refer to restrictions for substances and measures for preventing dissemination of disease (such as certification, testing and inspection and quarantine).

  For example, the EU prohibits the placing on the market and the import of meat treated with certain hormones and of chlorine-washed chicken.

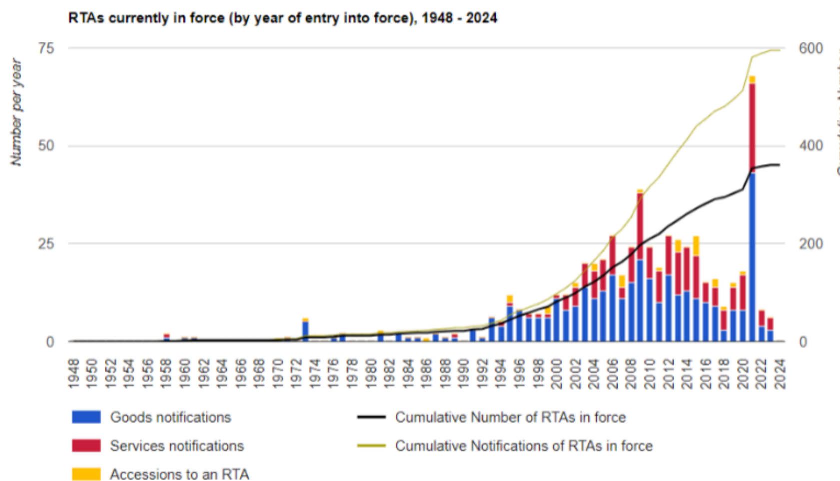
  Another example: kinder eggs in the US
- **Technical measures** refer to labeling and other measures protecting the environment, standards on technical specifications and quality requirements (e.g. to flammability or azo dyes).

These requirements (legitimate when they aim at preserving consumers' health) constitute a burden on producers and build a complex layer of multiple requirements **constituting additional costs** (thus higher prices).
=> since specifications must be implemented, the cost of labour/research is higher so **the product becomes less competitive**

Why a MINI ready for the European market cannot be sold in the U.S? The parts of the toys are considered too small and pose a choking risk to children.

Free Trade Areas (FTAs) and Customs Unions (CUs)

The pandemic was a boost to decrease transaction costs.



the presence of **regional trade agreements** has been increasing over time

RIAs are groupings of countries formed with the objective of reducing barriers to trade between members of the group

- They constitute a driving force of globalization, and are permitted by the WTO rules under article XXIV ofGATT
- EU is a prominent example of RIA
- As of January 2020, 303 RIAs are in force (see full list here)
- Almost all countries are nowadays members of a RIA, with more than 1/3 of global trade taking place within RIAs

- Two main modes: **“Free Trade Areas” vs. “Customs Unions”**

2 countries: Home (H) and Partner (P)
Starting point: **protectionism with all trade partners**.

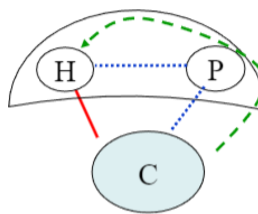
1) H and P maintain positive tariffs TH, TPbetween themselves. (TH,P >0)
2) H and P now set zero tariffs between them (free trade). ⇒ free trade (TH,P = 0)

Free Trade Area: Free Trade Area H-PCountries maintain individual tariffs TH, TP with the RoW but liberalise trade between themselves NAFTA/USMCA (US,Canada, Mexico)	**Custom Union:** Customs Union H-PCountries agree on a uniqueCommon External Tariff with the RoW and liberalize trade between themselves European Union - 1969

<u>The EU is a customs union</u>
There is free trade among EU members.A product coming from another country has the same treatment (e.g. tariff) independently of the point of entry in the EU

<u>Trade Deflection:</u> deviation from intuitive logistic trade path in favour of another because of tariffs. Ex: no trade with neighbouring countries because they have no tariffs

⇒ trade deflection is illegal



Suppose that a Free Trade Agreement (FTA) is in place between countries Home (H) and Partner (P);

- Suppose that country P autonomously decides to have free trade with country C while country H keeps its protectionist policy vis-à-viscountry C (OK in a FTA, impossible in a Customs Union).
- For example:P is Mexico, which has a free trade agreement with the U.S. (H) and with theEuropean Union (C).But there is no free trade agreement between the EU (C) and the US (H),thus still tariffs between H and C

If you are based in Europe (C), you can export duty-free to Mexico (P)but it you want to export from Europe to the U.S. (H), you have to pay the tariffWhat if, in order to avoid the American tariff, first you export duty-free to Mexico, and then youre-export the same product from Mexico to the U.S.?This phenomenon is named: (direct) trade deflection

To prevent trade deflection that shrinks country H’s -US’s - tariff revenues, the agreement (such as theNAFTA/USMCA) writes down rules of origin to assess the nationality of traded goods.Rules of origin: only goods that have “origin” in theFTA (H and P) can freely circulate between H and P.How to assess this? Only goods whose value added is mostly created in P are said to have“origin” in PGoods manufactured in C entering country H, directly or indirectly (via P), have to pay TH

- If H and P are in a Customs Union, no need to check nationality of imported goods, the tariff is the same in the entire CU.If instead H and P are in a FTA, there should be custom controls to check the origin.

Rule of Origin:
to prevent trade deflection, control where the good has originated from

Substantial transformation: if goods substantially change its nature, ex from fabric to neck tie.

There is no harmonised set of rules of origin (RoO) but there are some common provisions entailed in free trade agreements (WTO page).

- While product-specific rules of origin differ between different sectors, general rules of origin normally apply to all sectors (video).
- There are two basic criteria for determining the origin of products:1. Wholly obtained or produced: it applies to commodities and related products that have been entirely grown, harvested or extracted from the soil in the territory of that member country or have been manufactured exclusively from these products (e.g. plants, animals born and raised, fish when caught in the territorial waters).2. Sufficient working or processing (sufficiently transformed): for complex products there are different criteria such as:
- Changes in tariff classification;
- Percentage of regional value content.

NAFTA (North American Free Trade Area, i.e. US, Canada, Mexico) is shaped as a FTA.In fact, Mexico and Canada are allowed to have a FTA with the European Union, withrules of origin protecting NAFTA from EU exports.

- The **European Union** is shaped as a **Customs Union** (since 1969, after its creation in the1957 Treaty of Rome)
- The **EU-Turkey** trade relations are shaped as a **Customs Union** since year 1995
- The **EU-Korea** trade relations are shaped as a **FTA** as of 2014

Why have the EU founding countries chosen to create a Customs Union ?Why the US have chosen to create a FTA with Mexico and Canada?Why has the EU opted for a FTA rather than a CU with Korea?

From an economic perspective, FTAs are more efficient than Cus.
However, from a transaction-costs perspective:

1) Customs Unions imply a political cost of negotiations, which grows with the size and heterogeneity of the CU, thus generating a trade-off with different optimal solutions depending on the specific case.
2) Customs unions can generate greater welfare effects for member countries by increasing their bargaining power on the global stage (i.e. removal of the “small country” hypothesis), leading to favourable trade agreements.

Why did the EU choose to be a Customs Union and not a Free Trade Area?

- One of the reasons is that with an FTA the EU would remain a union of "small" countries with independent tariffs and independent trade policies.
- A CU allows them to play as one single player at the table of international trade negotiations (eg the WTO). In this position the EU would get **more bargaining power if it is a CU than a FTA**. If it is a CU it can threaten the rest of the world to raise CET credibly.

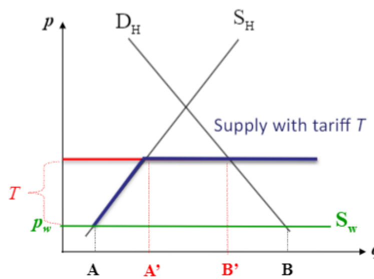
Why should this be credible?

- Because, as a CU, the EU becomes a "large country" and might gain by charging a moderate tariff unilaterally. This gain makes the threat credible. At the bargaining table for tariff reductions, a credible threat would lead third countries to reduce their tariffs too.
- Let’s see why this gain could arise…

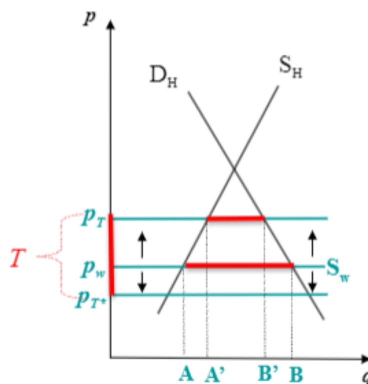
Consider one country H and one homogeneous good,produced both at home as well as somewhere else in the world

⇒ perfect competition ⇒ insignificant transport costs ⇒ upward sloping domestic supply SH ⇒ world supply Sw perfectly elastic at price Pw ⇒ small country hypothesis

The Small Country Hypothesis

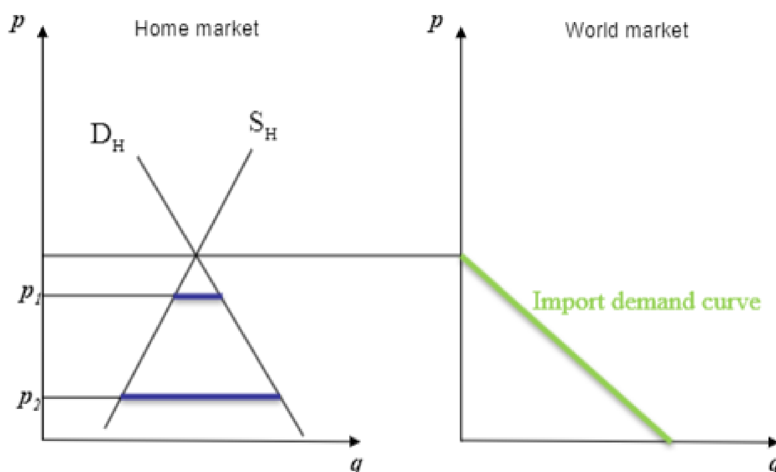


The "small" country assumption implies that the price of imports that foreign producers receive is equal to the world price pw, independently from the quantity imported!In other words, for a small country the import price is not influenced by the amount imported (because the country is so small that its imports are negligible with respect to what's traded in the world market).When we consider a small country:- under free trade:home consumers pay pw foreign producers receive pw- with a tariff:home consumers pay pw + TForeign producers receive pw(T*A'B' is the tariff revenue)



In that case, introducing a tariff T on imports would drive a wedge between the domestic and foreign price.We will see an increase in the domestic price paid by consumers (pT < pw + T) increase in domestic production (OA'>OA) lower imports (A'B'<AB) a reduction in the price received by foreign producers pT* < pw (why? because imports are now lower, due to the tariff and the "size" of home, that now matters!)

Import Demand Curve



At p1, quantity consumed is until the end of the blue line, but quantity produced is just until the left corner of the line.

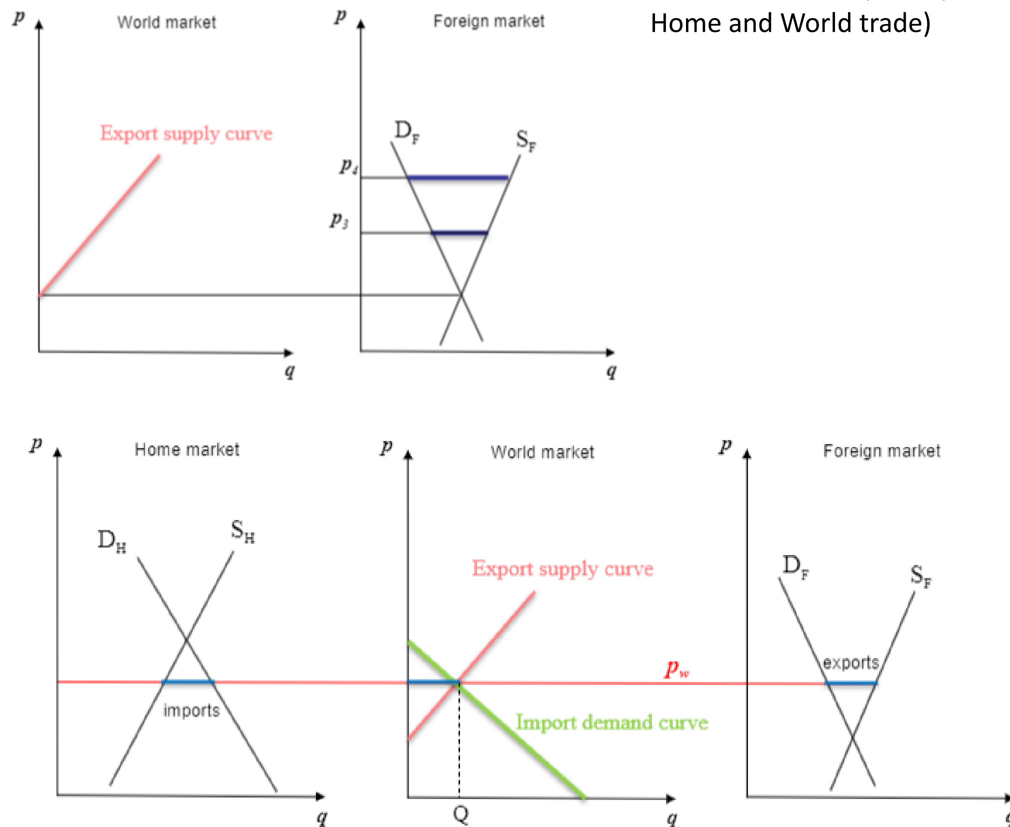
⇒ the lower the price, the lower the producers want to produce and the higher the imports are

⇒ foreign producers are always assumed to be more efficient than national producers because of different comparative advantages

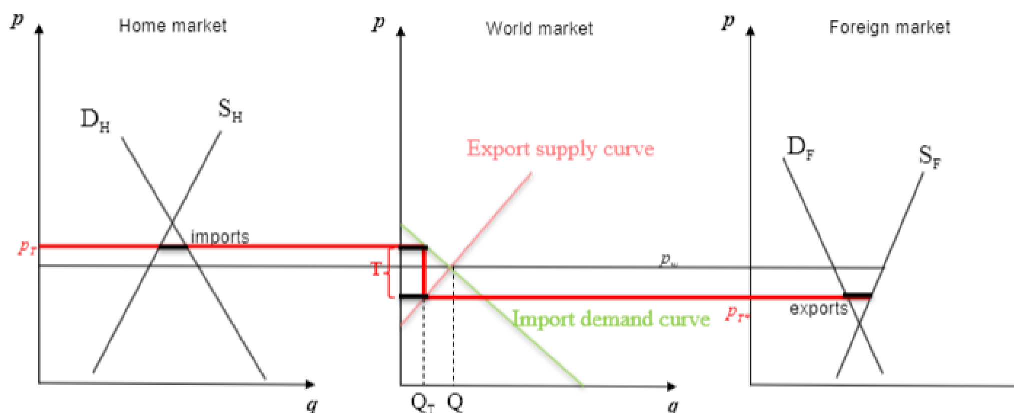
Import Supply Curve

The blue line is surplus products produced by the national economy.
⇒ the higher the price, the more the national consumers are willing to produce, but the lower domestic consumers are willing to consume.

3 markets: home, RoW, and Foreign (where Home and World trade)

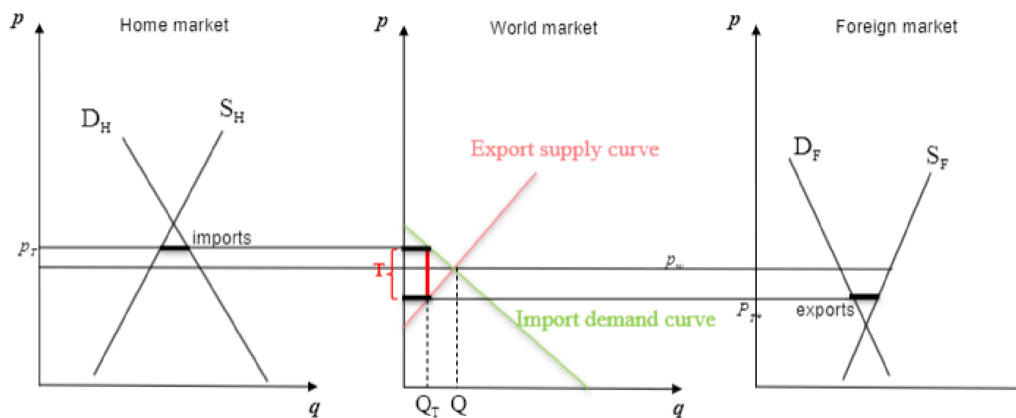


What if the home country has tariffs on imports?



Introducing a tariff creates a wedge between the home price and the foreign price:pT = pT* + TIn home, consumers demand less and domestic producers supply more ⇒ imports decrease
⇒ In foreign market , producers supply less and consumers demand more ⇒ export decrease

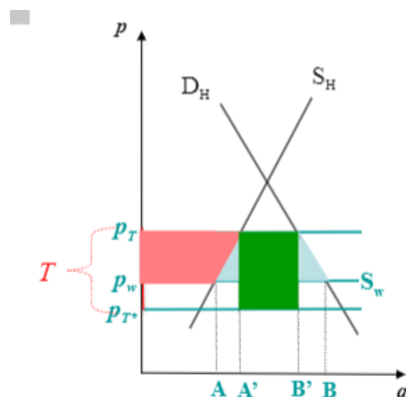
What if Home is a large country?



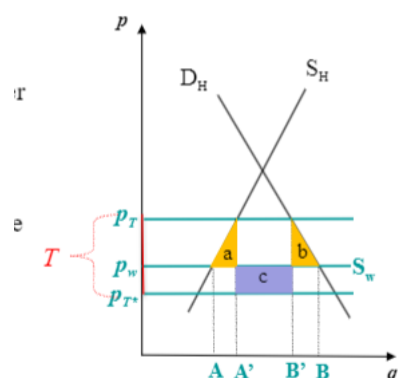
There is a decline in the foreign export price ⇒ not all the tariff's burden falls on home consumers.
If Home were small, such an effect on the foreign price is null, and the full tariff's burden would fall on home consumers.
The tariff has an impact on foreign supply since the RoW is inevitably dependent on the big country, so the supply curve is not vertical. ⇒ foreign country produces less

Welfare Analysis: Free Trade vs Tariff

Consider a large country. Let's start with a free trade situation and then let's introduce a tariff on imports.



⇒ consumer surplus would decrease
⇒ producer surplus would increase
⇒ the government would receive some tariff revenue



(a+b) represent the efficiency loss:- consumers consume less and pay a higher price
(area b)- the good is now partly produced at home,even though the rest of the world is a better producer in terms of costs
(area a)c represents the terms of trade gain: the tariff on home imports lowers the export price since home is a large country some welfare is lost (a + b) and some new welfare is gained (c) due to the tariff introduction in a large importer.
(c) is the welfare increase for the government
The net effect is **c – (a + b)** and is ambiguous! ⇒ It could be the case that a moderate import tariff increases welfare in the home country. A and B are not necessarily equal.

From CU to the Common Market

We proved that, as a CU, the EU becomes a "large country" and might gain by charging a moderate tariff unilaterally ⇒ integration is good.

Can we think about other gains arising from integration? So far, we assumed that the production activity could not be relocated among thedifferent CU members. If economies of scale existed, however, it could be cost-effective to concentrate production in one specific location belonging to the CU!

What if we had a CU in which producers H could move their production to P? Rules are have to be written for allowing a movement of factors of production (labour and capital) ⇒ a Common Market, with 4 fundamental freedoms, "naturally" follows a Customs Union where economies of scale are relevant

EU Trade Policy

⇒ **European Single market**

The trade policy established how the single market interacts with the RoW.

With the Treaty of Rome (signed in 1957 and entered into force in 1958), the EUmember States decided:

- to start the process of forming a common/single market by abolishing legal restrictions to trade within the EU.
- to set up a Customs Union, i.e. a unique EU trade policy vis-à-vis the rest of theWorld with the aim to liberalize trade (see for example EU involvement in the WTOand the trade bilateral agreements).The EU adopts a consistent approach for the internal and the external dimension, ie,inside and outside the single market: free and fair trade

The EU is the world's biggest trader.

- **Open trade** among EU countries (i.e. the common market) is the cornerstone of the EU and has brought prosperity to all its member states. ⇒ it is proved that increasing mobility of trade brings welfare for the consumer
- The EU believes that increased trade (and competition) is likely to boost world growth to **everybody's advantage**.
- **Globalisation** can bring economic benefits to all, including the developing countries, provided appropriate rules are adopted at the multilateral level and efforts are made to integrate developing countries in world trade.
- That is why the EU:– Is a member of the **World Trade Organization (WTO)**– Negotiates and signs (bilateral/regional) trade agreements with third countries.

⇒ this is free and fair trade, not globalisation per se without rules

EU Trade Policy has always been one of the most effective foreign policy tools

- The Lisbon Treaty considers explicitly trade policy as an integral part of the EU external action.

In particular, Article 3 par. 5 of the TEU states:*'In its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security,the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights, in particular the rights of the child, as well as to the strict observance and development of international law,including respect for the principles of the United Nations Charters.'*

The customs union was the EU's first big step towards economic integration.

