INDEPENDENT & TRIPARTITE
High Level Group
Trade Policy Innovation

REPORT & RECOMMENDATIONS
(virtual) Meeting

19 January 2021

The chairman, John Bruton welcomed all members[1] and reminded that these independent tripartite High Level Groups on EU Policy Innovation need to 'think outside-the-box', according to their original mandate from the Competitiveness Council.[2] They are a new, 'open innovation' approach between governments, business and academia, to inject innovative policy ideas into the EU system.

The chairman expressed pleasure about a nearly complete attendance from Europe. New Year's wishes were exchanged. He indicated the importance of the discussions for the preparation of ongoing Commission policy proposals on external coercion, and for the realisation of the Green Deal. He also wished to exchange views on the consequences of the Brexit deal.

A constructive exchange engaging all participants followed; it can be summarised as follows.

RECOMMENDATIONS

The High Level Group on Trade Policy Innovation would like to propose the following recommendations:

The key part of any specific measure is to let the world understand the strength of European Solidarity. This is not just for political reasons; the economic value chains which stretch across the Single Market imply that Member States have a self-interest to stand together if coercion is attempted.

If strategic sovereignty is to mean anything, the EU needs therefore a comprehensive trade defence toolbox, with a variety of mechanisms, and a clear statement of mutual solidarity; this is the key tool to gain influence and ensure a level playing field in line with WTO and International Law; coercion on one country, or one sector, causes collateral damage on other countries and other sectors.

Inclusive strategic autonomy: Commission and governments face the challenge to balance the global value chains of business and increasing geopolitical interdependence; it requires an inclusive, open concept of strategic autonomy, including a toolkit of potential measures and counter-measures.

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[1] Members participate in their personal capacity. All recommendations for action and all ideas for further consideration have not always been agreed on by all members, but advice is based on a very wide consensus. The final version is written under responsibility of the Chairman and the Secretary General.

[2] Council of the EU, 5-6 December 2011, Presidency Note.

Therefore, the HLG proposes a variety of instruments to consider:

- **European Collective Defence Instrument**: the EU has no legal instrument to respond to third parties' infringements of national sovereignty and its essential economic security interests through the use of instruments (such as trade tools, sanctions, vastly expanded export controls, or other extraterritorial measures). When it comes to sanctions, some EU Member States are heavily dependent on Foreign Direct Investment, which may come from third states to be sanctioned. The competences for trade of the EU can be explained to imply trade defence too, and to allow to set up such a mechanism, operating with similar checks and balances between Commission and Council.

- **European Export Bank** would be an important instrument of such Collective Defence Instrument, facilitating European companies to operate outside the control of the Office of Foreign Assets Control (OFAC) and the US Dollar; a objective method of evaluating costs of coercion measures needs to be developed, through cooperation with a network of leading European economic research institutes, to be able to plan targeted counter-actions and restore a level playing field;

- **European Office for Economic Coercion should be set up** to create a European interlocutor on "eye-level" with third country agencies and to operate as a central body that represents European interests in dialogue and negotiation with entities like the Chinese State Export Control Administrative Departments (SECAD), the US OFAC. It should operate jointly with Commission and EEAS.

- **Personal sanctions**: EU Member States often struggle to find a way to respond reciprocally when third countries use sanctions to punish individuals and organisations; the option of using personal sanctions, including travel bans, asset freezing, and prohibitions to provide economic resources, as a tool for reciprocity that is no trade policy tool, should be explored, following the recently agreed example of a personal sanctions mechanism in case of human rights violation. It would be important to have countries in the EEA participating in it (Norway, Switzerland) and to coordinate with other like-minded countries (USA).

- **Data Protection Authority is an urgent measure because**: EU companies are facing growing pressure from non-EU authorities to transfer sensitive business data to them; an EU-27 authority tasked with protecting European companies could require approval of certain sensitive data transfers to third countries; this body could be supported by national authorities.

