

# "Global Europe": An Initial Assessment of the European Commission's New Trade Policy

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The principal elements of the European Commission's recent Communication on its external trade policy (titled "Global Europe") are assessed in this paper. Certain shifts are discernible in the Commission's position, in particular as they relate to the prominence given to market access objectives and to bilateral and regional trade agreements. Even so, this latest Communication is probably best thought of as an evolution in the Commission's trade policy and not an abrupt break with the past. Particular attention is given here to the potential payoffs from the proposed bilateral trade negotiations with selected Asian nations and the need for further thinking on the Commission's part with respect to the multilateral trading system.

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## 1 Introduction

In 2005 Europe imported 18.03 percent of the world's traded goods, transactions whose total value exceeded 1.4 trillion U.S. dollars. Two-thirds of those imported goods were manufactures, a quarter were fuels and mining products, and the remainder agricultural goods. The buying power of nearly 460 million people living in the 25 countries that make up the European Union (EU), a union whose combined gross domestic product exceeds 12 trillion U.S. dollars, is one important factor that underlies the potential clout of Europe's trade policy. Likewise, the vast scale of Europe's exports to the rest of the world provides its policymakers with a strong interest in commercial conditions abroad. It is significant, therefore, when the European Commission (EC) issues a new Communication on its external trade policy, as it did in October 2006.

The purpose of this paper and the others in this Special Issue is to assess the principal elements of this Communication, ascertaining where changes might be expected and their rationale and likely effects. The contributors to this Special Issue were drawn from important regions of the world economy and no attempt was made to arrive at a common viewpoint. So as to reduce the overlap between this paper and others in the Special Issue, here I focus on the following three matters: the relationship between the latest Communication and its predecessors (thus allowing an assessment of the extent to

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which this Communication actually represents a departure from existing EC practice); the likely payoffs to European exporters of the European Commission joining the scramble for Asian market access compared to other options available to European firms; and the need for further thinking by the European Commission on the future of the multilateral trading system. As a result, the paper is organised as follows: The next section provides a brief overview of the October 2006 Communication by the European Commission on its external trade policy. Sections three through five each address the three matters described immediately above. Concluding remarks are found in section six.

## 2 A Brief Overview of the European Commission's Recent Communication on External Trade Policy

On 4 October 2006 the EC issued a Communication titled "Global Europe: Competing in the World" and, significantly, subtitled this document "A Contribution to the EU's Growth and Jobs Strategy" (EU 2006a).<sup>1</sup> The subtitle indicates an important feature of this Communication, namely that it concerns the contribution of the EU's external trade policy to the BARROSO Commission's overall objectives, including supporting the renewed Lisbon Strategy. The following paragraph, quoted directly from the Communication, situates this set of proposals in the overall context of the EU's economic policies:

"The purpose of this Communication is to set out the contribution of trade policy to stimulating growth and creating jobs in Europe. It sets out how, in a rapidly changing global economy, we can build a more comprehensive, integrated and forward-looking external trade policy that makes a stronger contribution to Europe's competitiveness. It stresses the need to adapt the tools of EU trade policy to new challenges, to engage new partners, and to ensure Europe remains open to the world and other markets open to us" (EU 2006a, page 3).

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<sup>1</sup> A Commission Staff Working Document was also issued with this Communication (EU 2006b). This contains other interesting information about the likely future course of Europe's trade policy.

Before turning to precisely what those new challenges are and who the new partners might be, the Communication is clear about the causal links involved, as the following paragraph makes apparent:

"There are two critical and linked requirements for European competitiveness. First, having the right internal policies, which reflect the external competitive challenge and maintain our openness to trade and investment. Second, ensuring greater openness and fair rules in other markets, in particular [in] our future major trading partners. Both must be underpinned by transparent and effective rules – domestic, bilateral, and multilateral" (EU 2006a, page 4).

This paragraph indicates that the targets of the EU's new external trade policy are the large emerging markets and the shift away from an almost exclusive focus on multilateral rule-making (which has been the norm in recent years).

I now turn to the EC's plans for the different trade negotiating *fora*. With respect to the World Trade Organization (WTO) the principal statement in the Communication is confined to the following observation:

"Europe remains committed to the WTO and is working hard to revive [the Doha Round] negotiations as soon as circumstances in other countries allow" (EU 2006a, page 9).