- A **customs union** requires political coordination as it defines the external dimension of the Union. ⇒ To exit the EU customs union you must also leave the EU.

- The Treaty of Rome granted supranational powers to the **EU's institutions: 'exclusive competence', ie, the EU has exclusive power to set the trade policy with third nations**(individual Member States **cannot** sign independent trade agreements).
- 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 has been extended (eg, to foreign investment, services, property rights): big step forward with theLisbon Treaty (2009).

The European Commission has the task of negotiating trade matters with third nations on behalf of the Member States.

The Commission has also the **right of initiative** on trade agreements and it supervises the implementation of such agreements.

- The European Parliament is co-legislator with the Council on all basic EU trade legislation (eg, grantingGSP preferences, imposing anti-dumping measures).
- Negotiations are conducted by the Commission in accordance with specific mandates defined by theCouncil and the Parliament. Such directives are approved through '**ordinary legislative procedure**'.
- *Once the Commission has negotiated*…The Council must adopt any agreements negotiated by the Commission after the Parliament has given its consent. *Parliament cannot amend* in this case (but has influence through veto power).

⇒ In the U.S.: Trade Promotion Authority (TPA), also called "fast track", gives the President the power to negotiate trade agreements, draft implementing legislation to change US law, and sign agreements into international law. Congress's involvement is restricted to an up or down vote on the final bill with no amendments allowed

EU's competence

The EU's exclusive competence covers the following matters:

- trade in goods, including regulatory matters;
- trade in services, including mutual recognition agreements and all transport services;
- trade related aspects of Intellectual Property (IP);
- public procurement;
- market access in the area of FDI;
- investment protection as far as it concerns FDI;
- trade and sustainable development in its entirety; and
- the termination of member State bilateral investment agreements for the parts concerning exclusive competence.

When agreements covering policy areas that are not only of the EU's exclusive competence are named 'mixed' and, along with the EU approval, national parliaments (36 chambers) have to ratify them. For example, in the EU-Singapore FTA the ECJ found that portfolio investments and the investor-State dispute settlement(ISDS) procedures were not an exclusive competence of the EU.

EU Institutions for trade policy

Financial Times (11 November 2021). France persuaded the EU to postpone signing two new trade agreements until after its presidential elections in April 2022, angering other member states that want the deals to be concluded.

- The EU had hoped to finalize trade pacts with **Chile and NewZealand** in 2022 but Paris convinced the European Commission to delay the deals.
- EU diplomats said Emmanuel Macron, president of France, feared a surge in imports of chicken from Chile and lamb from NewZealand, which opposition candidates could use to mobilize farmers and groups opposed to globalization as he campaigns for re-election.p.s.

⇒ The deal with Chile would give the EU easier access to secure supplies of lithium to boost its electric car industry and reduce dependence on China

EU and WTO

The World Trade Organization (WTO) is an international organization that is concerned with the regulation of trade between nations.

- The WTO commenced in 1995 and replaced the General Agreement onTariffs and Trade (GATT).

The objectives of the WTO are:

- That international economic relations should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand;
- Expanding the trade in goods and services; and

While allowing for the optimal use of the world’s resources in accordance with the objectives of sustainable development, seeking both to preserve the environment and to enhance the means of doing so in a manner consistent with their respective needs and concerns at different levels of economic development.

) The WTO as a negotiating forum.• WTO members (countries) negotiate and adopt agreements with the aim to promote free and fairtrade. 164 countries are in the WTO; the observers: Algeria, Belarus, Ethiopia, Iran, Serbia, Somalia,Sudan...; not even observers: North Korea, Eritrea ...• WTO’s scope is not limited to tariffs reduction but also to trade-related issues (eg, services, standards,labour, competition, IPRs).• Agreements can be multilateral (all WTO members) and plurilateral (some WTO members).• The bulk of the WTO's current work comes from the 1986-94 negotiations called the Uruguay Roundand earlier negotiations under the GATT.• WTO members launched a new round of negotiations in 2001 “Doha Development Agenda” (afterSeattle 1999); still ongoing, but its future is uncertain.2) The WTO as a resolution mechanism for trade disputes that arise, for example, when a membergovernment believes another member government is violating an agreement or a commitment that ithas made in the WTO

Rounds of Trade Negotiations

Avg. Tariff on goods 1946 = 50%

Avg. Tariff on goods 4%

Year	Place	Issues	N. of Countries
1947	Geneva	Tariffs and Duties on Goods	23
1949	Annecy	Tariffs and Duties on Goods	13
1951	Torquay	Tariffs and Duties on Goods	38
1956	Geneva	Tariffs and Duties on Goods	26
1960-1961 *(Dillon Round)*	Geneva	Tariffs and Duties on Goods	26
1964-1967 *(Kennedy Round)*	Geneva	Tariffs and Duties on Goods Anti-dumping measures	62
1973-1979 *(Tokyo Round)*	Geneva	Tariffs and Duties on Goods Non tariff Barriers	102
1986-1994 *(Uruguay Round)*	Punta del Este Geneva Marrakech	Tariffs and Duties on Goods Non tariff Barriers General Agreement on Services (GATS) Intellectual Property (TRIPs) MFA (textiles) Agreement on Agriculture (AoA) Creation of WTO	123
1999 Millennium Round 2001 Development Round	Seattle Doha	Tariffs andDuties on Goods Non tariff Barriers Agriculture Services Intellectual Property Competition and Investments Environment Development	137 (China since 2001) 164

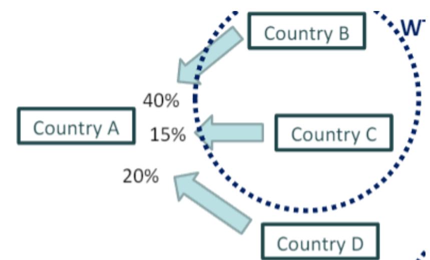
1) **Reciprocity**. WTO members have symmetric rights and obligations, and should obtain mutually beneficial reductions of trade barriers.
2) **Consensus**. In the WTO nothing gets decided unless there is ‘consensus’: if no Member,present at the meeting when the decision is taken, formally objects. 164 members,

but they often negotiate in coalitions (e.g. agricultural exporting countries such as the Cairns group).

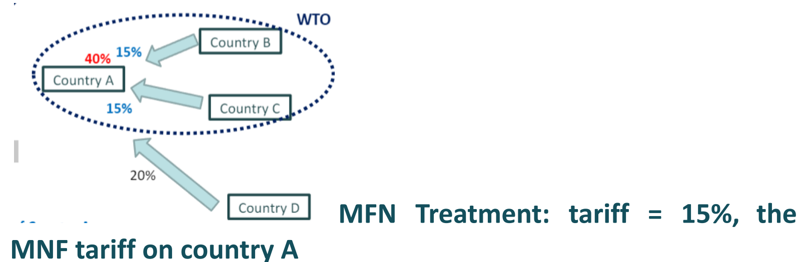
3) **Single undertaking**. Every item of the negotiation is part of a whole and indivisible package and cannot be agreed separately. i.e. Nothing is agreed until everything is agreed.
4) **Non-discrimination**. Once foreign products enter into an importing country, they should be accorded a treatment equal to the one guaranteed to similar national products (National treatment); all WTO members should receive by another member the same treatment as the one accorded to the partner country that receives the best treatment (Most favoured nation,MFN).
5) **Tariff bindings.** Once a tariff reduction has been negotiated and accepted, it becomes "bound"at the negotiated rate

The MFN Treatment

1) **Country A is not in the WTO** so it can set different tariffs on imports coming from other countries (B and C are already members of the WTO)



2) **Country A joins the WTO**, then it is obliged to apply to every member of the WTO the "best conditions" (in our case 15% applied to goods coming from C)



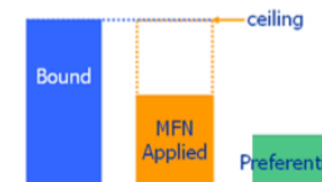
MFN Treatment: tariff = 15%, the MNF tariff on country A

- Countries enter the WTO with their own tariff profiles and they can keep tariffs once member;tariff elimination is a long-term aim of the WTO members.
- MFN tariffs are what countries promise to impose on imports from other members of the WTO,unless the country is part of a preferential trade agreement (such as an FTA). Thus, MFN tariffs are the highest that WTO members charge, by default, one another.
- The tariffs that country A adopts against import from country B is, in majority of cases, different from the tariffs country B adopts against import. Reciprocity has more a 'dynamic' understanding(thus about the change) rather than the absolute value of respective tariffs

MFN: Bound vs Applied

When countries join the WTO, or when WTO members negotiate tariffs with each other during trade rounds, it is about MFN bound tariffs.

- The bound tariff is the maximum MFN tariff level for a given product.
- However, bound tariffs are not necessarily the rate that a WTO member applies in practice to other WTO members' products.
- Members have the flexibility to increase or decrease their tariffs (on a non-discriminatory basis) as long as they don't raise them above their bound levels (this is the MFN applied tariff).

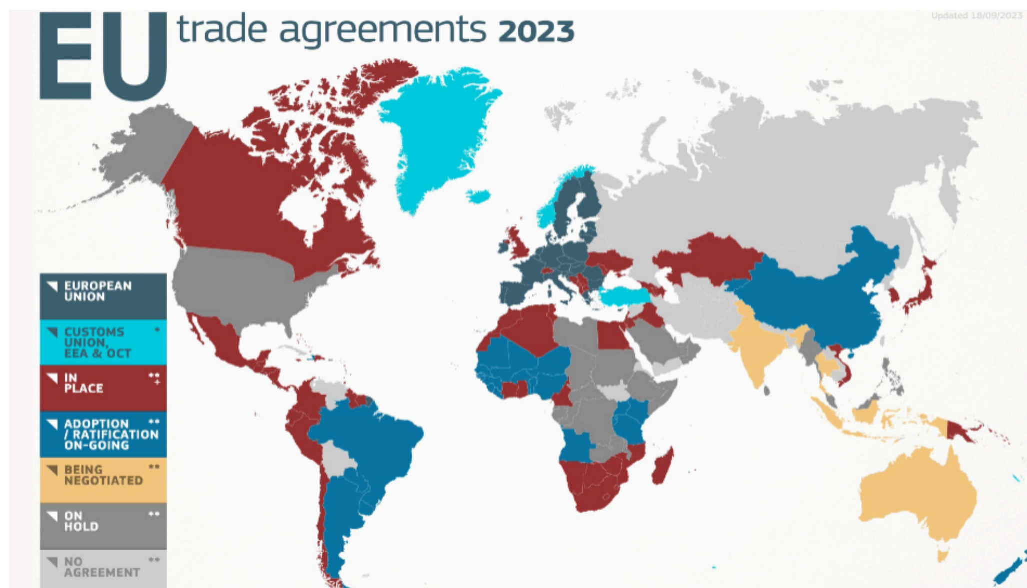


- If one WTO member raises applied tariffs above their bound level, other WTO members can take the country to dispute settlement

EU Tariffs, bilateral agreements and the GSP

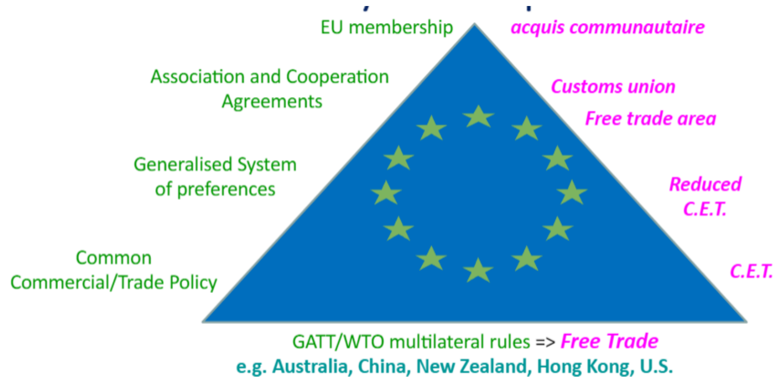
Binding in %: the percentage of tariff lines or products based for which a WTOmember has bound duty commitments.
Duty-free in %: Share of duty-free HS six-digit subheadings in the total number of subheadings in the product group

The EU (as other countries) negotiates its own bilateral trade agreements with countries orregional groups of countries.• If a country negotiates agreements with other countries, that means that the tariffs that bothparties are committed to set are below the MFN tariff (the default tariff set for WTO members),this is why they are also named preferential trade agreements (PTAs).For example EU signed FTA agreements with, among others: Balkan States (e.g. Albania, Serbia)and other European States (Norway, Iceland and Switzerland), Mexico (2000), South Africa(2000), Chile (2003), Korea (2010), Colombia and Peru (2012), Canada (2016), Japan (2018),Singapore (2019); and CU agreements with Andorra (1991), San Marino (1992) and Turkey (1995).• Recently the EU is signing Deep and Comprehensive FTAs involving FDI, services, protection ofintellectual property rights etc



The pyramid of preferences

ranks the preferential relationships of the EU with the various countries in the world according to a decreasing degree of preference.
<u>The top of the pyramid</u> expresses the maximum preferential treatment that the EU can grant to another country, i.e. the membership of the EU.
<u>At the bottom of the pyramid</u>: the MFN tariff (i.e. the default CET) applied by the EU when no specific preferences are granted but the ones agreed within the WTO rules



The WTO tariff is the default tariff (the MFN, also known as 'erga omnes'). This tariff is reduced in case of free trade agreements. FTA are symmetrical.The WTO allows to violate the MFN rule to give a special and differential treatment to developing countries (see EU, US). In the EU:

tGSP: The 'Generalized Scheme of Preferences' is a unilateral reduced MFN tariffs for a list of developing countries. This applies to e.g. Indonesia, India, Kenya, Vietnam.
tGSP+: The "GSP+" enhanced preferences implies deep cuts or full removal of tariffs for the same product categories as in standard GSP. This can be granted to countries which implement international agreements on human rights, labor rules,environmental issues and good governance. This applies to e.g. Bolivia,Mongolia, Pakistan, Philippines, Sri Lanka.
tEBA: The 'Everything but Arms' initiative is a special exemption granting to the least developed countries (LDCs) a zero-tariff access to the EU for all their products but arms. This applies to e.g. Bangladesh, Eritrea, Ethiopia, Gambia, Haiti, Nepal,Senegal

EU: Non-regional FTAs

The EU is always open to Deep and Comprehensive FTAs involving FDI, services, protection of intellectual property rights etc.
In recent years, the EU has signed a number of these deals (via cooperation or association agreements), e.g. Mexico, Chile, South Africa, South Korea, Japan. FTA with Canada (CETA) under ratification.
Current focus: Work on FTAs with Australia, Philippines and Indonesia... Asia-Pacific region identified as crucial

EU-Korea FTA

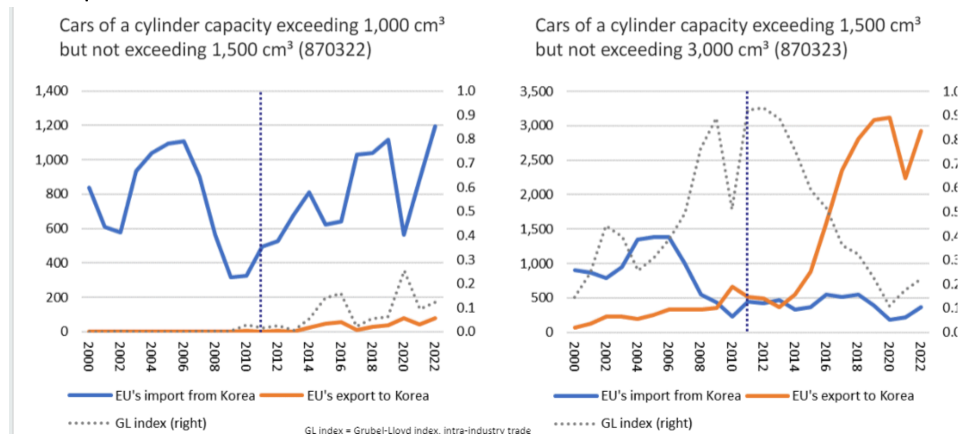
Korea was designated a priority FTA partner for the EU in its trade policy strategy and negotiations were launched in 2007.
The Agreement has been provisionally applied since July 2011 and is **fully operational since 2014**.

The EU-Korea FTA is the most comprehensive free trade agreement ever negotiated by the EU:

- Import duties are to be eliminated on nearly all products; 98.7% of duties in terms of trade value will be eliminated within five years (for a limited number of highly sensitive agricultural and fisheries products the transitional periods will be longer than seven years).
- There is far reaching liberalisation of trade in services including in telecommunications,environmental services, shipping, financial and legal services.
- Specific rules on a common jurisdiction for the protection of foreign direct investments have also been negotiated

⇒ Different interests within the EU:
Fiat-Chrysler Group CEO Sergio Marchionne called on the EU to change the direction of trade negotiations and to help strengthen domestic producers.
Marchionne opposed the free trade agreement between Europe and Korea

The change in the automotive industry
→we imported a lot of small cylinder capacity cars from Korea but exported a lot more of powerful and expensive cars to Korea



EU-Mercosur FTA
The EU and Mercosur states – **Argentina, Brazil, Paraguay and Uruguay** – reached a political agreement in June **2019** for a free trade agreement.
Talks began in 1999, but stalled before regaining momentum in 2016.

- On 7 December 2023, the parties were due to sign the agreement in Rio de Janeiro. But Argentina's elections (Milei took office as president on 10 December) and the concerns of French President Emmanuel Macron about deforestation called for a postponement.
- The agreement would increase bilateral trade and investment, and lower tariff and non-tariff trade barriers; create more stable and predictable rules in areas such as intellectual property rights (including for geographical indications), food safety standards, competition; promote joint values such as sustainable development.

Moreover, Mercosur countries are strategic for the **EU's de-risking and friendshoring**: they hold vast reserves of the critical raw materials (eg, graphite, nickel, manganese, niobium, lithium and rare earths) that are crucial for the EU's green energy transition and they can welcome part of European firms' supply chains especially after tariff elimination (now tariffs on car parts are up to 35%, up to 20% on machinery and up to 18% on chemicals).

⇒ ***Protests:***
In January 2024 tractors blocked roads in many EU countries.

- Farmers criticize the cost of EU green policies (eg, the cut of subsidies for diesel in farmyard vehicles in Germany) and theEU's free trade deals with third countries that they say flood Europe's markets with cheap, low-quality produce,squeezing their profits.
- With the trade deal, the EU is expected to import from the Mercosur more beef and other agricultural products.
- On 30 Jan 2024, a French Presidency official said:"*The Commission understood that it was impossible to conclude talks in this context"*.

- On 31 Jan 2024, the EU executive's lead spokesperson replied: “*The EU continues to pursue its goal of reaching an agreement that respects (...) sensitivities, particularly in the agricultural sector*”

WTO and Trade Remedy Measures

Free trade is, in principle, beneficial: it improves efficiency, reduces costs and prices, and boosts innovation.

- However, this competition should favour the best suppliers that compete ‘fairly’, thus avoiding:

Dumping: when a firm exports a product to another WTO member at a price that is lower than the normal value of the product (the domestic prices of the same product or the cost of production + a reasonable profit) and the domestic industry of the importing country is (or risks to be) seriously injured.

Subsidies: when a government or any public body of a WTO member confers a financial benefit to a firm or a group of firms. Subsidies are frequently used to promote legitimate objectives (e.g.social policies). However, they may also have adverse effects giving a favourable treatment to specific firms that other firms in the same market (domestic or foreign) do not get. (See State aid rules in the EU in Competition Policy slide set) Putting national security of importing country at risk

Fair Trade: Restoring the right price

What happens if a WTO member (country) is negatively affected by an alleged dumping or subsidisation?

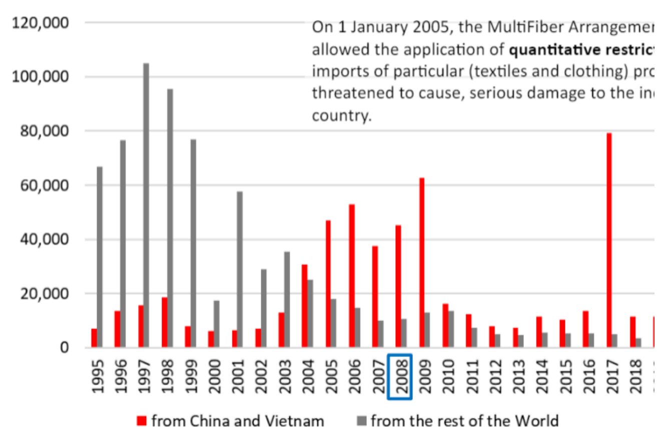
It can adopt:

- **Anti-dumping duties:** a temporary increase of the tariff to fill the gap caused by the dumping (i.e. the difference between the normal value and the export price of the product at issue).
- **Countervailing duties**: a temporary increase of tariff(s) to counteract the injurious effects of subsidised imports and restore fair competition. The level of an anti-subsidy duty should thus correspond to the difference between a subsidised export price and a non-subsidised export price

Case study on Anti-Dumping: leather shoes from East Asia to Europe

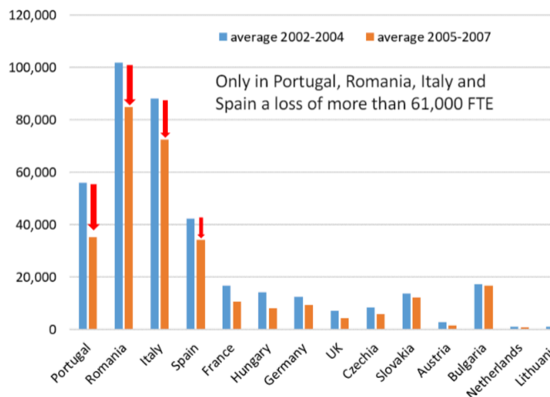
30 May 2005. The **European Commission** received a complaint lodged by the European Confederation of the Footwear Industry on behalf of producers representing more than40% of the total EU production of certain footwear with uppers of leather.