- **Bilateral Free Trade Agreements:** the EU preferred option of multilateralism and diplomatic engagement is no longer sufficient if other parties interpret this as a sign of weakness; the EU trade policy of concluding FTAs bilaterally should be encouraged and it should include, besides enforceable rules on sustainability, climate or social and human rights, also measures against coercion.

- The EU's wish for soft power and for being seen as a promotor of a rule-based global order implies that it should itself **resist the temptation of coercion** as long as possible, in particular with smaller or developing countries.

1. Economic coercion, International Law and Europe in Geopolitics

Members heard a presentation by an expert from the ECFR. Besides existing trade defence measures against unfair trade practices, the EU will need a wider toolbox to deal with extra-territorial sanctions and all kinds of threats aimed at limiting its freedom of action externally or internally and which distort its competitiveness and its societal model. The EU preferred option of multilateralism and diplomatic engagement is no longer sufficient if other parties interpret this as a sign of weakness. The direct and secondary economic damages are becoming ever more significant. In a context where China and US are weaponising Europe for their trade conflict, this is increasingly clear. A European Collective Defense Instrument is needed.

The EU is faced with punitive tariffs, extraterritorial sanctions and export controls, and sensitive data transfers – the latter having not only external consequences but also a far-reaching impact in the EU internally. If strategic sovereignty is to mean anything, the EU needs therefore a comprehensive trade defence toolbox, with a variety of mechanisms, and a clear statement of mutual solidarity. The very existence of both may already serve to reduce the readiness of other powers to use their coercion measures.

An important instrument could be a European Export Bank (EEB) which would facilitate European companies to operate outside the control of the OFAC and the US Dollar. In addition, a method of evaluating costs of coercion measures needs to be developed to be able to plan targeted counter-actions and restore a level playing field. The dysfunctional EU Blocking Statute needs fundamental revision, as well as sensitive data protection rules. An EU Office to deal with coercion and act as counterpart for similar bodies in US or China needs to be set up to protect trade by EU based companies, equipped with economic foreign policy tools and with a geopolitical perspective. Sanctions against individuals may also be an option.

The root of the problem is that the EU interdependence has become too high in many important sectors, coupled with a financial system still dominated by the use of the US Dollar. The concept of strategic autonomy is helpful to seek first to diversify trade relations, and where necessary to reduce dependency, but this reality requires a coherent long-term approach. This requires cooperation with business which often submits to US laws in its contract.

But there is also strategic competition between various political-economic-societal models (American, European, Chinese, others), these structural differences will remain. However, a rule-based system aims precisely at cooperation between them without seeking internal change. The EU trade policy of concluding FTAs bilaterally should be encouraged. [2]

Commission and governments face the challenge to balance the global value chains of business and increasing geopolitical interdependence at the one hand, and the autonomy of member states within the Union and across borders at the other. It requires an inclusive concept of strategic autonomy, including a toolkit of potential measures and counter-measures and a comprehensive policy of decoupling.

They have to do so in a world with different political-economic systems whose deep roots are often difficult to fully appreciate. The US and the EU need to rebuild trust, after Trump, but one should not be naïve, it will take time and fundamental disagreements (such as on China) will remain. Moreover, there are other players to take into account, such as Russia or India, or Mercosur.

A key objective should be to ensure a level playing field in line with WTO, international law, and the practices of diplomacy. The key tool to gain influence is solidarity among the 27, which is easy to argue for because the EU as whole is very dependent on global trade, and business value chains stretch across the single market. Coercion on one country, or one sector, causes collateral damage on other countries and other sectors.

An infringement on our economy for coercion purposes is difficult to define. Commission and governments should develop a clear understanding of short- and long-term costs and then use instruments in a gradual way. In this sense, account should be taken of the fact that Europe has benefited from Foreign Direct Investment.