I will comment more on this matter in the section 5 below.

With respect to potential bilateral or regional trade agreements, the Communication notes that "if approached with care" (page 9) they can build on the WTO and address matters that are not yet the subject of WTO disciplines or go beyond whatever multilateral disciplines have been agreed. Specific mention is made in this regard of investment policies, government procurement policies, and the enforcement of intellectual property rights. The Communication also states the criteria to be used to identify potential free trade agreement (FTA) partners:

"The key economic criteria for new FTA partners should be market potential (economic size and growth) and the levels of protection against EU export interests (tariffs and non-tariff barriers). We should also take account of potential partners' negotiations with EU competitors, the likely impact of this on EU markets and economies, and the risk that the preferential access to EU markets currently enjoyed by our neighbouring and developing countries may be eroded" (EU 2006a, page 10).

On the basis of these *desiderata* the Communication identified the Association of Southeast Asian nations (ASEAN), Korea, and Mercosur as "priorities." India, Russia, and the Gulf Cooperation Council (GCC) members are said to "have combinations of market potential and levels of protection which make them of direct interest to the EU" (page 10). China, it is argued, meets many of the criteria "but requires special attention because of the opportunities and risks that it presents" (page 10). Indeed, the Communication goes on to discuss the case of China separately<sup>2</sup> and does not mention pursuing a FTA in this case (page 11).

The EC's negotiating priorities for future FTAs is said to reflect a high level of ambition and tackling non-tariff barriers should receive plenty of attention, as the following quotation demonstrates:

"In terms of content new competitiveness-driven FTAs would need to be comprehensive and ambitious in coverage, aiming at the highest possible degree of trade liberalisation including far-reaching liberalisation of services and investment. A new, ambitious model EU investment agreement should be developed in close coordination with Member States. Where our partners have signed FTAs with other countries that are competitors to the EU, we should seek full parity at least. Quantitative import restrictions and all forms of duties, taxes, charges and restrictions on exports should be eliminated. FTAs should also tackle non tariff barriers through regulatory convergence wherever possible and contain strong trade facilitation provisions. They should include stronger provisions for IPR<sup>3</sup> and competition, including for

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<sup>2</sup> It should be noted that the EC issued a separate Communication on its relations with China on 24 October 2006.

<sup>3</sup> Intellectual property rights.

example provisions on enforcement of IP<sup>4</sup> rights along the lines of the EC Enforcement Directive. We will seek to include provisions on good governance in financial, tax and judicial areas where appropriate. We should also ensure Rules of Origin in FTAs are simpler and more modern and reflect the realities of globalisation. We will put in place internal mechanisms to monitor the implementation and the results of new FTAs" (EU 2006a, page 10).

The Communication acknowledges that these FTA negotiations could be tough and cautions

"We will need to ensure that we share similar ambitions with our prospective partners at the outset in order to avoid negotiations later stalling because of a mismatch of expectations. The decision to launch negotiations should be taken case-by-case, based on these economic criteria but also on our parties' readiness and broader political considerations" (EU 2006a, page 11).

The Communication goes on to make specific comments on a number of non-tariff barriers (intellectual property rights, public procurement policies, and trade defence instruments, in that order) and calls for a renewed Market Access Strategy, noting the earlier market access strategy launched in 1996. A Communication on this renewed Market Access Strategy is promised for early 2007 and prioritisation of specific sectors and markets abroad is anticipated.

In summarising the next steps to be taken, the Communication identifies the following seven as being pertinent to its external trade policy:

- "-Maintain our commitment to the Doha Trade Round and the WTO as the best way of opening and managing world trade.
- Make proposals on priorities in trade and investment relations with China as part of a broad strategy to build a beneficial and equal partnership.
- Launch a second phase of the EU IPR enforcement strategy.

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<sup>4</sup> Intellectual property.

- Make proposals for a new generation of carefully selected and prioritised FTAs.
  - Make proposals for a renewed and reinforced market access strategy.
  - Propose measures to open procurement markets abroad.
  - Conduct a review of the effectiveness of our trade-defence instruments"
- (EU 2006a, pages 18 and 19. Bold text in original document).