- The product allegedly being dumped is footwear “*with uppers of leather or composition leather other than: footwear which is designed for a sporting activity and has, or has provision for the attachment of, spikes, sprigs, stops, clips, bars or the like, skating boots, ski-boots and cross-country ski footwear, snowboard boots, wrestling boots, boxing boots and cycling shoes, slippers and other indoor footwear, and footwear with a protective toe cap*” originating in China and Vietnam



On 1 January 2005, the **MultiFiber Arrangement (MFA) expired**. MFAallowed the application of **quantitative restrictions** when surges in imports of particular

(textiles and clothing) products caused, or threatened to cause, serious damage to the industry of the importing country.



Employees in the industry (Full-time-equivalent)

<u>According to the European Commission's investigation</u> (undertaken in factories jointly agreed with the Vietnamese and Chinese governments):There is dumping flowing from evident state intervention (cheap finance, tax holidays, non-market land rents,improper asset valuation)

⇒ The Commission concluded that there is **clear evidence of injury to EU producers.**
Since 2001, closely tracking the rise in dumped imports, European footwear production has contracted by about 30%.
February 2006. Provisional duties: 19.4% for China and 16.8% for Vietnam.
October 2006. Definitive duties: 16.5% for China and 10% for Vietnam.
December 2009. A 15-month extension of duties (instead of 5 years, the maximum allowed)

Subsidies: Boeing and Airbus

Since 2004 there has been a dispute between the US and the EU over subsidies to respective airplane makers: Boeing and Airbus.

1) **US against EU:** Airbus received unfair subsidies by government loans (from France, Germany,Spain and Britain) for the A350 jetliner and the A380 superjumbo. ⇒the WTO confirmed that Airbus received illegal subsidies and authorised the U.S. to increase its tariffs on goods imported from the EU up to 7.5bn USD (14 Oct 2019).
2) **EU against US:** Boeing received support from the US government, NASA and various states and municipalities; in particular for the twin-engined 777X Boeing got a tax break of 8.7 billion USDfrom Washington state. ⇒ the WTO confirmed that Boeing received illegal subsidies and authorized the EU to increase its tariffs on goods imported from the U.S. up to 4bn USD (26 Oct 2020).

⇒*On 15 June 2021*, the **U.S. and the EU agreed to suspend retaliatory tariffs for five years**,and they committed to ensuring a level playing field for Boeing and Airbus.

BRUSSELS, Sept 13 (Reuters) - The European Commission launched an investigation on Wednesday into whether to impose punitive tariffs to protect European Union Producers against cheaper **Chinese electric vehicle (EV) imports it says are benefiting from state subsidies**

<u>The National Security exception</u>

<u>In the GATT (Art. XXI)</u>: nothing in the agreement shall prevent a government from *"taking any action which it considers necessary for the **protection of its essential security interests.**"* However, those "interests'' are **not defined by the GATT**.

- For almost seven decades, first GATT Contracting Parties and later WTO Members commonly regarded Art. XXI as a Pandora's box that was best kept closed, due to the **high potential for abuse** of this provision as for some countries, every country must be the judge in the last resort on questions relating to its own security.
- A totally self-judging provision means that **any Member could unilaterally suspend its WTO obligations** by invoking this provision, leaving the affected Members unprotected.
- The danger is indeed that national security exceptions can be used by countries to give themselves 'carte blanche' freedom to flaunt their obligations under the WTO agreements

Steel and Aluminium - US

The US is imposing tariffs on foreign steel (25%) and aluminium(10%) justifying them on national security grounds.

US President argued that global oversupply of steel and aluminium, driven mainly by China,threatens American steel and aluminium producers, which are vital to the US

What about US trade partners' reactions? China, Canada, Mexico and the EU adopted **retaliatory measures**; for example EU's reaction and Harley-Davidson's reduction of manufacturing in the US).

- In June 2018 the EU requested consultations with the US and in October 2018 the establishment of a panel.
- The US: *"there is no basis for a WTO panel to review the claims of breach raised by the EU. Nor is there any basis for a WTO panel to review the invocation of Article XXI by the U.S. We therefore do not see any reason for this matter to proceed further. ... it is simply not the role of the WTO to review a sovereign nation's judgment of its essential security interests".*
- In December 2022, the WTO panel declared that the 2018 US tariffs on steel and aluminum products are against WTO rules. On 26 January 2023, the US notified the Dispute Settlement Body of its decision to appeal to the Appellate Body (currently 'paralyzed')

By raising domestic prices the tariffs distorted incentives. The extra cash, combined with an apparentrise in demand, induced steel companies to splash out on new capacity.• Domestic demand? Some American manufacturers have delayed steel-heavy projects or switched toalternative materials.• Extra supply, where to? Overseas, America's high-cost producers cannot compete with cheap alloysfrom places like China.• Joe Biden's commerce secretary has warned that protecting U.S. steel is a matter of national security,adopting predecessor Donald Trump's position.• Favouring an input industry means disadvantaging downstream customers. Manufacturers such asGeneral Motors have complained about prices and shortages for semiconductors and raw materialsuch as steel. But, so far, makers have passed on costs to their end-consumers

The Alliance for Competitive Steel and Aluminum Trade (ACSAT) is created in 2018 andincludes a large group ofcompanies producingintermediate and finished goodscontaining steel and aluminumas important inputs

The Truce EU-US:

31 October 2021. During the G20 meetings in Rome and on the eve of the Glasgow COP26conference, the EU and U.S. announced that they had reached a deal over their dispute onsteel and aluminum (Bruegel post):• The US will remove tariffs on a quota of 4.4 million tons; tariffs remain beyond thatquota.• Suspension of EU retaliatory tariffs of up to 50% on items such as steel products,bourbon, motorcycles, jeans etc.• Suspension of scheduled additional EU retaliatory tariffs on $4.2 billion US exportsplanned for 1 December 2021.• Withdrawal of WTO cases on both sides. (On 4 November 2021 the EU requested asuspension of the panel)• A joint statement on the

intention to negotiate some form of carbon content standardon steel imports, and at the same time deal with overcapacity, including a specificmention of China.

WTO and Trade Agreements

The WTO also works as a resolution mechanism for trade disputes that arise when a WTOmember believes another member is violating a WTO commitment and damaging its domesticeconomy.• A WTO member (the complainant country) can follow the dispute settlement process that consists,if a consultation goes unsuccessful, in: 1) the establishment of a panel to hear the dispute and toissue a report to be adopted by the Dispute Settlement Body (DSB); 2) The appeal of the panelreport in front of the Appellate Body.• Since the Obama Administration (2009-17), the US blocked the appointments of members of theAppellate Body, who serve a four-year term, thus paralyzing it (the US mainly criticizes its "broader authority to over-reach the rules"). Thus, a country that loses at the DSB-level can avoidcompliance by appealing to a non-functioning Appellate Body.• However, 23 WTO members (among which EU, China, Australia, Singapore and New Zealand)created the new "Multi-party interim appeal arbitration arrangement" (MPIA), in effect sinceApril 2020 until the WTO's Appellate Body is once again able to function.• As of today, 53 WTO members are part of the MPIA.

Bilateral Agreements and MFN Clause

Bilateral Agreements not compatible with WTO

EU and NZ are members of the WTO. In clothing, for example, NZ applies a 9.7% MFN tariff, the EU 11.5%.

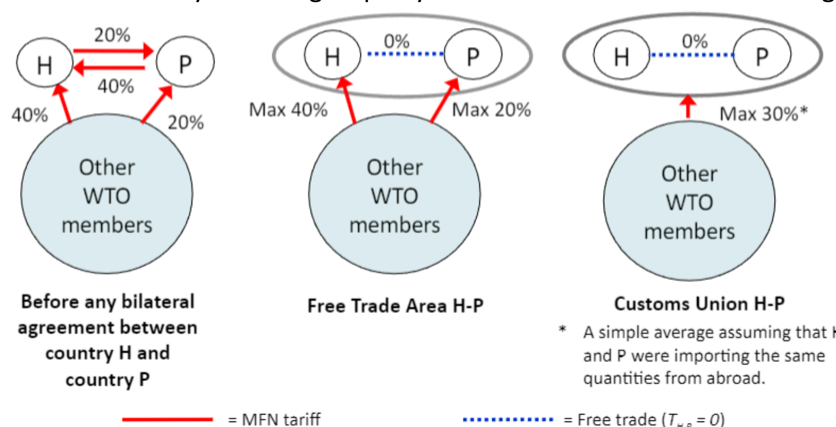
- NZ and the EU are negotiating a Free trade agreement (FTA) to eliminate bilateral tariffs, also on clothing.
- According to the MFN principle, as soon as the FTA enters into force, tariff elimination should be extended to all other WTO members (a zero tariff is the best treatment possible).
- If NZ and the EU do not extend this treatment to other WTO members, yes, it is a violation of the principle of non-discrimination.

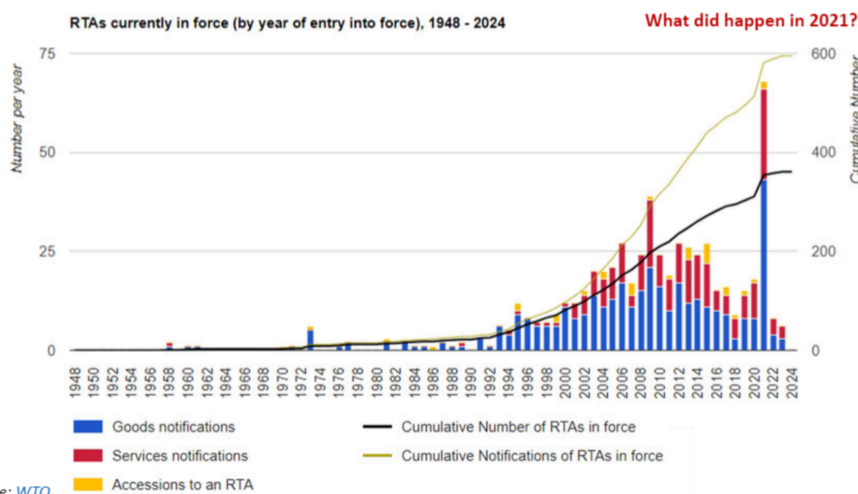
But the WTO allows those preferential bilateral agreements as an exception to the MFNprinciple if two conditions are fulfilled:

1) Tariffs and other trade barriers should be reduced or removed on substantially all sectors.
2) Countries that are not part of the agreement should not find trade with the newly created group any more restrictive than before the group was set up

Bilateral Agreements compatible with the WTO

The 2nd condition (previous slide): Countries that are not part of the agreement should not find trade with the newly created group any more restrictive than before the group was set up





Source: WTO

WTO and Bilateral Regional Agreements

Why are WTO members so active in negotiating bilateral/regional trade agreements?

- After 1995 (when WTO as an institution was created) multilateral negotiations were not progressing: failure of the Millennium Round (Seattle, 1999) and deadlock of the Development Round (Doha, 2001).
- Agreements among 164 countries are extremely complicated to negotiate (consensus as a principle).
- Negotiations are not focused anymore on tariffs, but more sensitive issues are at stake such as **environment and labour standards**.
- Coalitions might facilitate the decision-making but divide the countries in separate fields such as free vs protected agriculture, developed vs developing countries

Why is a network of bilateral/regional trade agreements not a perfect substitute of WTO multilateral agreement?

- In bilateral negotiations, unilateral bargaining power matters (power-based trade thanks to *divide et impera*).
- Non synchronization of bilateral trade agreements generates (negative) trade diversion, ie, efficient exporters lose market shares abroad simply because their respective countries of origin are not part (yet) of FTAs.
- A network of FTAs increase complexity of trade since each agreement has its own rules and administrative requirements (see the rules of origin)

EU Single Market

The ingredients of the European Single Market (ESM)

With the Treaty of Rome (1957), the member States decided:

- to remove trade barriers between them,
- to set up a Customs Union (1968),
- to start the process of forming a Single Market (or common market).

In a single market, economic frontiers between member States are eliminated and the so-called four fundamental freedoms (i.e. free circulation of people, services, capital and goods) would be guaranteed.

Single market

A market has got its distinct geography due to restrictions of different nature: physical (oceans, mountains ..), economic (transaction and transportation costs), legal (exclusive rights, tariffs, standards ..).
Market integration is a situation such that the **flows of products**, services and factors between countries are on the same terms and conditions as within countries.
This creates new opportunities for businesses, but also gives consumers wider choice and lower prices.
In the single market price differences eventually arising among countries should be no more than the cost of transportation plus related transaction costs.

How to create a single market:
In order to change the geographic dimension of the market (i.e. from national markets to a single market), States have to facilitate free circulation of goods, services, capital and labour by:

1) abolishing legal restrictions: no tariffs, no quantitative restrictions (quotas), no legal monopolies. ⇒**European single market**
2) promoting fairness in free trade: no public subsidies and protections granted in the domestic market to national players or anti-competitive behaviors by national players. ⇒**Competition policy**
3) reducing the impact of physical obstacles: building or upgrading transport infrastructure. ⇒**Trans-European Networks**
4) reducing economic costs: fixing exchange rates between currencies, substituting national currencies with a single currency. ⇒ **Economic and Monetary Union (EMU)**

Implementing the single market
In order to maximize the gains from market integration, two dimensions of potential costs/distortions have to be eliminated, namely:

1) **Market fragmentation** caused by:

Non-tariff barriers (NTBs)
The absence of a regulatory framework

2) **Negative macroeconomic spillovers**

⇒ Regulatory framework (single market programme), Fragmented markets (mutual recognition), Macroeconomic coordination (european monetary system)

- **Four fundamental freedoms.** In the Treaty of Rome, the EU has the aim to achieve free movement of goods, capital, services, and labour.
- **Level-playing field.** A market based on free and fair competition where everyone, independently of the nationality, has the same chance of succeeding.
- **Liberalization**. It is the process of removing government control, reducing entry barriers (e.g. authorizations and licenses) and opening up the markets to competition.
- **Ownership neutrality.** Usually liberalization goes with privatization (i.e. the transfer of ownership from the government to the private sector). However in the EU, according to the principle of ownership neutrality, *State-Owned Enterprises (SOEs)* are not illegal. However SOEs, as any other firm, cannot receive preferential treatment by any public institution.

Examples: The French State is the main owner of Renault (15.01%); 20% of the votes in Volkswagen are in hands of the State of Lower Saxony State and the Italian State is the main owner of ENI (30.1%).

Three steps (and counting) for the creation of the ESM

First step: elimination of tariffs and quotas

Second step: elimination of NTBs

Elimination of tariffs and quotas is not enough if **Non-Tariff Barriers (NTBs)** keep markets fragmented thus preventing the creation of a workable Single Market.
NTBs might be imposed by countries to norm industrial production methods, standards for safety, environment, consumer protection such as: Sanitary and phytosanitary measures and Technical measures (eg, labelling)

With the Treaty of Rome, the EU started a programme for the approximation of Member States' national legislations through directives and regulations.
However, the progress in this area have been very limited, due to the application of the unanimity voting rule in the Council of the EU (i.e., every Member State has the veto power) on all issues related to the single market.
Problem: **innovation is faster than political decision-making**, especially when every country would like to propose its national standard as the European standard..

A watershed moment was in 1979 with the "Cassis de Dijon" case …

Crème de cassis (also known as Cassis liqueur) is a sweet, dark red liqueur made from blackcurrants.
A German company requested authorisation from the German administration for spirits to import Cassis into Germany from France.
The response was that Cassis could not be marketed in Germany as there was a national rule which required fruit liqueur to have at least 25% alcohol content (Cassis is between 15% and 20%).
The German company then brought proceedings against that decision in the national courts and the national courts referred to the CJEU for further guidance.

CJEU, in the "Cassis de Dijon" judgment,
established the ***principle of mutual recognition of national rules:*** the legislation of another member State is equivalent in its effects to domestic legislation.

In other words, every member State is obliged to accept on its territory products which are legally produced and marketed in another member State.
This helped in eliminating the negative impact of most NTBs in place.
However, the principle of mutual recognition is not enough to liberalize economic activities within the European Single Market … a certain degree of harmonization of legislation is required.

Third step: harmonization of legislation

Many services are non-tradable (e.g. local transport, retail banking, mobile telecommunication); this means that foreign firms cannot ship the service from their home country but they need to locate assets in the target country.

National regulations can block or can slow-down the entry of foreign firms.
For example: being a dentist in Italy requires a **certification** issued by an Italian authority, an airport in Germany allows only German airlines to land and take-off, different rules to operate as a mobile telecom firm in different EU states.

a common regulatory framework has to be in place to guarantee the right of establishment, i.e. the possibility for every national of a member State to exercise its own economic activity in another member State.

Moreover, the EU wants to set **common essential** health, safety, and environmental protection **requirements**. Only if manufacturers follow these common rules, can their products be sold freely in the European market.
'Common' means: harmonization of legislation.

In 1985 the Commission identified **282 regulations and directives** to boost the completion of the Single Market by dismantling two main categories of obstacles:

1) **cost-increasing barriers:** (e.g. delays at borders, customs administration, or the need to comply with different national technical regulation and standards);
2) **market entry restrictions**: all measures preventing the right of establishment or trading across frontiers in certain service industries (e.g. insurance or electricity) or professions, or the entry in some regulated markets (e.g. civil aviation, public procurement).

To facilitate the approval of the proposed regulations and directives, Member States amended the Treaty of Rome with the **Single European Act (SEA)** entered into force in 1987.
With the SEA, for single market legislation, Member States **abandoned unanimity and adopted qualified majority voting in the Council**: with a majority system instead of unanimity, decision-making is more efficient and member States lose the individual veto power.

Unanimity is still required for measures relating to fiscal provisions, freedom of movement for persons and the rights and interests of workers.
Those 282 directives and regulations were approved by 1992.

Institutions nowadays
At the same time, a Council Resolution of **1985** implemented a new system for technical **harmonization and standardization.**

The harmonisation directives would, from then on, focus on the essential demands of health, safety and environmental protection at the European level (general principles)
Defining **technical standards is left since then to specialised bodies** such as CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standardisation) and ETSI (European Telecommunications Standards Institute), and other specialised Committees eventually set up at this purpose.
⇒ From here on **comitology** started to emerge, as another important part of the decision-making process of the EU.

The peculiar case of services liberalization

During the 90s the EU liberalized big service sectors such as civil aviation, telecommunication, energy (before that liberalization it was common to have national monopolies or oligopolies protected by national governments).

- The approach for those services was *'vertical'*, i.e. sector specific legislation (regulations and directives).

In 2004, the Commission proposed an *'horizontal'* directive to liberalise other services in the ESM such as: management consultancy, certification and testing, facilities management (including office maintenance and security), advertising, recruitment services, legal and fiscal advice, real estate services, the organisation of trade fairs, car rental, travel agencies, health care services, household

support services, tourism, audio-visual services, leisure services, sports centres and amusement parks.
The aim of liberalization? ⇒ Again, to facilitate cross-border activity within the ESM.

Absent an harmonized legal framework for those services, the Commission proposed the application of the '**country of origin principle**': a service provider is subject only to the law of the country in which she is established and other Member States may not restrict services she provides.
Surprise surprise, the idea of the Commission is not far from the principle of mutual recognition (do you remember the "Cassis de Dijon" case?).
Were the directive approved, a dentist who is legally practicing in Poland, can offer her services in Germany subject to the Polish legal framework (e.g. taxation).
Don't forget, proposed directives need to be approved by the Council and by the European Parliament (EP).

The Commission's proposal was labeled (especially by French and German socialists) as "ultra-liberal" and the country of origin principle was an invitation to "social dumping", in which competition from poorer EU countries would drive down wages and welfare standards.

Liberalization of services: Directive

After that 'icy' reaction, the European Commission modified its proposal eliminating the 'country of origin principle' and reducing the range of services covered.

In 2006 the Council and the EP approved the modified '**Service Directive**'.
Now, according to the approved Directive, a dentist who is legally practicing in Poland, can offer her services in Germany only after she gets an authorization by German authorities (if needed) and she will be subject to the German legal framework … and German taxes.

So today, if you produce a car in Poland with Polish workers, paying Polish salaries, paying Polish services (e.g. electricity) and Polish taxes, you can sell it in Germany without any type of restriction.
But if you want to sell your Polish service as a dentist in Germany, you need to pay German taxes.
Or, you can invite your German patients to drive a few kilometers and provide the full package.