This requires scientific analysis of costs/benefits. But analysis alone is not enough, capacity for efficient action(s) require to urgently upgrade the efficacy of EEAS and coherence with Commission policies (as advised before by this HLG). In some cases, high level political support will be needed and in all cases the threats need to be credible.

Between doing nothing and immediate harsh retaliation should lie a whole spectrum of measures, whose use must depend on the inclusive cost/benefit analysis. But the EU itself should respect the international rules which it favours, and not be found to practice coercion pro-actively itself (such as on developing countries).

[2] Except in the case of Africa, where the HLG on Partnership Africa-Europe advises to give priority to continent-to-continent approach, due to the African Common Free Trade Area launched on 1.1.2021.

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2. The European Green Deal and Global Trade

The European Green Deal cannot be realised without taking into account global economic interdependences, though it can also help increase European strategic autonomy with a more circular economy (hence making Europe less resource-dependent), technological innovation, energy saving and industrial diversification. Global value chains cannot be ignored if one wants to avoid leakage of investments and jobs.

The European Green Deal risks to create obstacles for trade if it does not take into account the complexity of industrial value chains at the global scale. This is particularly the case with the EU Taxonomy currently under development, based on a binary ('green/non-green') model. What is considered helpful today for the environment may not be in future, as past experiences have shown. Likewise, the pathway towards climate-neutrality should consider the various starting positions of each country and region, both intra-EU and in other continents. It is desirable to seek global harmonization of sustainability policies, i.e. by defining what is sustainable and what type of progression should be incentivized to mitigate climate change (e.g. switching from one type of technology to another, based on a rational and evidence-based classification system of economic activities on a gradual scale 'from brown to green', rather than simply rewarding the greenest assets).

The proposed European Carbon Border Adjustment Mechanism (CBAM) may be considered as the result of a lack of global harmonization on sustainable policies and regulations, which therefore requires correction measures via trade policy. The compatibility of such instrument with multilateral (WTO) rules has been discussed in recent literature[3]; the HLG has also put emphasis on the alternative solution of a Green VAT system, which may *de facto* stand as a carbon border tax on imported goods, provided that it is used for such purpose. The political risks associated with sensitive instruments such as VAT on food should be cautiously examined.

The greening of WTO in line with the Paris Climate Agreement could be a project which again focusses on the concept of the global public good. The EU Taxonomy can be a first step towards this goal but it should become a system based on graduality in order to facilitate synergy with other world's regions and to avoid minimum trade distortion. The complex implementation of the Paris Agreement should be considered, too, for instance potential EU-China inconsistencies deriving from different taxonomy systems.

In general, Europe's own economic interests should be kept in mind, with a similar level of strategic importance as other countries. The international rule-based trading order must be upheld, even though its greening is desirable and urgent. The collateral effects on developing economies are equally important, if not the negative effects will come to haunt Europe anyway.

[3] OECD (2020), "Climate Policy Leadership in an Interconnected World: What Role for Border Carbon Adjustments?"; ETLA (2020), "Carbon Border Adjustment Mechanisms and Their Economic Impact on Finland and the EU".

Currently, EU policy proposals are disruptive in a negative way, through lack of coherence with other regulations (e.g. sustainable requirements and labels for products); to avoid this, cooperation with industry is indispensable.

3. Brexit

The Chairman introduced the topic and wondered about democratic control on the agreed system and the role of the ad hoc arbitration tribunals. All divergence has in fact been pushed to the future as a result of the pressure of concluding an agreement. Brexit has created a new source of uncertainty, especially as the UK has yet to decide how it intends to diverge.

In the discussion which followed, there appeared concern about consistency with the single market and the role of the ECJ.

There was a risk for many years of conflictual negotiations and uncertainty for business. Moreover, there can be expected a rise in technical trade barriers, if the UK seeks to copy EU regulations yet to diversify just a bit to stay within.

Overall, the EU is dealing now with one more trading partner with a different system, as the US or China. It has to learn to manage the interfaces.

4 February 2021