### 3 Comparison of "Global Europe" with Previous Statements on EU Trade Policy

I now turn to discussing two distinct yet related official conceptions of the challenges facing EU trade policy since 1995, one associated with SIR LEON BRITTAN'S tenure as Trade Commissioner and the other with his successor, MR. PASCAL LAMY. Arguably both perspectives partially inform current EU trade policy and, as I will argue later, the latest (October 2006) Communication from the EC on trade policy is in many respects closer in spirit to the former approach.

Although globalisation is much discussed today, it is worth recalling that in the mid-1990s the integration of national economies into world markets was seen as an important factor too. In a 1996 Communication on trade policy titled "The Global Challenge of International Trade: A Market Access Strategy for the European Union," mention was made of the "relocation" of business and the potential for dislocation that this could cause. The connection between opening foreign markets and the ability of European firms to exploit their competitiveness was also made (EU 1996, page 2). Furthermore, the rising might of Asia was already on the minds of European policymakers, and the WTO Trade Policy Review of EU trade policy in 1995 notes that a 1994 EC paper "asserts a need to accord Asia a higher priority than in the past" (WTO 1995, page 26).

Having painted a global picture of commerce, the 1996 Communication characterised the trade policy challenge for the EU as follows:

"Greater access to markets worldwide should be one of the prime objectives shaping the deployment of Community resources in the months and years

ahead. To achieve significant increases in market access is necessarily a long-term process. Both in tackling pressing problems under existing rules and in developing new rules to remove other obstacles to trade and investment, the Community will be successful if it produces a clear analysis of its own priorities and works closely with its trading partners, developed and developing alike. We should concentrate on actions which respond to the demands and priorities of industry and which results in tangible and direct benefits for our exporters and investors" (EU 1996, page 19).

This quotation is worth reflecting on for a moment. First, market access is the lens through which trade policy instruments were assessed, whether they are directly tariff-related or not. Second, non-tariff barriers receive significant priority. Rules for these barriers would not be developed for their own sake, but because they constitute an impediment to market access. (It is noteworthy that in the 1996 Communication the following non-tariff barriers are specifically mentioned: the failure to protect intellectual property rights, rules of origin, selected government procurement practices, investment policies, and competition policies). Third, the beneficiaries of this policy would be exporters and investors, that is, principally commercial interests. The strategy would be market access- and demand-driven (EU 1996, page 10), developing bilateral and multilateral approaches as appropriate.

By 2003, in contrast, SIR LEON BRITTAN'S successor was characterising the challenges facing EU trade policy and its rationale in a different light. It may well be that the high-profile protests by some elements of civil society against the multilateral trading system, and globalisation more generally, had some bearing on the thinking of senior EU trade policymakers. In a report at the end of his tenure as EU Trade Commissioner, MR. LAMY noted that from the very start he had set himself a goal of "*la globalisation maîtrisée*" (EU 2004, page 3). In his view European trade policy had to be "properly integrated" with the other goals of the EU,

"And much of the responsibility for that [integration] lies with the European Commission, not just to regulate trade with third countries but to ensure we properly manage the interface between our external policy and the internal EU market, and of course the European Model" (EU 2004, page 3).

Lest anyone be in any doubt about the relative importance of market access in MR. LAMY'S schema, he went on to argue:

"But the opening of markets is not an end in itself, but is a way of making progress. Moreover, while necessary, market opening is not sufficient. It does not by itself ensure development. Internal policies have to be right too, not least to ensure that the distribution of its benefits is more equitable" (EU 2004, page 3).

A broader audience and set of outcomes is conceived, then, for EU trade policy. MR. LAMY notes that it is "critical" to keep a sizeable majority of the European public in favour of open trade policies, and presumably market access opening abroad is not enough in this respect. He acknowledges that these changes have made trade policymaking more difficult and affects the assessment of such policymaking. In his view the effects of trade policy on transparency and legitimacy, on development, and on cherished values and sectors are important too, not just the amount of market opening and number of trade agreements signed. Arguably, therefore, this perspective reflects a distinct evolution from the thrust of the 1996 Communication discussed earlier, although some common tenets recur.