A soft liberalization of services

With the new '**Bolkestein' Directive**, Member States have to be more 'business friendly' by **simplifying procedures** (eg, setting up points of single contact to enable businesses access to information and complete all procedures), by **abolishing discriminatory requirements** (eg, nationality or residence requirements) and other restrictive measures.

However, after 14 years, there are still nearly 6,000 national rules on professions across the EU, and they tend to have restrictive effects on cross-border activity.
One common type of restriction is national rules that require a **qualification/ certificate to be obtained in that specific State**, without taking due account of service providers' qualifications/certificates already obtained in other Member States.

In 2005 the EU introduced a system of **automatic recognition of professional qualifications** for nurses, midwives, doctors, dentists, pharmacists, architects and veterinary surgeons.

In 2006 the EU introduced the **European Professional Card (EPC)** for general care nurses, physiotherapists, pharmacists, real estate agents and mountain guides.

Transposition Deficit

The Community legislation governing the setup of the single market is largely in the form of **directives (framework laws).**

But directives require the adaptation of the national legislation via **transposition measures from the EU framework law** to the national laws.

This transposition has not been straightforward, leading to **delays** in the implementation of the single market or an uneven playing field.

For these reasons, on the one hand the EC regularly monitors the **extent of the transposition deficit**, forcing non-complying countries to accelerate in the implementation of EU legislation (via fines that could be imposed by the Court of Justice)

On the other hand, the **most controversial** legislation (e.g. new rules on banking) takes the form of **regulation**, as these are directly enforceable in each Member State to the letter, from the moment they are published in the Official Journal of the European Union (OJEU).

To calculate the transposition deficit of each Member State, the Commission includes:

- directives for which no transposition measures have been communicated
- directives considered to be partially transposed by Member State after it notified some transposition measures
- directives considered to be completely transposed by Member State, but for which the Commission has opened an infringement proceeding for non-communication and the Member State has not notified new transposition measures after the latest procedural step taken by the Commission

The economic rationale of the single market

Static gains derive from improved allocative efficiency within a wider area: reallocation of resources boosting overall per capita GDP.	**Growth effects** (also called "dynamic gains") derive from increased rates in the accumulation of the factors of production, in particular capital (physical and human). We will use Solow's growth model to explain it.

Static Gains

If competition is effective, the ESM:

reduces barriers and costs of cross-border economic activities;

allows economic agents (firms and consumers) to do business with the most efficient partners (customer/supplier) in a wider area;

selects the European 'winners' i.e. the efficient firms that can now serve a wider market and can take advantage of economies of scale.

Economies of scale means: the larger the quantity produced, the lower the average cost, thus lower prices for consumers!

But the ESM gives an opportunity to the losers.

Thanks to liberalization, workers and capital employed in inefficient firms can move to another sector (within the same country),

Thanks to free circulation of workers and capital, they can move to another EU country.

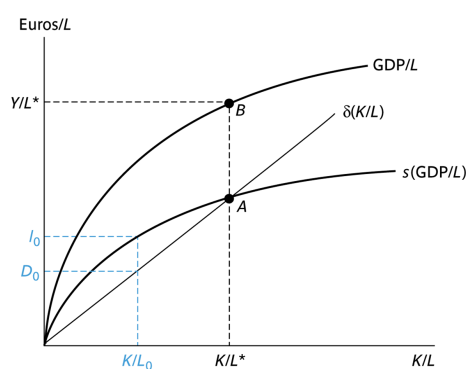
EU rules for State aids allows governments to support the competitiveness of firms under special circumstances and with conditions attached.

Solow's growth model

The production function we are about to use is the Growth Model proposed by Robert Solow (1987 Nobel Prize).
Basic assumptions:
GDP (output) has three basic sources: Labor (L), Capital (K) and Total factor productivity (TFP).
Annual output is either consumed or saved in fixed proportions.
Closed economy, thus no trade.
Full employment.
Since TFP is calculated as a residual (the portion of GDP that is not explained by Capital and Labor), this model is dubbed "exogenous growth model".
Decreasing marginal product of both capital and labor. This occurs when one factor is variable (e.g. labor) and one factor is fixed (e.g. capital).

Ex.

As long as I > D, new capital for the domestic economy.

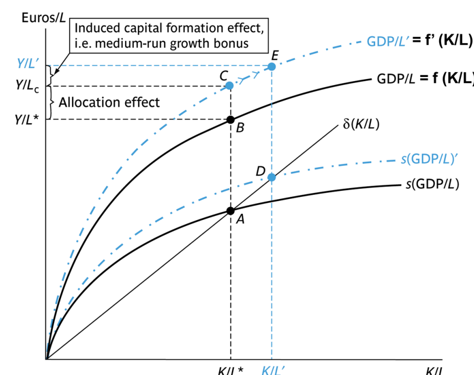


When I = D (in A), savings are used to maintained the capital already invested. No extra for new net investment, no increase in capital, thus the economy is in **steady-state.**

(K/L) Depreciation in a function of capital = D

s(GDP/L)Savings are a function of GDP = Gross investment (I)

Dynamic gains in the medium-term



From Y/Lc to Y/L* = Allocation effect is a static gain

Towards a capital market union

The efficiency of the financial sector can generate additional growth. However, the financial sector in the EU is far from being a single market.
Even though free circulation of capital is one of the four pillars of the common market since 1958, there are some obstacles to cross-border transactions that keep markets fragmented along national borders.
Relevant rules (eg, company law, securities law, insolvency procedures, access to collateral) differ across EU States: less competition, no economies of scale, less efficiency!
Moreover, high bank dependency in the EU. If we consider firms' liabilities, bank loans weight for 14% in the EU and 3% in the U.S. while corporate bonds weight respectively 4% and 11%.
High bank dependency means that firms, in particular the small ones, have difficulties accessing alternative funding sources when they cannot get credit from banks. And, since the financial crisis (2008), cross-border lending in the EU declined and banking activities migrated increasingly back to home jurisdictions.

Along with other factors, this explain why, notwithstanding its economic size, the EU's financial system has not reached the dynamism of the American one (there are very few European Apples, Amazons, Googles and Teslas …)

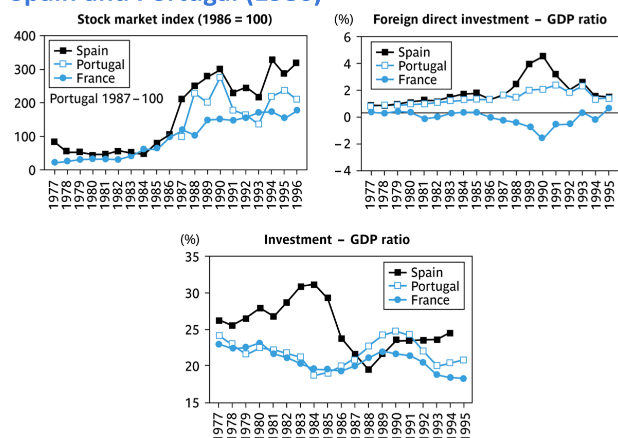
The Commission launched a capital markets union (CMU) initiative in 2015 but markets remained fragmented. The Commission re-launched the CMU in September 2020.
Why now? A strong and complete CMU is needed now more than ever, in order to support the economic recovery following the COVID-19 crisis and finance the green and digital transitions.
The CMU action plan proposes 16 actions such as:
Action 1: Making companies more visible to cross-border investors: Establishing a European single access point (ESAP) to provide for seamless, EU-wide access to all relevant information (including financial and sustainability-related information) disclosed to the public by companies including financial companies.
Action 2: Supporting access to public markets: Making listing cool again.
Action 7: Empowering citizens through financial literacy.
Action 14: Consolidated tape to provide complete, accurate and comparable data on prices and volume of traded securities in the EU, thereby improving overall price transparency across trading (and competition between) venues such as stock exchanges.

Growth effect of EU accessions-Medium Term

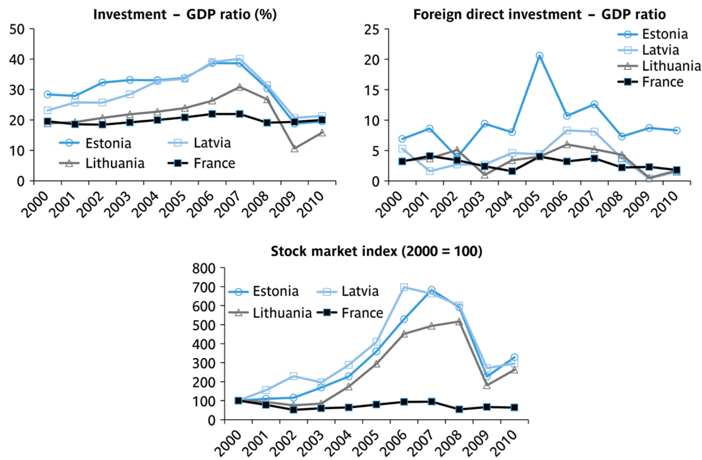
Accession countries provide a natural experiment to evaluate the medium-term growth effects of European integration since these countries experienced a rather sudden and well-defined increase in economic integration when they joined.

stock market prices should increase (due to higher efficiency, thus profits and expected dividends);
the aggregate investment to GDP ratio should rise;
the net direct investment figures should improve.

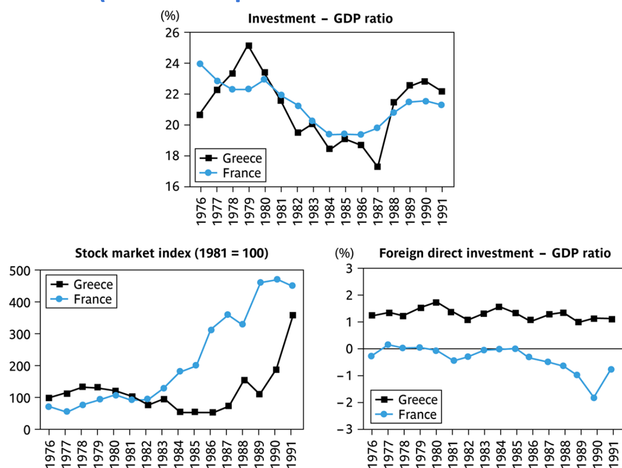
Spain and Portugal (1986)



The Baltic States (2004)



Greece (1981. Sharp contrast with other accessions)



Long-run growth effects

Can economic integration lead to permanently higher growth rates?

'Qualified' Yes:

If the rate of technological progress is positively affected by market integration

If tough competition as induced by the closer integration of the single market leads to continuous productivity gains

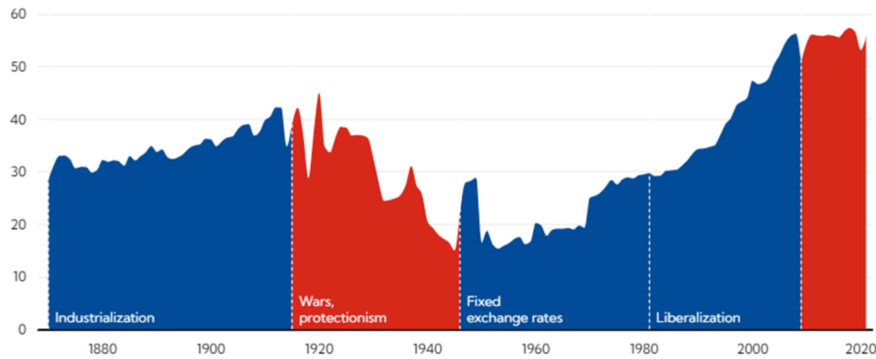
If structural reforms boost the potential growth of the involved countries

Any empirical evidence? Baldwin (1989) estimated a permanent 0.5% extra-growth per year. The EU Commission (1996) estimated a permanent 1% extra-growth per year.

[GVCs and the new EU Trade Strategy]

Eras of globalization

Trade openness slowed following the global financial crisis.
(sum of exports and imports as a percent of GDP)



Sources: PIIE, Jorda-Schularick-Taylor Macrohistory Database, Penn World Data (10.0), World Bank, and IMF staff calculations. •
Note: Sample's composition changes over time.

Nowadays it seems that Globalisation is benign pushed back by governments and trade tensions:

"Made in All of America" by All of America's

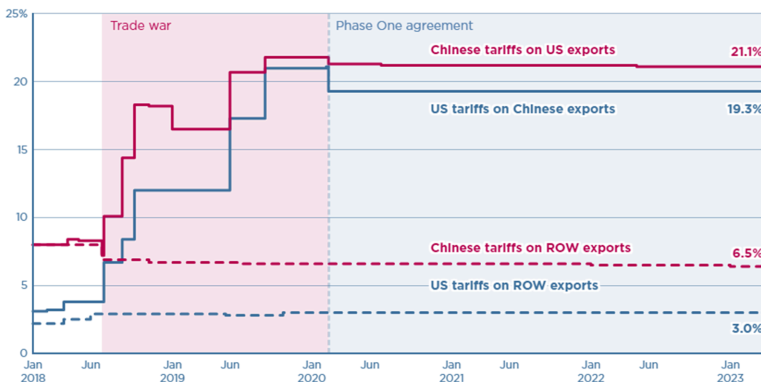
II. Together, the following six lines of effort will remake American manufacturing and innovation so that the future is made in America by all of America's workers:

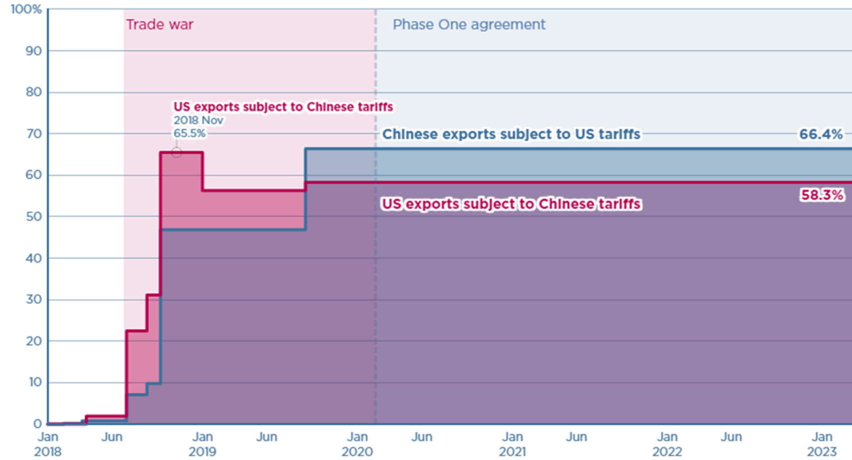
1. **BUY AMERICAN. Make "Buy American" Real and Make a $400 billion Procurement Investment**
2. **MAKE IT IN AMERICA. Retool and Revitalize American Manufacturers,**
3. **INNOVATE IN AMERICA. Make a New $300 Billion Investment in Research and Development (R&D) and Breakthrough Technologies.**
4. **INVEST IN ALL OF AMERICA. Ensure Investments Reach All of America so we draw on the full talents and invest in the potential of all our communities and workers.**
5. **STAND UP FOR AMERICA. Pursue a Pro-American Worker Tax and Trade Strategy**
6. **SUPPLY AMERICA. Bring Back Critical Supply Chains to America**

Extract from Joe Biden's electoral program

US vs China: trade war

a. US-China tariff rates toward each other and rest of world (ROW)





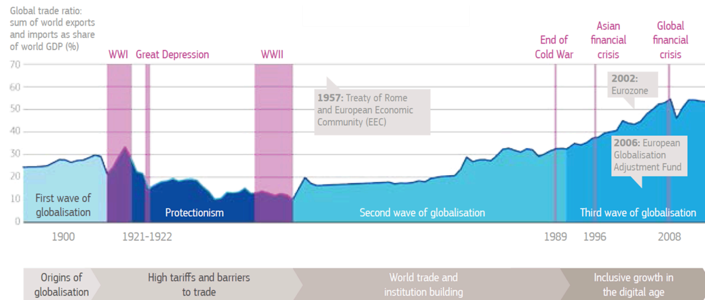
⇒ WTO opened a high-level ministerial meeting in 2024 with calls for consensus as geopolitical tensions and the looming US elections undermine chances of a major breakthrough

Globalization and Global value chains (GVCs)

Globalization:“*The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep;*

he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages; […]”
John Maynard Keynes “The Economic Consequences of the Peace” 1920.

Two (or three) waves of globalization



Source: European Commission (2016), Klasing and Milionis (2014), World Bank (2017), adapted from the National Bureau of Economic Research Macrohistory Database

World trade and world output

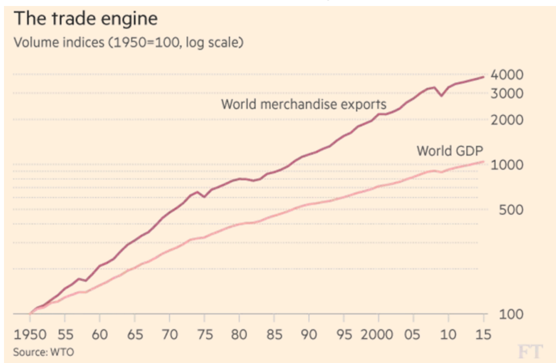
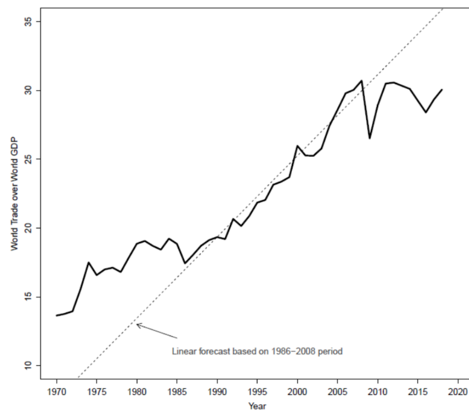
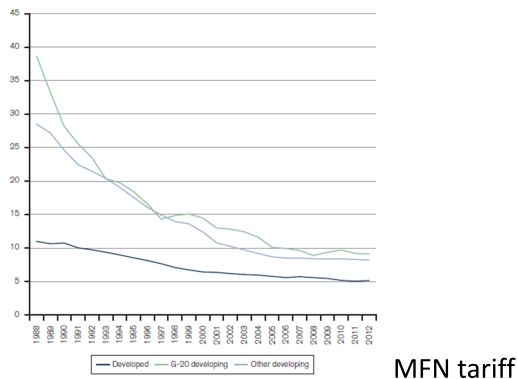


Figure 8: World trade over world GDP



Source: Authors' elaboration based on Antràs (2020) data.
Note: The solid line displays the ratio of world trade over world GDP. The dashed line is the linear fit based on the 1986-2008 period.

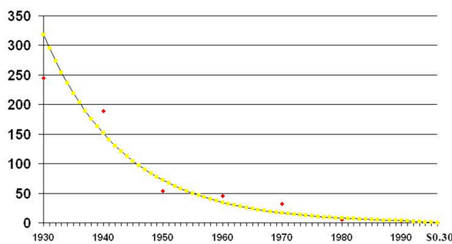
Globalization tariff reduction as driver



MFN tariff

Globalization: ICT as driver

Cost of a 3-Minute Telephone Call, New York to London (Constant 1990, U.S. $)

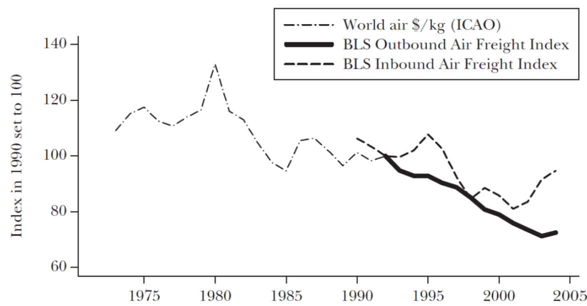


Moore's Law states that the number of transistors on a microchip doubles every two years. Therefore, we expect a positive impact on the processing power of our computers and on their prices. ⇒ this is what actually happened

* Gordon Moore, the co-founder and former CEO of Intel.

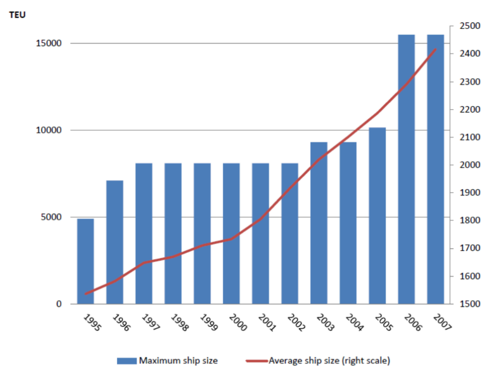
Globalization: transport cost reduction as a driver

Air Transport Price Indices



Source: International Civil Aviation Organization (ICAO), "Survey of Air Fares and Rates," various years; U.S. Department of Labor Bureau of Labor Statistics (BLS) import/export price indices, http://www.bls.gov/mxp/.

Figure 1: Development of container ships (TEU), 1995-2007



Notes. Source: authors' elaboration from UNCTAD, Review of Maritime Transport, various years.

* A TEU (twenty-foot equivalent unit) is a standard measure of a container.