In his assessment of the trade policy-related accomplishments of the PRODI Commission, of which he was a member, MR. LAMY argued that the EU was still able to resist trade policy initiatives that it did not like and to "set the international agenda" (EU 2004, page 4). He argues that the "priority given to development in the Doha Agenda, or the agreement on medicines are evidence of this pivotal European role" (EU 2004, page 4). Interestingly, MR. LAMY'S assessment also included the following reflection:

"Our arguments in favour of a better regulated multilateral world have thus been less effective. Indeed, arguably as a result, trade policy or the WTO has too often been the sole focus for efforts to strengthen international governance, which risks weakening its legitimacy both internally within the Union, and in the outside world. I don't believe the WTO can or should

remain the sole island of governance in a sea of unregulated globalisation"  
(EU 2004, page 5).

The experience of the ill-fated Singapore Issues, three of which were eventually dropped from the Single Undertaking of the Doha Development Round in 2004, may well have influenced this judgement. Whatever the motivation for international rules on non-tariff policies, it is apparent that the associated challenges described in the 1996 Communication had not been adequately resolved by the time this 2004 assessment of EC trade policy was written.

In the light of the above considerations the 4 October 2006 Communication arguably reflects an evolution rather than a revolution in the EC's thinking about the EU's external trade policy. The prominence given to market access, non-tariff barriers, and other economic considerations (such as jobs and economic growth) indicate a shift in the EC's thinking towards the ideas encapsulated in the 1996 Communication on external policy. It also represents a shift away from perceiving negotiated rules as being valuable in their own right and possibly as a useful instrument in strengthening European public support for globalisation and for international market integration. This is not to suggest that rules go without mention in the 2006 Communication, rather their justification is principally couched in commercial and economic considerations. Perhaps underlying the apparent differences in the role of rules is that current thinking may well be informed by the view that European public support for integration will be stronger if they are seen to be economically benefiting from openness (in terms of more jobs, higher growth, and lower prices), rather than seeing rules as allaying fears about globalisation and its compatibility with European values.

#### **4 The End of the European Commission's Moratorium on Launching Negotiations for New Free Trade Agreements.**

I now turn to the one prominent feature of the EC's Communication, namely, the abandonment of the moratorium on initiating new FTA negotiations.<sup>5</sup> By and large the

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<sup>5</sup> The growth of preferential market access into the EU had been the subject of discussion in Brussels in the mid-to-late 1990s. The WTO's Trade Policy Review in 1997 noted that preferential market access was "the subject of debate within the EU over the last two years" (WTO 1997, page 23). Furthermore in April 1997, the European Council of Ministers (ECM) called for close scrutiny of new preferential arrangements and argued that "the fundamental architecture of the EU's policy on preferential

motivation for this move has an Asian flavour, reflecting the light EU footprint in that region as far as trade agreements are concerned. Here the principal question that I want to address is should the European Union join the scramble for Asian markets? In what follows I will argue that the potential payoff from the EC's likely plans is probably less than many might think and almost certainly less than the export increases that could be secured if lagging European firms made more of their existing market access to Asian markets. While these arguments could readily be used against joining the scramble in the first place, I strongly suspect that this would amount to advocating closing the stable door after the horse has bolted. Instead, in my view a sober assessment of the potential benefits and pitfalls of joining the scramble for Asia ought to condition how the EC conducts any FTA negotiations and the nature of the mandate that the EU's Member States (MS) give the EC in this respect.

The first point to be made about the scramble for Asia is that, as currently conceived of in the 4 October 2006 Communication, it omits two countries that alone amount to 55 percent of the "market potential" in the Asian region. In the Statistical Annex to the Communication a table of EU trading partners is reproduced, reporting the estimated value in euros of their market potential over the years 2005-2025. The total value of the market potential of the Asian nations in that table (including Australia) is €474 billion. Of that total €278 billion is accounted for by China and Japan, neither of which are mentioned as possible FTA partners in the Communication. In contrast, India, ASEAN, and Korea, which are listed as FTA targets, have according to the Communication a combined market potential of €160 billion. Now, access to a market potential of €160 billion is not peanuts, but it does represent just over a third of the total size of the economic potential of the Asian market. Asia may appear vast and full of promise, but it is important to remember that the EC's FTA strategy only envisages securing better market access to a slice of it.

It could be argued in the Commission's defence that the successful conclusion of any negotiations for FTAs between the EC and China or Japan would strongly diminish the

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agreements has been put in place and should be preserved" (WTO 1997, page 23), a remark that the WTO secretariat concluded "implicitly left little scope for the further expansion of the current network of agreements" (WTO 1997, page 23). This effectively led to a moratorium on the launch of new negotiations towards FTAs, a moratorium that was adhered to until the presentation of the October 2006 Communication on the EU's external trade policy. It should be noted that the moratorium applied to the launching of new free trade agreements and not to the completion of previously launched negotiations towards free trade agreements or other preferential trade agreements.

interest of such large trading nations in the multilateral trading system's rules and so threaten the support for the WTO. I would not only agree with this argument but also point out that the desire of China and Japan (in particular Japan) to seek such FTAs may well be prompted by the successful conclusion of any EU FTA with Korea. There are already indications that prominent Japanese commercial interests would encourage their government to seek a FTA with the United States should the latter successfully complete its current FTA negotiations with Korea. It is not clear why such Japanese commercial interests would not take a similar line should an EU-Korea FTA be concluded. Given the systemic threat to the multilateral trading system described above, the European Commission needs to recognise that by launching FTA negotiations with Korea it is playing with fire. Even though the EC has stressed its commitment to the multilateral trading system, it must be hoped that some of the trade policy strategists in the Commission and in the key Member States recognise this point and take steps to avoid inadvertently undermining the WTO.<sup>6</sup>

One important consideration for policymakers, trade negotiators, and the like that I would like to raise is in many respects very complementary to the thrust of the latest Communication. That document recognised that internal reform within Europe should proceed along with a recalibrated external trade policy and that such internal reforms can allow European firms to better capitalise on market-opening opportunities abroad. There is a related but distinct point to be made here and that is given the wide variation across EU MS in industry-level export performance in Asian markets, how much more could European firms make of their existing access to Asian markets? Indeed, the question arises as to whether the export increases to Asian markets that could follow from laggard European firms catching up with their better European rivals might exceed

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<sup>6</sup> Of course, the associated dynamics are not entirely under the European Union's control. It is possible to conceive of "nightmare" scenarios that can keep you awake at night. Suppose, despite the growing number of reports in late 2006 to the contrary, that the United States and Korea did conclude an ambitious FTA in early 2007 and that this agreement wins approval from the U.S. Congress (the latter being a distinct and problematic matter). Then suppose the relatively new Japanese government of Prime Minister ABE, who has stated his desire to strengthen ties with the United States, acquiesces to pressure from Japanese commercial interests and seeks FTA negotiations with the United States and signals his government's willingness to contemplate a comprehensive FTA. Notwithstanding the likely difficulties in negotiating such a US-Japanese FTA, would European policymakers be able to resist the pressure to seek FTA negotiations with Japan too? All of the arguments that appear to have convinced Europe's trade policymakers to seek a FTA with Korea would apply with greater force to a FTA with Japan, yet the only principled counterargument would be the need to protect multilateral trading system. The nightmare arises from the fear that interest-driven arguments tend to win policy debates more often than principles do.

whatever the EC could negotiate in FTAs on behalf of European business? In what follows I will present some empirical evidence that sheds light on this matter.<sup>7</sup>

Trade economists have long established the following correlates (determinants) of bilateral flows between nations at the industry level: the total amount of output of the industry in question in the exporting country (which itself may reflect production costs and other determinants of "competitiveness"), the share of the importing country's national income in world income, the distance between the two nations (a proxy for international transportation costs and knowledge flows), the tariff barriers erected by the importing country, the use of common languages, and the presence of previous colonial relationship. In principle, variation across the EU MS in the level of exports from a given European industry to a given Asian country can be accounted for these factors. However, few of these factors differ across the EU MS. Take, for example, the EU MS exports to Korea. No EU MS shares a common language with Korea. No EU MS had a colonial relationship with Korea. Each EU MS faces the same Most Favoured Nation (MFN) tariffs to Korea. And, each EU MS is approximately the same distance from Korea (once scaled in logarithmic terms, which is the norm in this type of study). In which case, the share<sup>8</sup> of an EU MS' total exports of a given industrial product that are shipped to Korea reflects in large part the competitiveness of that EU MS' products in the Korean market. The extent to which this share varies across EU MS is, therefore, likely to reflect differences in the competitiveness of producing this good across the European Union.