⇒ between 1988 and 2013, container ships improved, became bigger and more efficient
In 2023, MSC Irina, built in 2023, max TEU 24,346 (ca. +6,000 compared to 'triple E' class)

From a 'romantic' view of trade
When people think of trade, they tend to consider a stand-alone company producing a good in country A (eg, a car produced in Germany), exporting it to another stand-alone company in country B (eg, China)… or vice versa

To a different model of trade
Slicing up production processes (ie, the value chain) across countries.

As a result, when a final good is produced, its value reflects physical inputs and services that have been produced in different parts of the world.

Trade in intermediates nowadays dominates trade flows, representing 56% of trade in goods and 73% of trade in services in OECD countries.

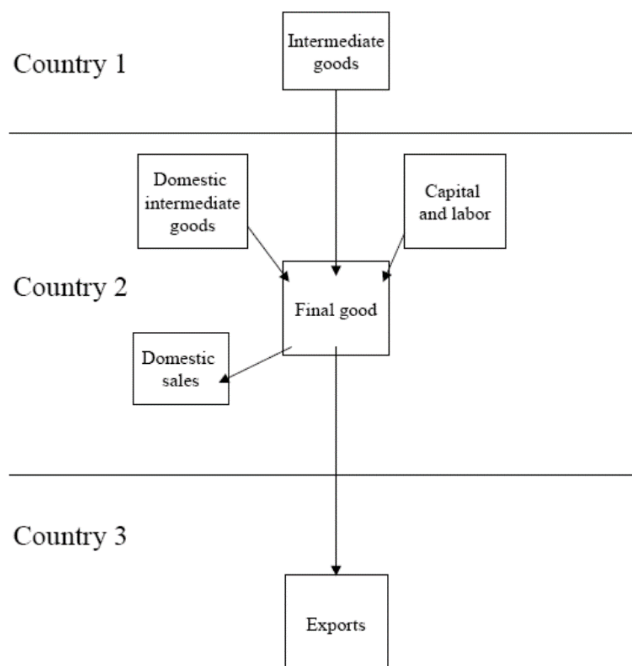
Since 2000, the value of trade in intermediates has tripled to more than $10 trillion annually.

<u>What is a value chain?</u>
A value chain is the full range of activities that firms engage in to bring a product to the market, from conception to final use (from design, production, marketing, logistics and distribution to support the final customer).

Globalization 3.0: international fragmentation and GVCs
Globalization 2.0 (1950-1995) ⇒ Globalization 3.0 (1995-nowadays)
Goods crossing borders ⇒ Factories crossing borders: goods, know-how, ideas, capital & people

Lower barriers to trade
Lower ICT costs
Lower transport costs
Liberalization of foreign direct investment (FDI) to new markets with relatively cheap labor

→ Emergence of **Global Value Chains (GVCs)**



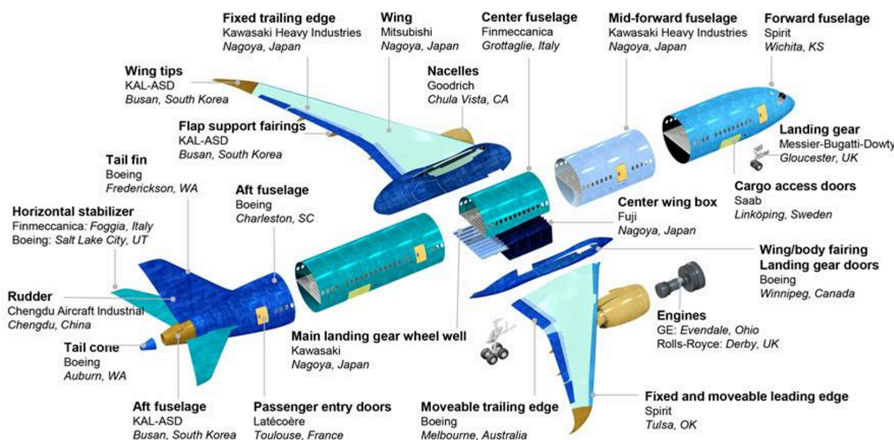
Factors affecting sourcing decisions:
Labor cost is an obvious one, but not only…

- Access to key inputs
- Access to high-skilled workforce
- Supplier ecosystems
- Good infrastructures
- Good institutions, eg, protection of intellectual property rights
- Proximity to large markets, which often leads to regionalization of value chains
- Resilience and risk reduction

Global value chains (GVCs) are the natural offspring of globalization:
Reduction in transport, trade and investments costs (due to technology, trade and investment liberalization).

The growing interconnectedness of economies and access to foreign markets (inputs and outputs). In GVCs economic activities are fragmented and dispersed across countries.
Specialization of firms and countries in **tasks and business functions.**
Networks of global buyers and suppliers. In GVCs **firms control and co-ordinate activities in networks of buyers and suppliers**, and multinational enterprises (MNEs) play a central role.
New drivers of economic performance. In GVCs, **trade and growth rely on the efficient sourcing of inputs abroad,** as well as on access to final producers and consumers abroad.

<u>GVCs: Boeing 787 Dreamliner</u>



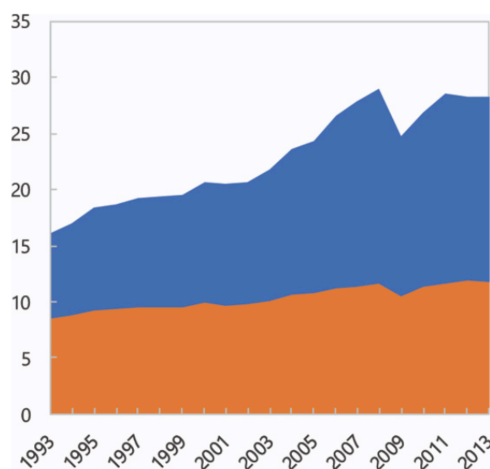
Every part was produced in a different part of the world. GVCs are even for less complex products such as bikes (Saddle exports: China, Italy; Wheel, Frame and Brakes)
Nutella also relies on global value chains: the headquarters are in Italy, but main international suppliers are Brazil,China, Malaysia, Turkey, Nigeria. Main factories are in Europe, Americas and Australia, while sales offices are distributed around the globe.

<u>GVCs with many tiers:</u>
(the higher the tier the higher visibility issue)

OEM: Original equipment manufacturers
Tier 1: automotive parts & systems
Tier 2: Non-Automotive Grade Parts
Tier 3: Raw & semi-raw materials

Traditional trade and GVCs

Traditional trade comprises exports of goods and services that are produced in one country and absorbed in the destination.



Traditional trade increased over time at a lower pace than GVCs trade.

GVCs architecture & risk exposure

GVCs may deliver with great efficiency… but they can also contain **hidden vulnerabilities!**

Examples: natural disasters, geopolitical uncertainties, oil price fluctuations, cyberattacks, pandemics.

Exposure depends upon many variables, like geographic dispersion/concentration and trade intensity with trade partners.

Highest exposure for industries that are more trade intensive and with exports concentrated in a few countries. Examples: computers and electronics, semiconductors and components, apparel and textiles.

There are 180 products across value chains in which one single country accounts for more than 70% of global exports. This creates the potential for global bottlenecks (eg, China and India for pharmaceuticals).

Regional-oriented value chains, like food and beverages or fabricated metals tend to be more sheltered.

Dangers: heavy reliance on just-in-time with low inventories; sourcing from single suppliers; relying on customized inputs with no substitutes.

Covid-19 crisis has highlighted the risks of GVC. However, plenty of cases before: US-China trade war, earthquakes, oil price crises.

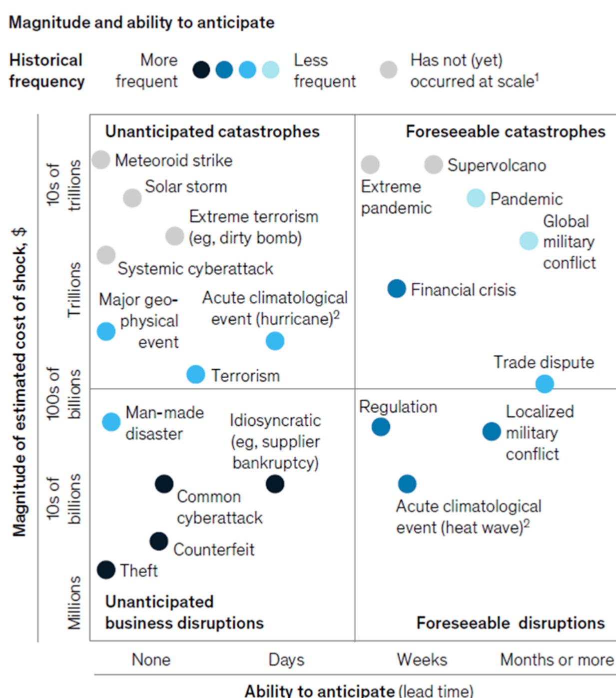
The share of global trade involving countries in the bottom half of the world for political stability (World Bank) rose from 16% in 2000 to 29% in 2018.

Firms can expect supply chain disruptions lasting a month or longer to occur every 3.7 years. This entails a loss of 40% of a year's profits every decade.

A single severe shock lasting more than 100 days can absorb the earnings of a full year.

Disruptions to economic activity are a regular feature in business. Disruptions of course can have a different nature, based on:

- **severity**: shocks can affect one (few) firms, industries or countries, and thus costs relatively little (millions), or have a major global impact, with their cost hitting the trillions
- **frequency**: shocks can happen with different frequencies (eg, hurricanes take place every year, but major hurricanes making landfall are less frequent), which impact on the overall tally of costs
- **lead time:** the time a shock could be foreseen in advance, putting in place containment measures (eg, pandemics foreseen better than earthquakes).



Managing these disruptions requires firms to analyze their exposure and vulnerability and put different types of resilience measures in place.

Also, different disruptions might require different economic policy responses, either cyclical or structural.

Last but not least, the magnitude of these shocks (and of the responses) is also a function of the **degree of interconnection**

of the economy (a local contagion in Wuhan might become a global pandemic…)

⇒ Some value chains are more exposed to shocks than others (based on geographic footprint, factors of production, and other characteristics)
Ex. Medical devices are less exposed while communication equipment is more exposed.

Where firms cannot directly prevent shocks, they can still position themselves to reduce the cost of disruption and the time it takes to recover.
Improving the resilience of GVCs is a key challenge in the years to come.
This may entail changes in physical location of activities; holding more inventories; improving flexibility in production across sites; building redundancy in suppliers; design products with common components, like modular manufacturing platforms in automotive.
Strategic considerations at the country level will be relevant, eg, search for autonomy in key industries such as pharma, semiconductors, and more.

The Future Value Chains

GVCs have brought many benefits by allowing firms to source their inputs more **efficiently**, to access knowledge and capital beyond the domestic economy and to expand their activities into new markets (perfectly consistent with Ricardo's theory of comparative advantage).
GVCs have also played a pivotal role in reducing poverty and offering an opportunity for developing countries to grow and catch up with richer countries.
Enter Covid-19. The closure of factories in China at the end of January 2020 drew attention to the reliance of many manufacturing value chains on inputs from China. The subsequent lockdowns implemented all over the world have re-ignited the debate on the risks associated with international production.
Enter Russia's invasion of Ukraine. Many European countries discovered that they were highly dependent on Russian energy resources. Moreover, even the dependence on China became an issue that you cannot underestimate.
This is why in countries like the US and the EU **resilience** (ie, the ability to withstand disruptions) has become more important than the efficiency guaranteed by globalization.

In order to **improve resilience**, the immediate reaction was **stockpiling**: from the 'just-in-time' (parts delivered to factories right as they were required were keeping inventories thin and cheap) to the 'just-in-case' model.

Resilience will also inspire the **geographical re-design of supply chains** along with the technological revolution (3D printing, robotics), climate change and sustainability (ESG), the rise of economic nationalism, and the fading of China's cost advantage.

Responding to these challenges, a new vocabulary for global trade has emerged :
- **Diversification**: Enlarging the number of suppliers and countries involved in the value chain.
- **Nearshoring**: bringing operations nearer to the main production hub or the end customer, shortening the value chain, and mitigating the risk of trade disruptions.
- **Reshoring**: bringing productive activities "home."
- **Friendshoring**: strengthening trade relationships with allies and trusted countries.
- **De-coupling**: complete cutting off between the US-centered economies and the China-centered ones.
- **De-risking**: a soft decoupling.

Value Chains were already more regional than global, centered around US, China and Germany.

The Gravity Model behind regional value chains

According to this model (Jan Tinbergen, a Dutch Nobel-prize winner), two simple points about the geography of international trade.

1. **Size**. The bigger the GDP of the countries involved in a bilateral trading relationship, the more they trade with each other. Larger economies have more demand for goods and services and offer more products, supplying a broader range of consumers.
2. **Distance**. The farther away two countries are from each other, the smaller the volume of trade. That is partly related to transport costs: sending a parcel from Britain to France costs half as much as sending one to India. Cultural and linguistic differences also come into it. Exporters have a better feel for nearby markets and can meet suppliers more easily geography may matter less than economists assume.

Value Chains never sleep

Ex. Forbes: 'Apple to diversify its supply chain by producing MacBooks In Vietnam'

Key takeaways:

- Apple has relied in China to manufacture all of its products, but due to the pandemic and ongoing trade tensions between US and China, Apple is moving production out of the country.
- Apple has moved production of its iPhone to India and now will have MacBooks produced in Vietnam
- While Vietnam offers many benefits to Apple, this country is not without its own issues

Towards a new EU's trade strategy

The drivers that triggered a new phase in the EU:

1) **The WTO got stuck:** the Doha Round is not progressing and the Appellate Body is not working (the US is preventing the appointment of its members).
2) Former **President Trump** thought that he inherited "a significantly flawed trading system" that justified a more confrontational and mercantilist U.S. approach, imposing tariffs also on EU exports.
3) In 2001 **China** joined the WTO but the expectations of deep liberalization did not materialize: China ranks first in EU's anti-dumping tariffs and is purchasing businesses abroad through its State-controlled enterprises that are allegedly subsidized by the State.
4) With the **Covid-19 pandemic,** trade is not flowing like it used to be. Lockdowns stopped manufacturing and shipping, national security concerns stopped the export of essential/critical products such as personal protective equipment and vaccines.

In 2020 the European Commission coined "**Open strategic autonomy**". In the communication you read (emphasis and comments added):

*(…)The crisis has revealed a number of areas where Europe needs to be more resilient to prevent, protect and withstand future shocks. **We will always be committed to open and fair trade** but must be aware of the need to reduce dependency and strengthen security of supply, notably for things like pharmaceutical ingredients or raw materials.*

*Open strategic autonomy will mean shaping the new system of global economic governance and developing **mutually beneficial bilateral relations,** while protecting ourselves from unfair and abusive practices. This will also help us **diversify and solidify global supply chains** to protect us from future crises and will help strengthen the international role of the euro (…)*

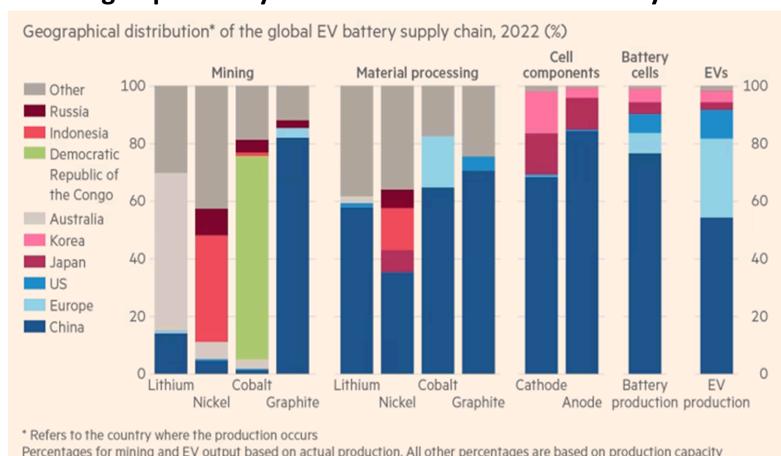
Alan Beattie (Financial Times) made fun of this new slogan that sounds like an oxymoron to appease the free-traders (especially after Brexit), those who think they are sufficiently powerful to do the cherry picking, and those who love sovereignty and protectionism. He also invites to create your own

slogan by choosing one word in each of three columns here

In February 2021 the Commission published the communication "***Trade Policy Review - An Open, Sustainable and Assertive Trade Policy***" listing six policy areas:

1) **Reform the WTO:** eg, restoring a fully-functioning WTO dispute settlement with a reformed Appellate Body.
2) **Support the green transition** and promote responsible and sustainable value chains: eg, the Carbon Border Adjustment Mechanism (CBAM) as an autonomous measure.
3) **Support the digital transition** and trade in services: eg, pushing WTO agreement on digital trade including rules on data flow and privacy.
4) **Strengthen the EU's regulatory impact** by 'exporting' EU standard at an international level (the so-called 'Brussels effect').
5) **Strengthen the EU's partnerships** with enlargement and neighboring countries such as African countries.
6) **Strengthen the EU's focus on implementation and enforcement of trade agreements,** and ensure a level playing field.

Reducing dependency cannot translate into autonomy



⇒ no country is self-sufficient and a chain is only as strong as its weakest link

Brexit: enjoying national sovereignty, but don't forget that size matters.
Boris Johnson's hopes of striking an early trade agreement with the US – seen as one of the biggest prizes of Brexit – have faded after new warnings that such pacts were not a priority for president Joe Biden's new administration.

UK ministers had hoped to agree 'foundational trade partnership' before both countries head to polls.

EU Competition Policy

A peculiarity of the EU: **Economic integration** (from national markets to a Europe-wide market) **+ liberalization** (no special protection to national firms) = competitive pressure on firms need to restructure (mergers, acquisitions, exits) and 'survival of the fittest' in the enlarged market (fewer, bigger, more efficient firms) incentives for firms to collude and for national governments to subsidize national firms in trouble.

If there is a push for **market integration** and larger markets then competition will increase and less firms will survive, entry barriers will increase.
The EU wants integration, but the concentration of power in the hands of a few firms will pose risks of collusion and losses in consumer welfare/risk to consumers.

<u>Collusive behavior:</u> firms start to strategically behave in a specific way ex. Setting the price at a high level for the whole industry.

State aids are illegal because they alter the normal functioning of the market by financing firms that would otherwise default, disappear or change markets

<u>Single Market and competition</u>

Competition policy is aimed at ensuring: **economic freedom** and **efficient resource allocation**.
Competition needs to be fair: firms should 'fight' in a **level-playing field** (ie, with the same rules) and should not abuse their powers.

- Always protect the consumers

<u>Perfect competition</u> among firms in a market assures (allocative and productive) efficiency and maximizes consumers' welfare.
Perfect competition in such a big market
⇒Lower number of firms surviving and higher possibility of them to collude
Perfect competition works only under strict assumptions (theory for the microeconomics textbooks), however it remains a benchmark for policy makers.

<u>The main aim:</u> Competition policy is used to protect European consumers.
⇒ if the benefit of state aids or high market power of firms increases consumer welfare then it is generally allowed

Big firms (regardless of their nationality) that **want to do business in the EU** have to comply with competition rules, even if the headquarters are in another continent.

EU rules are very similar to U.S. ones (Sherman Act, Clayton Act, Robinson-Patman Act…).
Competition policy encompasses antitrust, but it is **not only antitrust**.
Monopolies, or concentrated markets, might not be dangerous for consumers' welfare (economies of scale, contestable markets, innovation).
A **case-by-case approach** is needed (only few per-se prohibitions).
⇒ a very big and well performing firm is allowed to operate normally even if it has the majority of the market, competition laws intervene only if the company is abusing its dominant position in a way that undermines customer welfare or the society. Ex. Google, Apple

<u>Antitrust</u>

<u>Art. 101 of the Treaty on the Functioning of the EU</u>

Agreements and collusive behavior restricting competition

<u>Art. 102 of the TFEU</u>

Abuses of firms in dominant position ⇒ ex. Google, Apple. Assume that you want to buy a barbecue and you search on google, then google shows you only items sold by themselves and not a wide array of products.

<u>Control on concentrations (Mergers and acquisitions)</u>

Merger Regulation 139/2004 ⇒ when two separate companies become one

State Aid control

Art. 107-109 of the TFUE

Community Dimension

The EU legislation not only identifies the legal instruments to be used in order to guarantee the effectiveness of competition in the single market, but it also defines its **scope of application.**

The Treaty in fact states that EU rules apply only when a competition issue concerns practices which are capable of "*affect trade between Member States*" (TFEU art. 101, 102 and 107), where "trade" **covers all cross-border economic activities**
⇒ when the entire market is affected the EU intervenes, otherwise it is left to member states. They are going to intervene even if only one or two countries are involved if the trade is key for the whole European economy like special imports.

The latter can be considered the **criterion defining the so-called Community dimension**, marking the boundary between the European and the national competition legal frameworks (don't forget the principle of **subsidiarity**).

The European Commission manages EU Competition Policy

In the EU, the **European Commission is the Institution responsible for managing competition policy**.

- The Commission has a wide range of inspection and enforcement powers, eg, to investigate businesses, hold hearings, impose fines and grant exemptions.

Nonetheless, some of its enforcement functions have been undertaken by **national antitrust authorities** of the Member States.

The **Commission decides independently on cases**; no role for the Council of the EU or the European Parliament.
Under a system of checks and balances, the Commission's decisions can be challenged in the General Court with a **final appeal before the Court of Justice**.

Undertakings, subsidiarity and responsibility

EU competition policy applies to the behaviour of "**undertakings**", where this word is not confined only to company or business; rather, the understanding is broader covering **any entity engaged in an economic activity regardless of its legal status**.

Thus, parent and subsidiary firms may be held to be part of the same undertaking (that is relevant in establishing sanctions for antitrust violations). Most of the ECJ cases have been concerned with the imputation of a subsidiary's conduct to the parent and in Commercial Solvents (1974) the conduct of a **51% subsidiary** was attributed to its parent.

The Treaty states that EU rules apply only when a competition issue concerns practices which are capable to "*affect trade between Member States*".
⇒ Therefore **undertakings should have a certain amount of market power**; market share is always a good proxy, but not the only variable taken into account.

⇒ ownership also entails voting rights so the parent firm might be accounted responsible for the actions of a subsidiary if it owns more than 50% of its shares.

The Definition of the relevant market

Size of undertaking/total market size

Is the measure of the level of risk to the society of the firm, the bigger it is the more critical for the economy.
There isn't much debate about the size of the firm since the data is complete, but the total market size is more difficult to evaluate so the Commission wants to set it as low as possible to keep more firms in check, they can only intervene if the firm is critical. While the firms want the total size of the market to be as small as possible in the dispute.

Market definition is a tool to identify and define the **boundaries of competition between firms**, with the objective to identify market power.

⇒ Generally, it is in the interest of the defendant undertaking to describe the market as broadly as possible, and for the Commission to verify the correctness of the proposed description.

Two dimensions of boundaries: product and geographic

a. The product market comprises all those products and/or services which are regarded as **interchangeable or substitutable** by the consumer, by reason of the products' characteristics, their prices and their intended use (the principle of substitutability).
b. The geographic market comprises the **area in which the undertakings concerned are involved in the supply and demand of products or services**, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighboring areas because the conditions of competition are appreciably different in those areas.

Substitutability

The assessment of demand substitution entails a determination of the range of products which are viewed as substitutes by the consumer.
One way of making this determination can be viewed by postulating a hypothetical "***Small but Significant Non-transitory Increase in Price***" **(SSNIP test)** and evaluating the likely reactions of customers to that increase.
The question to be answered is whether the parties' customers would switch to readily available substitutes or to suppliers located elsewhere in response to an hypothetical **small** (in the range 5%-10%), **permanent** relative price increase (above the current level) in the products and areas being considered.

If substitution would be enough to make the price increase unprofitable because of the resulting loss of sales, additional substitutes and areas are included in the relevant market. (if the consumer switch then market power is similar and products are substitutes so they belong to the same market, while if consumers don't switch market power is high and the product does not have acceptable substitutes)
This would be done until the set of products and geographic areas is such that small, permanent increases in relative prices would be profitable.

SSNIP Test with market for pasta substitutes

Is "Barilla" big enough to cause competition concerns in the EU with its economic activities? What is its market power?
In order to calculate its market share (as a proxy for market power) we need the denominator, i.e. the relevant market definition.
Using the SSNIP we assume a 10% increase of the price of pasta.

If a 10% price increase for pasta pushes customers to buy more rice so that the price increase is unprofitable (due to the decrease in demand for pasta), then the two products are substitutes and the relevant market has to include both pasta and rice.

SSNIP Test with market for banana
Are banana importers capable of causing competition concerns in the EU? What is their market power?
Using the SSNIP we assume a 10% increase of the price of bananas.

If the 10% price increase for bananas is profitable, that means that consumers keep on buying bananas even though they are more expensive.
Therefore no other fruit is a substitute, and banana is a relevant market on its own.

In United Brands case the Commission: "the banana is a very important part of the diet of certain sections of the community namely the very young, the elderly, and the sick and the banana has unique characteristics: appearance, taste, softness, seedlessness, and easy-handling".

Relevant markets might be defined in a way that might not appear a priori obvious. In most cities restaurants and bars might be part of the same market at lunch time, when most people look for a quick and light meal during the short office break.
At dinner time, when people go to restaurants to spend their evening in a nice environment it is unlikely that sandwiches sold by a bar would provide a good substitute for a restaurant meal.

⇒ the objective is to have a free and fair market so competition policies are a counterbalancing force of market integration

The geographic relevant market
Consumers' preferences may be such that geographic and cultural (e.g. linguistic) barriers are relevant. For example, the relevant geographic market was defined by the Commission regional in retail banking (BAI/Banca Popolare di Lecco, 1993) and world-wide in oil (e.g. BP Amoco/Arco and Exxon/Mobil, 1999).

As a rule of thumb, the **size of the market is in inverse proportion to the product's transportation costs relative to the value of the product**: a product with a high value and a low transportation costs will have a large geographical market and vice-versa as in Napier Brown-British Sugar (1988) where UK constituted a separate market.

Ex. *Sugar*: transportation cost is high (heavy and difficult to move) and value is low so the market is very local
Ex. *Plane*: transportation cost is very low, value is high, so the relevant market is global
⇒ The geographic relevant market of Airbus and Boeing is global.

SSNIP test and cross-price elasticity

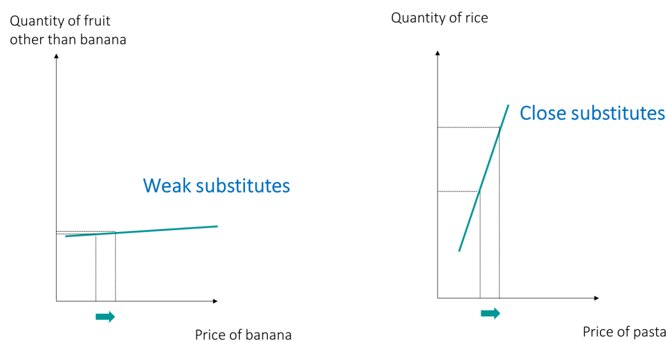
- If price increase of product 1 is profitable (because consumers do not buy product 2) then product 1 and product 2 are in different relevant markets.
- If price increase of product 1 is unprofitable (because consumers abandon product 1 to buy product 2) then product 1 and product 2 are in the same relevant market.

The cross-price elasticity of demand shows the relationship between two goods or services; it captures the responsiveness of the quantity demanded of one good to a change in price of another good.

$$E_{A,B} = \frac{\%Change\ in\ Quantity\ Demanded\ for\ Good\ A}{\%\ Change\ in\ Price\ of\ Good\ B}$$

The cross-price elasticity may be positive when the two products are substitutes or negative when the two products are complements.

SSNIP test and the cross-price elasticity



Agreement between firms (eg. cartels)

It is normal for firms to sign agreements: they can be **vertical** (eg, between a manufacturer and a distributor, their standing in the value chain is at different levels) or **horizontal** (with a firm in the same market to develop a joint project, they are located in the same phase of the value chain).

In agreements, firms keep their own **independence** (≠ from mergers).

Agreements which contribute to improving the production or distribution of goods or to promoting technical or economic progress might not be dangerous for competition, **provided that consumers are allowed a fair share of the resulting benefit.** ⇒ decreasing costs, decreasing prices. The focus is on the consumer and not the firms in the market so they don't care if it is an oligopoly or monopoly as long as consumers have benefits.

Agreements which have as their object or effect a **distortion of competition in the ESM are prohibited.**
⇒ Certain types of agreement are always considered harmful to competition and are thus prohibited without exception: **price-fixing agreements** (ex. Cartel decides to not sell apples below a certain price) **and territorial protection clauses**.

Horizontal and vertical agreements

Research and Development (R&D) ⇒ OK!

Marketing ⇒ only if the pair is not dominant in the relevant market
Negotiating together with distribution channels ⇒ only if the pair is not dominant and retailers are not too fragmented
Price fixing ⇒ NO!
Restricting quantities ⇒NO!

Sharing markets ⇒ NO! Monopolies and restrictions on variety of products that must be consumed

⇒ agreements are not always verbalized in contracts especially if they concern competition

The concept of agreement clearly includes a contract, but is broader.

An agreement is the faithful expression of the parties intention to conduct themselves in a certain way.

An agreement **does not require to be made in writing** and does not require **any signature**. It exists wherever there is the necessary consensus between the parties determining the lines of their mutual action or abstention from action in the market.

The CFI in Cartonboard (1998): the **producers who, without objection, attended** meetings which they knew were intended to reduce price competition, were **liable to fines**, even if they said nothing, missed some of the meetings and cheated the cartel.

Decisions by association of undertakings

Undertakings usually belong to an **association that acts on behalf of its member** companies.

Such actions might include promotional campaigns, market research, standard setting, and even charitable functions on behalf of workers in the industry. These associations may also act as a front for collusive activity.

In *Belasco*, the Cooperative Association of Belgian Asphalters: bans on bribes, joint advertising, and the studying of ways of **standardizing** and **rationalizing** the production and distribution of roofing felt.

Further objectives set out in the agreement: the **adoption of a price list and minimum prices** for all roofing felt supplied in Belgium, the allocation of **quotas between members,** and penalties for breaches of decisions made under the agreement.

In Fire Insurance, the Commission: *"in spite of the fact that the title of recommendation describes it as being 'non-binding', the recommendation was in the nature of a 'decision' by an association of undertakings […]. It is sufficient for this purpose that the recommendation was brought to the notice of members as a statement of the association's policy"*.

Concerted practices: cartels and tacit collusion

Concerted practices (aka collusion) refers to conduct where firms cooperate over time to raise prices above competitive levels.

⇒ usually at an horizontal level, cartels happen between firms doing the same business ex. distribution

Explicit collusion refers to a cartel that colludes by directly communicating with each other.

Tacit collusion is where firms collude without such explicit communication.

Concerted practices generally have an "horizontal" dimension.

Parallel price increases by several undertakings are not in themselves prohibited. They could be purely coincidental or the result of a particular market situation (eg, an increase in the price of inputs).

The problem is the origin of that parallel price increase….

Tacit collusion: smoking gun

When there is no evidence of an agreement the Commission analyzes the **behavior of concerned undertakings** which leads to conditions of competition which do not correspond to the normal conditions of the market.

In order to increase the efficiency of its action, the Commission focuses on those relevant markets where there are conditions easing collusion such as:

- homogeneity of product
- importance and number of undertakings (it is easier to coordinate a small number of undertakings, but participation should represent a large part of the market)
- entry barriers
- information sharing (price leader's announcement, trade association, discounts)
- low variability of the market (it is easier to control the behaviour of undertakings belonging to the cartel).

⇒ The Commission operates checks with:

Unannounced inspections are a preliminary investigative step into suspected anticompetitive practices. The fact that the Commission carries out such inspections does not mean that the firm in question is guilty of anti-competitive behavior.
This is why in the press releases you do not find the names of the firms inspected, however…

Fines and immunity

Firms involved in illegal agreements (cartels) are liable to be **fined up to 10% of the turnover of the entire group of companies worldwide and for all products sold.** (if a company participates in a cartel for only one of their products then they have to pay a fine related to all the products sold by parent firms and subsidiaries).

Since it might be very difficult to find evidence of a cartel in a market, the Commission waits for information coming from the market, handled by a **whistle-blower**. ⇒ bring evidence of the damage done to consumers, if the cartel has not taken effect yet then it is not liable for prosecution.
A **leniency programme** encourages firms to inform the Commission about their infringements.
The first firm to submit evidence that is sufficient for the Commission to launch an inspection, or enables it to find an infringement, receives full exemption from its fine: **total immunity**.
⇒ this could also be a strategic behavior to undermine competitors. All the incentives are put in order to avoid formation of cartels and it has proven useful.

Victim's claims for damage

In addition to public enforcement of EU competition rules (e.g. a Commission's fine), there is **private enforcement.**
Any citizen or business which suffers harm as a result of a breach of the EU competition rules is entitled to claim compensation from the party who caused it. This means that the victims can bring an action for **damages before the national courts.**
If the Commission has taken a prohibition decision regarding the infringement, this decision can be used before national courts to prove that the behavior took place and was illegal.

Cartel of LCD panel producers

In 2010 the European Commission fined six LCD panel producers a total of 649 million EUR for operating a cartel which harmed European buyers of television sets and computers.

The six firms are Samsung Electronics and LG Display of Korea and Taiwanese firms AU Optronics, Chimei InnoLux Corporation, Chunghwa Picture Tubes and HannStar Display Corporation.

The companies agreed on prices, exchanged information on future production planning, capacity utilization, pricing and other commercial conditions.
The cartel members held monthly **multilateral meetings** and further bilateral meetings. In total they met around 60 times mainly in hotels in Taiwan for what they called "**the Crystal meetings**".

Samsung received full immunity (thanks to the leniency programme) as it brought the cartel to the Commission's attention and provided valuable information to prove the infringement.
The risk for Samsung? A fine up to **22 billion USD** (10% of 220 billions USD, the worldwide turnover of Samsung Group in 2010)

Cartel of rechargeable battery producers
In 2016 the European Commission fined Sony, Panasonic and Sanyo a total of 166 million EUR.
Sony, Panasonic, Sanyo and Samsung took part in bilateral, and sometimes multilateral, contacts in order to avoid aggressive competition in the market for lithium-ion batteries. In particular, the four companies:
agreed on temporary price increases in 2004 and 2007 triggered by a temporary increase in the price of cobalt, a raw material used in the production of lithium-ion batteries; and
exchanged commercially sensitive information such as supply and demand forecasts, price forecasts or intentions concerning particular competitive bids organised by specific manufactures of products such as phones, laptops or power tools.

Samsung received (again) full immunity as it brought the cartel to the Commission's attention and provided valuable information to prove the infringement.
The risk for Samsung? A fine up to 30.5 billion USD (10% of 305 billions USD, the worldwide turnover of Samsung Group in 2016)

Auction market price fixing
Sotheby's and Christie's used to handle 90% of the auction market and they were accused by the Commission of operating a price-fixing cartel lasting 7 years during the 1990s to inflate commission fees.
In 2002 Sotheby's was fined 20.4 million EUR by the Commission (6% of the annual Sotheby's turnover) and, after the European fine, 45 million USD in the U.S.
The rival Christie's escaped a fine, despite being implicated, because it was the first to provide crucial evidence.
Even in the U.S., Christie's had immunity, and Sotheby's then chairman, Alfred Taubman, was jailed for one year.

Cartel on canned vegetables
On 27 September 2019, the European Commission made a decision on a cartel for the supply of certain types of canned vegetables (eg, green beans, peas, sweetcorn) to retailers and/or food service companies.
The companies – Bonduelle, Coroos, Groupe CECAB, and Conserve Italia - set prices, agreed on market shares and volume quotas, allocated customers and markets, coordinated their replies to tenders, and exchanged commercially sensitive information.
Bonduelle was not fined, by revealing the existence of the cartel to the Commission.
Coroos and Groupe CECAB were fined a total of € 31.7 million and got a 10% discount since they admitted their involvement in the cartel and agreed to settle the case.
Conserve Italia decided not to settle this case with the Commission, so the Commission's investigation against Conserve Italia continued under the standard cartel procedure.
On 19 November 2021, Conserve Italia was fined € 20 million.

Vertical Agreements

Agreements between companies operating at different levels of the production or distribution chain (e.g. distribution, franchising) can have:

- **Anticompetitive effects:** when the agreement contains restraints on the supplier or the buyer e.g. an obligation on the buyer not to purchase competing brands or an obligation on the supplier to only supply a particular buyer (i.e. exclusive supply).
- **Procompetitive effects:** when the agreement helps a manufacturer to enter a new market, or when avoids the situation whereby one distributor 'free rides' on the promotional efforts of another distributor.

A Block Exemption Regulation provides a safe harbor for most vertical agreements (when both the supplier and the buyer **do not have a market share exceeding 30%**)

⇒ As long as there is effective **inter-brand competition**, an undertaking can restrict intra-brand competition (e.g. exclusive distribution).

The Single Market cannot be divided

=> an italian shop could not buy from a french supplier but only from a national supplier

In 2017, the Commission opened investigations into certain licensing and distribution practices of Sanrio and of NBC Universal to assess whether they illegally **restricted traders from selling licensed merchandise cross-border and online within the European Single Market.**

- **Sanrio** is a Japanese firm that designs, licenses, produces and sells products (eg, mugs, bags, bedsheets, stationery, toys) featuring Hello Kitty,
- **NBC Universal** is a U.S. firm in charge of licensing intellectual property rights for products featuring the Minions, Jurassic World, Trolls.

In July 2019, the Commission fines Sanrio 6.2 million EUR.
In January 2020, the Commission fined NBC Universal 14.3 million EUR.

⇒ usually the companies appeal before paying the fine or they pay in a very long time, there are fines for late payments

Abusive behavior of dominant firms

Firms in dominant position

In the EU, firms in a dominant position (eg, a monopoly) are not illegal per se.
⇒ It is the **abusive behavior** of those firms that is illegal. And a firm can restrict competition if it has a strong position on a relevant market.

When is a firm dominant?

Market share. The Commission's experience suggests that dominance is not likely if the firm's market share is below 40%; however dominance (not necessarily its abuse) becomes very likely if the market share rises **above 70%.**

Other factors to take into account are: **position of competitors** (a firm with a 40% market share is more powerful if the remaining 60% is shared equally among 10 competitors rather than it is hold just by one competitor), **entry barriers** in the market (low entry barriers reduce the power of the dominant firm) and the **bargaining power** of consumers (e.g. National health systems buying medical devices).

Abusive behaviours

Exploitative abuse: conduct whereby the dominant firm takes advantage of its market power to exploit its customers and increasing its profits (eg, by charging high prices);

Exclusionary abuse: conduct whereby the dominant firm prevents or hinders competition on the market by excluding its competitors by other means than competing on the merits of the products or services it provides.
The exclusion of competitors is not an end in itself, but a firm's strategy to increase its dominance (ie, increasing its market share) to undertake exploitative abuses that can increase its profitability.

Fines and Commitments

Like for agreements, dominant firms undertaking abuses are liable to be fined **up to 10% of the turnover of the entire group** of companies worldwide and for all products sold.

Some investigations into suspected infringements are **resolved** with '*commitment decisions*'.

The Commission drops the case and imposes **no fines in exchange for a commitment** from the company under investigation to implement measures to stop the presumed anti-competitive behaviour.

Commitment decisions are considered **speedier** than formal sanctions (prohibition decisions) in restoring normal competitive market conditions.

If the Commission, **after consulting market participants**, finds these commitments sufficient, it takes a decision to make them legally binding.

If the companies breach commitments they can be fined.

Unfair pricing: excessive prices

In 2001 the Commission imposed a fine of 19.76 mln EUR on French tyre maker **Michelin** for abusing its dominant position in replacement tyres for heavy vehicles in France between 1990 and 1998.

Michelin had **more than 50% of the market** for new replacement tyres for heavy vehicles in France. As regards the French retread market, its share is even higher. None of its competitors are comparable in size.

Michelin's complex system of quantitative rebates, bonuses and other commercial practices **illegally tied dealers** and foreclosed the French market to other tyre manufacturers.

Michelin's commercial policy for both the retread and the new replacement tyre market had the effect of keeping dealers in close **dependence** and preventing them from choosing their suppliers freely.

Unfair prices: predatory prices

In 2020, the Commission has informed the state-owned Czech rail incumbent České dráhy (ČD) of its preliminary view that ČD has **breached EU antitrust rules by charging prices below costs**.

On certain routes in Czechia, rail undertakings compete on a commercial basis, outside of public service contracts. In 2011 and 2012, two new rail undertakings, RegioJet and Leo Express, started operating commercial trains on the Prague-Ostrava route.
As competition increased in the rail sector in this area, the number of passengers using this route by rail doubled in a few years.
ČD reacted by starting to **offer its services at prices that did not cover its costs**, with the aim of hindering competition in the market.
The Commission therefore has reached the preliminary view that between 2011 and 2019 ČD engaged in predatory pricing on the Prague – Ostrava route.

AB InBev

In 2019 the Commission fined **AB InBev,** the world's biggest beer company, 200 million EUR.

AB InBev abused its dominant market position in Belgium by **restricting the possibility for supermarkets and wholesalers to buy Jupiler beer at lower prices** in the Netherlands and to import it into Belgium.

AB InBev used different ways to achieve this, such as by changing the packaging of some of its Jupiler beer products supplied to retailers and wholesalers in the Netherlands to make these products harder to sell in Belgium, notably by removing the French version of mandatory information from the label.

Price discrimination is not illegal per se;

Price discrimination is not prohibited if it is justified by **cost differentials** (eg in 2 different countries). Furthermore, **homogeneous prices can be harmful**, especially for consumers in less wealthy countries (Country B in the example below).

⇒ Demand could be lower in lower income countries

Refusal to supply and the essential facility doctrine

When the refusal to supply refers to a facility or an **infrastructure** without access to which competitors cannot provide services to their customers, we apply the "***essential facility doctrine***".

> Hence, access to a facility is "essential" when refusal to supply would exclude all or most competitors from the market.

The owner of an essential facility cannot use its power in one market (e.g. telecom network, airport) in order to protect or strengthen its position in another related market (phone calls, handling) imposing a competitive disadvantage on its competitor.
The **test** is four-fold:

1) control of the essential facility by a **monopolist**,
2) a competitor's **inability to duplicate** reasonably the essential facility,
3) the **denial of the use** of the facility to a competitor,
4) the **feasibility of providing** the facility.

Frankfurt airport is an essential facility

Flughafen Frankfurt/Main AG (FAG) owned and operated the Frankfurt airport and it has a **dominant position in the market for provision of airport facilities** for the landing and take-off of aircraft.
The Commission argued that the market of some ground-handling services (baggage loading, transport of passengers, cabin cleaning, fuelling aircrafts) was a neighbouring but separate market.
FAG refused airlines and independent suppliers access to this market for ground-handling services based on the lack of space at the airport.
But the Commission (1998) was not convinced by this argument. Hence, FAG was held to have abused its dominant position in breach of Article 102 of the TFEU.

Tying by Microsoft: Windows + WMP

In 2004, the Commission fined Microsoft (497 million EUR) because of leveraging its near monopoly in the **market for PC operating systems onto the markets for media players** (as well as for work group server operating systems).
Microsoft was fined and required to offer a version of its Windows OS without Windows Media Player (WMP).
⇒ Tying (prohibited in the EU) requires the presence of the following elements:

- The tying and tied goods are two separate products
- The undertaking concerned is dominant in the tying product market
- The undertaking concerned does not give customers a choice to obtain the tying product without the tied product;
- Tying forecloses competition.

The Commission found that:
Media Players and OSs were **separate products** (independent companies provided the tied product separately from the tying product, which indicated separate demand).

Microsoft was licensing 93.8% of the OS for PCs (network effect).

PC manufacturers were required to **pre-install WMP** when licensing Windows. MS's market share in media player market increased hugely after it started to tie.
Thus Microsoft had used Windows to distribute the WMP leaving its competitors at a disadvantage.
Tying raises the content and applications barriers to entry that protect Windows. This shields MS from effective competition from potentially more efficient vendors of media players.

⇒ this could be harmful to consumers because although the service was at present free, Microsoft could start raising prices once people became dependent on the service.

Google Case

Case #1 Google Shopping.

27 June 2016: 2.42 billion EUR fine

Case #2 Android.

18 July 2018: 4.34 billion EUR fine

Case #3 Ad Sense for search.

20 March 2019: 1.49 billion EUR fine

Case #4 Online advertising.

22 June 2021: Investigation opened

Exclusionary behaviour: Google Shopping

In 2010 the Commission opened an investigation against Google following complaints by search service providers about unfavorable treatment of their services in Google's unpaid and sponsored search results coupled with an alleged preferential placement of Google's own services.
According to the Commission' Preliminary Assessment: for its general web search service, Google has a market share of over 90% in the EU.

The Problem with Google Shopping:
⇒ Google abuses dominance as search engine to give illegal advantage to Google Shopping by promoting it at the top of the page when showing search results
⇒ Moreover other Google services are marketed on the right side of the page where research showed the attention of viewers to be.

⇒ **the remedy proposed** was to show both Google's and Competitors' products:

When Google charges for inclusion in its Google Shopping, the three rivals would be chosen from a pool of eligible specialised search competitors based on a dedicated **auction mechanism ($$$)**.
So, Google's proposed remedy 3+3 was not accepted by its competitors and by the Commission.

In June 2017 **the Commission fined Google** with 2.42 billion EUR for having abused its market dominance as a search engine by giving an illegal advantage to Google Shopping, its comparison shopping service (source).
Google's fine could have been higher, up to 10% of its worldwide turnover (Alphabet in 2017: 110 billion USD).
In September 2017 Google appealed against the fine.
On 10 November 2021 the General Court confirmed the Commission's decision.

Case #2 Android

In July 2018, the Commission fined Google **€4.34 billion** for imposing illegal restrictions on Android device manufacturers and mobile network operators to cement its dominant position in general internet search. In particular:

Google has ensured that its **Google Search app and mobile browser are pre-installed** on practically all Android devices sold in Europe.

Google has **prevented manufacturers** wishing to pre-install Google apps from selling even a single smart mobile device running on alternative versions of Android that were not approved by Google (so-called "Android forks" e.g. Amazon's Fire OS).

For the Commission, pre-installation can create a ***status quo bias.*** Users who find search and browser apps pre-installed on their devices are likely to stick to these apps.

Amazon

10 November 2020. Commission sends ***Statement of Objections*** to Amazon for the use of **non-public independent seller data.**

Amazon has a **dual role** as a platform:

(i) it provides a marketplace where independent sellers can sell products directly to consumers; and

(ii) it sells products as a retailer on the same marketplace, in competition with those sellers.

As a marketplace service provider, Amazon has access to **non-public business data of third party sellers** such as the number of ordered and shipped units of products, the sellers' revenues on the marketplace, the number of visits to sellers' offers, data relating to shipping, to sellers' past performance, and other consumer claims on products.

Those data are available to Amazon which uses them to calibrate its retail offers and strategic business decisions to the detriment of the other marketplace sellers. For example, it allows Amazon to **focus its offers in the best-selling products across product categories** and to adjust its offers in view of non-public data of competing sellers.

M&A

Concentration

The concept of concentration covers any operation which results in two or more previously independent undertakings being replaced by, or merged into, a single undertaking.

Concentration of market power is a **natural outcome of European integration:** the number of firms is falling as firms merge or buy each other out.

Combining the activities of different companies may allow the companies, for example, to develop new products more efficiently or to reduce production or distribution costs. Through their **increased efficiency**, the market becomes more competitive and **consumers benefit** from higher-quality goods at fairer prices.

The determination of the existence of a concentration is **based upon *de facto control*,** rather than legal criteria.

The Procedure Followed by the Commission

Thus, according to the EU Regulation: "*A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular by the creation or strengthening of a dominant position, shall be declared incompatible with the common market.*"

A concentration (above certain thresholds) must be notified to the Commission prior to its implementation.

After notification, the Commission has 25 working days to analyse the deal during the Phase I investigation which involve:
Requests for information from the merging companies or third parties;
Questionnaires to competitors or customers seeking their views on the merger, as well as other contacts with market participants, aimed at clarifying the conditions for competition in a given market or the role of the merged companies in that market.
Calculation of market shares.

The Herfindal-Hirschman index (HHI)

The Herfindahl-Hirschman Index (HHI) is calculated by **summing the squares of the individual market shares of all the firms in the market.**

The HHI gives proportionately greater weight to the market shares of the larger firms. Although it is best to include all firms in the calculation, lack of information about very small firms may not be important because such firms do not affect the HHI significantly.

While the absolute level of the HHI can give an initial indication of the competitive pressure in the market post-merger, the change in the HHI (known as the "delta") is a useful proxy for the change in concentration directly brought about by the merger.

In the case of a **monopolist**, the HHI is 1002 = 10,000 (max)

If instead there are 10 firms with a 10% market share each, the HHI is:

102 + 102 + 102 + 102 + 102 + 102 + 102 + 102 + 102 + 102 = 1,000

If instead there are 10 firms with the following market shares:

52 + 52 + 52 + 52 + 52 + 52 + 52 + 52 + 52 + 552 , the HHI is: 3,250

HHI and unlikely horizontal concerns

- If the **post-merger HHI below 1,000**, the Commission is unlikely to identify horizontal competition concerns in a market.

- If the **post-merger HHI is between 1,000 and 2,000** and a delta below 250, and above 2,000 and a delta below 150, the Commission is unlikely to identify horizontal competition concerns in a market but further analysis (phase II) is required when:
  - one or more merging parties are important innovators in ways not reflected in market shares;
  - Indications of past or ongoing coordination, or facilitating practices, are present.

- Above the previous thresholds, the Commission requires further analysis (phase II)

1. **Example: Market shares of seven firms in the relevant market pre-merger**

A: 15% - B: 15% - C: 10% - D: 10% - E: 20% - F: 20% - G: 10%
HHI pre-merger: 225 + 225 + 100 + 100 + 400 + 400 + 100 = **1,550**

Case 1) Market shares of six firms after the merger between C and D
A: 15% - B: 15% - CD: 20% - E: 20% - F: 20%- G: 10%
HHI post-merger CD: 225 + 225 + 400 + 400 + 400 + 100 = **1,750 Delta = 200**

The post-merger HHI is between 1,000 and 2,000 and a delta below 250
Commission: OK, the concentration is cleared except special circumstances

2. **Example: Market shares of seven firms in the relevant market pre-merger**

A: 15% - B: 15% - C: 10% - D: 10% - E: 20% - F: 20% - G: 10%
HHI pre-merger: 225 + 225 + 100 + 100 + 400 + 400 + 100 = **1,550**

Case 2) Market shares of six firms after the merger between F and G
A: 15% - B: 15% - C: 10% - D: 10% - E: 20% - FG: 30%
HHI post-merger FG: 225 + 225 + 100 + 100 + 400 + 900 = **1,950 Delta = 400**

The post-merger HHI is still between 1,000 and 2,000 but the delta is above 250
Commission: Further analysis (phase II)

How to solve horizontal concerns
The Commission can approve a concentration with potential anticompetitive effects in case of:
Efficiency defense. The concentration can generate technical and economic progress that is to consumers' advantage (eg, a concentration that reduces the cost and the price for consumers).
Failing firm defence. The concentration - fewer firms in the market - would have happened anyway in the near future due a firm forced out of the market because of financial difficulties.
Remedies/commitments. The firms can propose solutions to keep a sufficient degree of competition in the market (eg, by selling assets or favouring the entrance of new competitors).

Remedies for competition concerns
The Commission is aware of the benefits linked to merging processes (only 30 prohibited mergers out of 8,083 notifications) and for this reason there may be actual negotiation between the parties and the Commission on the conditions for compliance with competition principles.
It is the responsibility of the undertakings to show that the remedies they offer will eliminate the problems identified by the Commission.
Remedies must be clear-cut and entirely remove competition concerns, and implemented effectively and within a short period with conditions and obligations containing specific details and procedures relating to their implementation.
Conditions are all the measures that change the market structure, while obligations identify the implementing steps (conduct) necessary to properly fulfil commitments.
The most effective ones are remedies that change the market structure, thus reducing the 'power' of wannabe merging firms.

Alitalia + KLM
The Commission assessed the alliance between Alitalia and KLM under the Merger Regulation despite the fact that these airlines neither merged nor constituted any Joint venture as a separate legal entity.
The parties originally submitted an application considering that their agreement did not fall under the scope of the Merger Regulation.
The Commission decision in 1999 has created a precedent as regards the nature of the operations that fall under the scope of the Merger Regulation in so far as the alliance between Alitalia and KLM is the first contractual Joint Venture authorised under that Regulation.
The Alitalia-KLM alliance would not be described as a contractual merger because the operation would not give rise to a single economic entity: both parties continue to have businesses that are excluded from the alliance (e.g. charter operations, maintenance, …) , independent decision making bodies etc.
However, the parties reached (by contractual means) such a degree of integration that the operation could be considered as the constitution of a Full Function Joint Venture.

The prospected Alliance did not raise competition concern with respect to cargo but rose concerns in two routes as regards the transport of passengers:
Amsterdam – Rome and Amsterdam – Milan

The investigation showed that indirect routes are not reasonably substitutable to direct routes where these exist.

These dominant positions were protected by barriers to entry such as congested airports (at both ends) and the disproportion between the high capacity offered by the parties (in terms of seats and frequencies) and the relative thinness of the markets concerned.

The clearance of the operation had therefore to be linked to the adoption of remedies likely to remove this competition concern.

Remedies have been imposed to overcome the slot shortages at congested airports. In practice, the parties have to make available 336 weekly slots to new entrants at Amsterdam-Schiphol, Milan-Malpensa and Rome-Fiumicino.

<u>Olympic air + Aegean Airlines</u>

In 2011 the Commission prohibited the proposed merger between Aegean Airlines and Olympic Air, as it would have resulted in a quasi- monopoly on the Greek air transport market.

Together the two carriers controlled more than 90% of the Greek domestic air transport market and the Commission's investigation showed no realistic prospects that a new airline of a sufficient size would enter the routes and restrain the merged entity's pricing.

Remedies: The parties offered to cede take-off and landing slots at Greek airports, but the Commission did not accept the proposal since Greek airports do not suffer from the congestion observed at other European airports.

However, after 2 years (2013) the Commission cleared the proposed acquisition of Olympic Air by Aegean Airlines.

The Greek crisis has seen a drop of 26% in demand for domestic air passenger transport from Athens from 2009 to 2012 and Olympic Air would be forced to exit the market due to financial difficulties.

Once Olympic would be out of business, Aegean would become the only significant domestic airline by capturing Olympic's customers.

Thus, with or without the acquisition, Olympic would have soon disappeared as a competitor to Aegean.

The acquisition causes no harm to competition that would not have occurred anyway.

<u>Google + Fitbit</u>

On 17 December 2020 the Commission approved the acquisition of Fitbit by Google conditional on full compliance with a commitments package offered by Google.

The commitments will determine how Google can use the data collected for ad purposes, how interoperability between competing wearables and Android will be safeguarded and how users can continue to share health and fitness data, if they choose to. For example:

Google will **not** use for Google Ads the health and wellness data collected from wrist-worn wearable devices and other Fitbit devices of users in the EEA, including search advertising, display advertising, and advertising intermediation products. This refers also to data collected via sensors (including GPS) as well as manually inserted data.

Google will ensure that EEA users will have an effective choice to grant or deny the use of health and wellness data stored in their Google Account or Fitbit Account by other Google services (such as Google Search, Google Maps, Google Assistant, and YouTube).

<u>Microsoft + Activision Blizzard</u>

On 30 September 2022, Microsoft (US) notified to the European Commission the proposed acquisition of Activision Blizzard (US). Activision Blizzard develops and publishes video games for

gaming consoles, PCs and mobile devices (eg, Call of Duty, World of Warcraft, Diablo and Candy Crush).
On 8 November 2022, the Commission opened the investigation and, according to a preliminary view, Microsoft may have the ability and the incentive to engage in foreclosure strategies vis-à-vis Microsoft's rival distributors of console video games (Xbox is a Microsoft's division) such as preventing these companies from distributing Activision Blizzard's video games on consoles or degrading the terms and conditions for their use.
On 15 May 2023, the Commission cleared the acquisition, but with conditions: Microsoft offered the following commitments, with a 10-year duration:
A free license to European consumers that would allow them to stream, via any cloud game streaming services of their choice, all current and future Activision Blizzard PC and console games for which they have a license.
A corresponding free license to cloud game streaming service providers to allow Europe-based gamers to stream any Activision Blizzard's PC and console games.

Amazon + iRobot
On 1 June 2023, Amazon (US) notified to the European Commission the proposed acquisition of iRobot (US). iRobot manufactures robot vacuum cleaners (RVCs) and sells them also through Amazon's online marketplace.
On 6 July 2023, the Commission opened the investigation and on 27 November 2023 sent Amazon its Statement of Objections since, after the acquisition, Amazon may have the ability and the incentive to **foreclose iRobot's rivals** aimed at preventing rivals from selling RVCs on Amazon's online marketplace and/or at degrading their access to it. This could restrict competition leading to higher prices, lower quality, and less innovation for consumers.
Amazon's online marketplace is a particularly important channel to sell RVCs in France, Germany, Italy, and Spain.
On 29 January 2024, Amazon notified the Commission of the decision to abandon its proposed acquisition of iRobot.
A Statement of Objections is not a veto on the deal; it is an interim view on possible violations of EU competition law. Amazon had the opportunity to reply to the Commission, to consult the Commission's case file and to request an oral hearing.

State Aids
State aid is an advantage conferred on a selective basis to undertakings by public authorities.
By giving certain firms or products favored treatment to the detriment of other firms or products, state aid seriously disrupts normal competitive forces (remember the ESM as a 'level playing field')
Very often, public subsidies simply delay the inevitable restructuring of operations without helping the recipient to return to competitiveness.
Unsubsidised firms who must compete with those receiving public support (ie, taxpayers' money) may ultimately run into difficulties endangering the jobs of their employees.
The entire market will suffer from state aid, and the general competitiveness of the European economy is jeopardized.
State aids are **generally illegal in the EU** unless it is justified by reasons of general economic development. State aids control means that the Commission is controlling how EU Governments are using taxpayers' money.

Legal State Aids
State aids are always legal when they have a social character (granted to individual consumers without discrimination related to the origin of the products concerned) and in case of natural disasters.
State aids can be legal (notified and approved by the Commission) when they:

- promote the economic development of areas where the standard of living is abnormally low or where there is serious under-employment;
- promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
- facilitate the development of certain economic activities or of certain economic areas;
- promote culture and heritage conservation.

State aids procedure:
The European Commission has strong investigative and decision-making powers.
EU State aid control requires prior notification of all new aid measures to the Commission. Member States must wait for the Commission's decision before they can put the measure into effect.
There are a few exceptions to mandatory notification, for example:
aid covered by a Block Exemption, giving automatic approval for a range of aid measures defined by the Commission (eg, local transport, broadband..),
de minimis aid not exceeding 200,000 EUR per undertaking over any period of 3 fiscal years or
aid granted under an aid scheme already authorized by the Commission.

When state aids are compatible
- The economic criterion underlying compatibility according to art. 107 (3) of the TFEU is the concept of market failure, sometimes supplemented by the concept of merit good.
- Market failure occurs when the market, left to itself, does not produce the optimal quantity (eg, Research & Development, venture capital, environmental investments ...)
- Merit goods are of particular importance for the State which gives a value judgment as interpreter of the will of the citizens. For those goods, the government can give a subsidy (ie, a State aid).
- Examples of merit goods include education, transport, communications, health care, welfare services, housing, fire protection and public parks.
- In contrast to pure public goods, merit goods could be, and indeed are, provided through the market, but not necessarily in sufficient quantities to maximize social welfare.

Ireland and Apple
Following the investigation launched in June 2014, the Commission has concluded (in August 2016) that two tax rulings issued by Ireland to Apple have lowered the tax paid by Apple in Ireland since 1991.
The 1991 and 2007 rulings endorsed a way to establish the taxable profits for two Irish incorporated companies of the Apple group - Apple Sales International and Apple Operations Europe - ultimately controlled by the US parent.
Since those two taxable companies were just two "head offices" with no employees or premises and existed only on paper, according to the Commission, they could not have generated such profits (87 billion $ euro over the past decade).
As a result of the allocation method endorsed in the tax rulings, Apple only paid an effective corporate tax rate that declined from 1% in 2003 to 0.005% in 2014 on the profits of Apple Sales International.

⇒ gave illegal preferential treatment to Apple
- All profits to Europe fails recorded in Ireland and taxed at a very low rate
- Profits taken back to US and used for R&D

This selective tax treatment of Apple in Ireland is illegal under EU state aid rules, because it gives Apple a significant advantage over other businesses that are subject to the same national taxation rules.

Ireland must now recover the unpaid taxes in Ireland from Apple for the years 2003 to 2014 of up to €13 billion, plus interest.
The amount of unpaid taxes to be recovered by the Irish authorities would be reduced if other countries were to require Apple to pay more taxes on the profits recorded by Apple Sales International and Apple Operations Europe for this period (eg, in India or in Germany).
The amount of unpaid taxes to be recovered would also be reduced if the US authorities were to require Apple to pay larger amounts of money to their U.S. parent company for this period to finance research and development efforts. These are conducted by Apple in the US on behalf of Apple Sales International and Apple Operations Europe, for which the two companies already make annual payments.

In July 2020, the General Court quashed the Commission's order for Apple to pay back €14.3bn in taxes to Ireland since the Commission did not prove, in its alternative line of reasoning, that the contested tax rulings were the result of discretion exercised by the Irish tax authorities. (press release of the judgment)

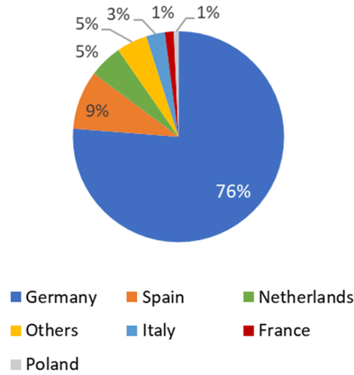
On 25 September 2020, Margrethe Vestager said that the Commission would appeal against the General Court's judgment.
The Commissioner: "*We have to continue to use all tools at our disposal to ensure companies pay their fair share of tax," she said. "Otherwise, the public purse and citizens are deprived of funds for much needed investments — the need for which is even more acute now to support Europe's economic recovery. We need to continue our efforts to put in place the right legislation to address loopholes and ensure transparency.*"

State Aids for European Green Deal
9 March 2023. The European Commission adopted a Temporary Crisis and Transition Framework (TCTF) to foster support measures in sectors that are key for the transition to a net-zero economy.
Member States have more flexibility to support measures in key sectors for the transition to a net-zero economy, such as batteries, solar panels, hydrogen, carbon capture and storage, zero-emission vehicles and energy performance of buildings.
This comes in the context of global challenges posing a threat of new investments in these sectors being diverted in favor of third countries outside Europe.
For example, United States approved a $369 billion green-tax credits initiative part of the **Inflation Reduction Act (IRA)**. Buyers get a tax credit for vehicles for which a minimum percentage of critical minerals has been extracted or processed in the US or a country with which the US has a free trade agreement, and an additional tax credit if a threshold percentage of battery components are manufactured or assembled in North America. Moreover, vehicles must meet other requirements to qualify, including final assembly in North America.

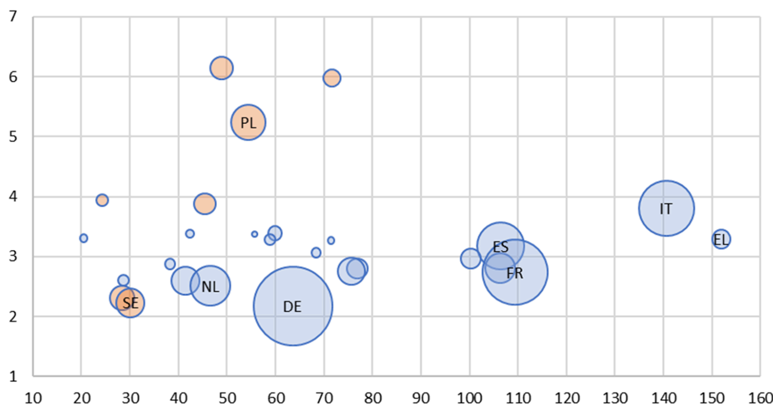
Northvolt is a Swedish firm committed to manufacturing EV batteries with the lowest embedded carbon content and using zero emission electricity.
In September 2023, Northvolt announced a plan to build a battery factory in Quebec (Canada). That location gives access to: plentiful and low cost hydropower, the IRA subsidized market and public subsidies (Canadian government and Quebec's provincial government).
In January 2024, the European Commission approved a €902 million German measure to support Northvolt in the construction of a plant in Heide (Germany) – a gigafactory - for the production of batteries for electric vehicles to foster the transition towards a net-zero economy.
The State aid will be granted under the temporary crisis and transition framework (TCTF).
According to the Commission, without the German subsidy the new site would have been built in the US where Northvolt was offered an equivalent subsidy for an equivalent investment.

State Aids may increase inequality within the EU

The Commission's plan about State Aid risks casting smaller EU countries against big powers.
To deal with this problem, the Commission also proposed a common "EU sovereignty fund" to finance state aid directly from EU sources to avoid fiscally stronger member states having an unfair advantage over poorer and debt-burdened members.
The Commission proposed a fund in the context of the review of the Multi-annual financial framework (MFF). The Council has not approved it yet.



Yield on 10y maturity Government bonds (%, January 2024 average) over **Public debt/ GDP (%2024)**



European Agricultural Policy

Why Agriculture?
1.7 % of the EU GDP and a modest contribution to growth
5.0 % of labour force
5.3 % of imports

BUT

- Today CAP weights 38% of the EU budget (>70% in the Seventies).
- The CAP was born as the only entirely communitarian policy, ie, financed entirely by the EU.
- It is a family business. Even though the situation varies from one member State to another, the holder plus family members provide over 90% of work in Ireland, Malta, and Poland.
- Agriculture is a hot issue when it comes to poverty reduction, international trade and development cooperation... and it accounts for many of the quarrels among EU member States.
- Agriculture is "old economy", but we still need food.
- In the EU, agriculture is not just agriculture.

From 1955 to 2009 the importance of agriculture over total GDP has been sharply declining
- In 1955 low level of productivity (GDP share < employment share)
- The British exception (long history of free trade -> downsizing of the sector)

The Call for a Policy

- The origins of the **Common Agricultural Policy (CAP)** relate essentially to the transition of the **post-war European economy** from an economy based on agriculture to one based on industry and services.
- The growing labour demand coming from the post-war **booming industrial sector** was creating increasing pressures for a potentially massive outflow of people from the rural areas towards the new urban industrial centres.
- **Farming is a risky business:** Agriculture is more dependent on the weather and climate than other sectors. Moreover, there is a **time gap** between consumer demand and farmers being able to increase supply as growing more wheat or producing more milk takes time and investment.
- EU farmers in principle generate a positive externality by supplying **public goods** which cannot be provided by the market alone: rural communities, natural resources, environmental protection, animal welfare, high-quality and safe food, in one word **"multi-functionality"**

No intervention: let the "**market**" do the necessary adjustment, which would have translated into massive emigration out of the countryside into the cities.	Intervention: find ways to **accompany this transformation** (from agriculture to industry and services), while protecting the multifunctional role of agriculture. ⇒ an ad hoc policy

- Europe needed a strong and healthy agricultural sector and the memory of food shortages over WWII was still vivid.
- **The Treaty of Rome (1957)** defined the general objectives of a common agricultural policy. The principles of the Common Agricultural Policy (CAP) were set out at the Stresa Conference (1958).
- In 1960, the CAP mechanisms were adopted by the six founding Member States and two years later… **in 1962 the CAP came into force.**

The Objectives of the CAP

The objectives of the Common Agricultural Policy (CAP), as set out in Art. 39 of TFEU, are:

- To **increase agricultural productivity** by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour;
- Thus to ensure a **fair standard of living** for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;
    - to **stabilise** markets;
    - to ensure the **availability** of supplies;
    - to ensure that supplies reach consumers at **reasonable prices**.

The original framework

In 1957 the **six countries** of the EU had their own national agricultural policies based on different **tools**: prices charged by farmers, controlling quantities produced and supporting the income without interfering with the market equilibrium.

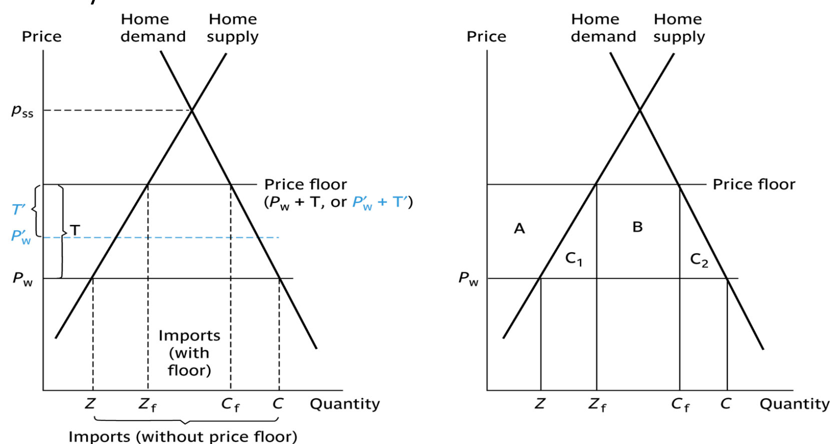
A compromise had to be found among the different needs, in order to reach a unanimous agreement and proceed with the integration process.

The CAP was shaped according to the following principles:

- **A unified market:** this denotes the free movement of agricultural products within the area of the Member States;
- **Community preference:** EU agricultural products are given preference and a price advantage over imported products;
- **Financial solidarity:** all expenses and spending which result from the application of the CAP are borne by the EU budget.

Price support mechanism

A **price floor** was set and implemented with tariffs (CETs) to ensure that imports never pushed EU prices below the price floor. As world prices were changing, tariffs were adjusted to guarantee price stability in the EU.



Welfare analysis of price support

- Loss in consumers' surplus: A+ C1 + B + C2
- Area A is captured by producers, who benefit from the price support
- Area B is tariff revenues going to the EU budget
- Areas C1 and C2 constitute a net welfare loss
- As the world price changes, only tariffs change (and thus the level of protectionism). EU consumption and imports are stable.

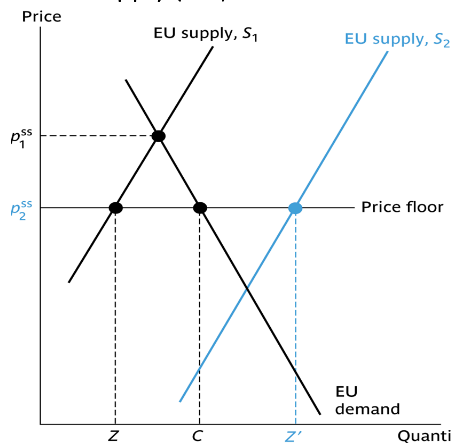
Early results and subsequent problems

- Initially, the CAP was well received in the EU:
  - Higher and stable prices to farmers, higher farmers' income.
  - Growing receipts of tariff revenues (via the CET) for the EU budget.
  - Pros and cons for consumers: higher prices with respect to RoW, but also more food and lower dependence on food imports; empathy with farmers; high food prices more than compensated by rising incomes.
- Post-war period saw productivity gains:
  - High guaranteed prices encouraged investment.
  - Agrochemical industry sprang up (pesticides, herbicides, fertilizers)
  - Since CAP rewarded output, output rose much faster than consumption.

No price fall: price still set above the world price.

→ EU became a net exporter of agricultural goods

The positive supply shock, ie, supply shift to the right, combined with fixed price floor, leads to excess supply (CZ').



Note how the price floor is now above the equilibrium price: a case of a more than prohibitive tariff !!

The CAP price support meant that producers could produce any quantity… and they would always get their sales at the (high) price floor guaranteed…!!!

EU farmers were producing more than the market could bear, creating excess supply, that had to be dealt with through the EU budget:

Instead of earning money by imposing tariffs on imports..

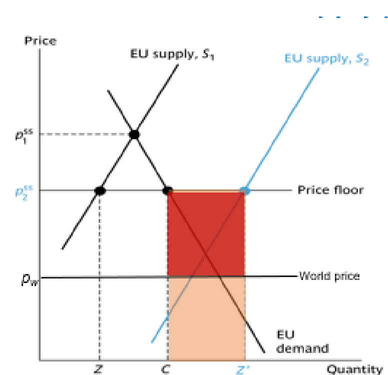
… EU money was spent on "Direct Purchases" at the floor price and stocking (the famous "wheat, beef and butter mountains"... mostly wasted).

e.g. In 1985 the EU had 18.5 million tonnes of cereals stored, about 70 kg for each of its citizens.

Later, to reduce the disposal problems, the EU also started buying at price floor and selling cheap abroad (or asking companies to sell abroad refunding the difference between world price and price floor). This form of dumping was called "**Export Subsidies**".

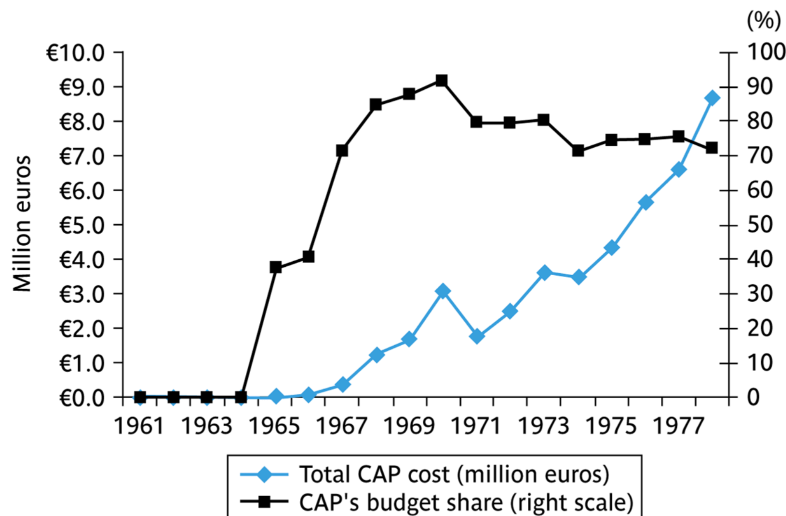
All these market interventions started to **raise the cost of the CAP** for the EU Budget...

⇒ In order to reduce the **budget expenditure** and disposal problems, the *EU started to export at the World price what was buying at the Price floor* (**dumping**)



The Cost of the excess supply

Cap costs from 8% of EU budget in 1965 to 90% of EU budget in 1969



The need for a reform

EU producers did not respond anymore to market signals (price as the key information). Farmers got closer to the EU governments than to EU consumers.
Producers in the rest of the World were damaged by EU market closure and the negative effect on international prices caused by the EU subsidies (dumping).

> *Under WTO rules dumping is not permitted, especially when driven by government subsidies. However, before 1994 Uruguay Round agreement, the WTO placed no restriction on the dumping of agricultural goods.*

Consumers were facing high prices, with regressive effects (poorer consumers spend a larger part of their income on food products than richer consumers do).
Environmental problems and **declining quality,** as producers just had an incentive to produce as much as possible, no matter what!

Uneven distribution of benefits: price floors help all farmers but in proportion to their production, large farmers were benefiting the most while small farmers were often barely surviving, with many leaving the countryside (contrary to the objectives of the CAP): 80.5% of the farmers got just 15.5% of all the payments; thus the remaining 84.5% of the money goes to 19.5% of them.

Drivers of reform in 1992

1) **Endogenous drivers:**

Decreasing internal support (environmental concerns, human health).
Enlargements in the Eighties (Greece in 1981, Portugal and Spain in 1986) increased the number of people engaged in agriculture and entitled to receive support.

2) **Exogenous driver:**

In 1986, a new round of multilateral trade negotiations, known as the Uruguay Round, had opened under the GATT agreement: for the first time, countries were supposed to discuss also the issue of liberalising international trade in agricultural products.
→ **Bottom Line:** the price support mechanism of the CAP was no longer reasonable internally, nor it was sustainable from an international perspective, and had to be replaced (elimination of any support was not politically feasible).

The reform process

1) MacSharry Reform (1992)
Main feature: from price support to income support

2) Before the “big enlargement” (1999, 2003)

Main features: decoupled income payments, cross-compliance, degression and rural development

3) Today's agricultural policy (2014-2020 MFF and 2021-2027 MFF)
Main features: strengthened decoupling, cross-compliance, degression, rural development, and climate change action

From price support to income support
→ reducing market distortions

The 1992 MacSharry reform started to **lower price support** (ie, the CET) and to compensate farmers for their income loss.
The attractiveness of "Direct Income Support" is threefold:

1. It does not entail market distortions, since the price is not set by the EU authorities but by market forces.
2. It is fairer than price support from a distributive standpoint: citizens do not pay as consumers but as taxpayers progressively via the EU budget.
3. It opens the EU market to extra-EU imports: as the CET decreases, more foreign products can be bought by EU consumers.

According to the 1992 reform, the amount of income support available to farmers was directly **proportional to the actual production** (thus maintaining for the farmers the incentive to maximise production).

→towards market prices

- These cuts in intervention prices have bridged the gap between internal and world market prices: **EU prices were progressively allowed to converge to the world level.**

eg, In the first years the price floor for wheat has been cut by almost 50%, sugar prices have been reduced by 40%, rice by 57%, and beef prices by almost 30%.

- Once farmers' production decisions started to be based on market demand, the production surpluses started to fall sharply for several sectors and net exports have decreased significantly.

eg, For beef and sugar, the EU has even switched from being a net exporter to a net importer. And the most competitive sectors have increased their share of world exports.

⇒ The reform of 1992 allowed the EU to close the **Uruguay Round of GATT (1994)**, and was generally regarded as successful.
Drivers of reform in 1999
Endogenous driver:
The method of remuneration of farmers based on actual production still led some producers to maximize their production output in order to get as many subsidies as possible, with the risk of **over-exploitation** of the land or the cattle, at the expense of the environment or food safety (eg, the "mad cow" disease).
Semi-Exogenous driver:
Granting the same level of income support to the 12 "agriculturally-biased" acceding countries would have put a **great strain on the EU taxpayers** (the Central and Eastern European Countries were and still are net beneficiaries from the EU budget).

Moreover, the income support for the 12 Central and Eastern European farmers would have been the compensation for the elimination of a price support which they never enjoyed.
=> A number of changes are implemented in the reforms of 1999 and 2003

→A 'decoupled' income support

The 1999-2003 reforms introduce several new elements.

- The first is **decoupling**

Decoupling means **progressively linking aid to the potential fair income of the farmer,** and not to the actual production (e.g. considering the dimension of his or her land and the number of cattle, among other things => see infra the concept of cross-compliance).

> A **"fair" income** should be that resulting from a correct exploitation of the land/cattle available to the farmer, taking into account the need to preserve the environment and the guarantee of food quality and safety (multifunctional role of agriculture).

→ cross compliance, degression and rural development

- **Cross-compliance** links direct payments (income support) to compliance by farmers with basic **standards** concerning the environment, food safety, animal and plant health and animal welfare, as well as the requirement of maintaining land in good agricultural and environmental conditions => remuneration of the public goods produced by farmers.
- **Degression** reduces direct payments for bigger farms, while new measures are also introduced to favor young farmers.

- **Rural development** (is commonly referred to as the 2nd pillar of the CAP whereas product and producer support is referred to as 1st pillar) is co-financed by member States and grants funds to promote quality, animal welfare, diversification, rural economy and to help farmers to meet EU production standards.

EU enlargement and CAP expenditure

As **the enlargement in 2004 was not accompanied by a corresponding budget increase** for the CAP, the **limited budget** had to be divided between almost twice as many farmers (as the number of full-time farmers increased from 6 to 11.5 millions with the accessions in 2004 and 2007).

This was a success: **CAP expenditure actually declined as % of total budget.**

Cap in the MFF 2014-2020

Main objectives: viable food production, sustainable management of natural resources, climate action and balanced territorial development.

Further decrease of resources as compared to previous MFF, but still 37.8% of EU Budget.

Three types of expenditure (new improved expenditure instruments):

1) **Market support**: mostly in terms of safety net for possible crises
2) **New direct payments:** greener and better targeted to those who are actively engaged in farming (vs. rentiers)
3) **Rural development**

Increased emphasis on environmental performance

Measures for encouraging young farmers

CAP 2023-2027

- **No changes with respect to previous MFF until 2022**
- **New CAP Strategic Plans started in 2023**
- **Further decrease of resources** as compared to previous MFF, but still 33.2% of EU Budget (+ more coming from Next Generation EU)

Two main funds for two pillars:

1. **European agricultural guarantee fund (EAGF)** – First pillar: finances income support schemes (and residual market support, eg, in case of extreme events to limit fluctuations)
2. **European agricultural fund for rural development (EAFRD)** – Second pillar: finances rural development and other green initiatives (with support from Next Generation EU in 2021-2022).

10 Key objectives:
1. to ensure a fair income for farmers;
2. to increase competitiveness;
3. to improve the position of farmers in the food chain;
4. climate change action;
5. environmental care;
6. to preserve landscapes and biodiversity;
7. to support generational renewal;
8. vibrant rural areas;
9. to protect food and health quality;
10. fostering knowledge and innovation.

Key Changes
Higher green ambitions, with a number of measures:
- **Enhanced conditionality:** payments are linked to stronger conditionality in a green direction (eg, on every farm at least 3% of arable land is dedicated to biodiversity and non-productive elements).
- At least 25% of the budget for direct payments is allocated to eco-schemes such as organic production.
- At least 35% of rural development funds are allocated to measures to support climate, biodiversity, environment and animal welfare.
- 40% of the CAP budget has to be climate-relevant and strongly support the general commitment to dedicate 10% of the EU budget to biodiversity objectives by 2027.

Countries encouraged to work on **redistribution**, focusing support on active farmers and young farmers

→But still, Farmers' income is lagging behind salaries in the whole economy

A note on quality
The EU supports schemes that encourage diverse agricultural production, **protect product names** from misuse and imitation, and help consumers by giving them information concerning the specific character of the products, and facilitate price comparison.
PDOs and PGIs are the so-called **Geographical Indications**.
EU may co-finance promotional campaigns.

Protected Designation of Origin (PDO) gives status to a food product which is produced entirely within a defined geographical area using recognised skills and ingredients from the region and which is linked to its geographical origin. This includes Aceto Balsamico Tradizionale di Modena, many cheeses (Queso manchego, Feta, Gorgonzola, Parmigiano Reggiano, Camembert de Normandie), meat products (Prosciutto di San Daniele), olive oil and wines.

Protected Geographical Indication (PGI) denotes a food linked by its quality and reputation to a region in which at least one stage of production, processing or preparation took place. This includes Aceto Balsamico di Modena, beers (Münchener Bier, Ceskobudejovické Pivo), meat (Scotch beef, many types of French poultry), fish (Scottish farmed salmon) and bakery (Turrón de Alicante).

Traditional Speciality Guaranteed (TSG): highlights traditional character, either in the composition or means of production (e.g. Pizza napoletana and Mozzarella (IT), Moules de Bouchot (FR). Moules de Bouchot TSG are farmed mussels produced exclusively on wooden stakes, known as bouchots, specially intended for growing mussels; Boerenkaas TSG cheese from the Netherlands is farm-produced using raw milk and a specific production method; Pizza Napoletana TSG must be baked in wood-fired ovens using a traditional Neapolitan recipe.

There is a special European logo for organically produced products which guarantees that European organic production standards have been complied with. Organic farming respects the natural life cycles of plants and animals. It minimises our impact on the environment. Production methods comply with precise and strict European legislation.