Below information on such shares is used to estimate how much larger Europe's total exports to Korea would be if, on an industry-by-industry basis, the EU MS with lower levels of competitiveness were able to raise their firm performance to match those of their industry leaders. This exercise, more details of the implementation of which follow, is repeated for several of the other Asian nations that the EC has announced the possibility of negotiating FTAs with, including India, Malaysia, and Thailand,

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<sup>7</sup> I thank JOAKIM REITER for encouraging me to think about this matter in quantitative fashion.

<sup>8</sup> By considering the share of total exports of a given good, rather than the level of total exports of that good, account can be taken of the fact that the economies of the EU MS vary in size. Therefore, on this metric, a country is not considered more competitive in shipping a good to Korea merely because its economy is larger (which would be an absurd proposition).

Vietnam.<sup>9</sup> Given that most econometric studies find that the impact of implementing FTAs are 20 to 40 percent increases in bilateral trade, it will be interesting to compare that finding with the estimated export increases that follow from internal increases in European industrial competitiveness.<sup>10</sup> Therefore, on the basis of a metric that was given prominent billing in the EC's October 2006 Communication, namely export growth, we will be able to compare the relative magnitude of signing new FTAs and improving intra-European export competitiveness.

What follows is an attempt to approximately answer that question, drawing on European export data at the industry/sectoral level for the years 2000-2004. Readers only interested in the findings and the discussion of their policy implications can skip without loss of continuity the next seven paragraphs (which are devoted to describing the calculations that underlie the empirical results presented later).

First, I obtained the import data for the years 2000 and after at the sectoral level (that is, formally, at the one-digit level of classification of the well-known SITC<sup>11</sup> classification of international trade flows) of India, Korea, Malaysia, Thailand, and Vietnam (the latter being three possible ASEAN FTA partners for the EU, the former two being explicitly mentioned in the 4 October 2006 Communication). The United Nations' COMTRADE database was the source of this data. Sectoral classifications 5-9 relate to different categories of non-agricultural products and account for almost all of the EU's exports to these five Asian countries.<sup>12</sup> I extracted import data associated with these five sectors as well.

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<sup>9</sup> Not all of these countries share the same characteristics with respect to Europe as Korea. For example, Korea did not have a colonial relationship with a European state, whereas India, Malaysia, and Vietnam did. India shares a common language with the United Kingdom and Ireland. For these reasons, the results presented below are on firmer ground for Thailand and Korea than for the other three countries.

<sup>10</sup> It should be borne in mind that FTAs can improve trade in services as well as trade in goods, only the latter of which are considered in the computations that follow. It is not clear a priori which option (negotiating FTAs or improving European export competitiveness without an FTA) this favours.

<sup>11</sup> Standard International Trade Classification. For details about this classification see the following website and the document attached thereto <http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=14>

<sup>12</sup> Sectoral classification 5 refers to chemicals and related products. Classification 6 refers to manufactured goods classified chiefly by material used or processed. Classification 7 refers to machinery and transport equipment. Classification 8 refers to miscellaneous manufactured goods. Classification 9 refers to commodities and transactions not otherwise classified. Tables 1-5 will show that only a small proportion of the EU's exports to these five Asian countries falls under the catch-all category of classification 9.

Second, I identified the EU MS that are also Organisation for Economic Co-operation and Development (OECD) members, and restricted the intra-EU comparison of export performance to these MS as they are more likely to meet the definition of an industrialised country and have advanced export sectors. (This step actually biases downwards any subsequent calculation of the export increase that would follow from intra-EU catch-up in competitiveness levels; in fact, all such steps taken in these calculations undertaken reduce the "headline" findings, suggesting that my conclusions understate the likely effect of competitiveness catch-up).

Third, for each sector I identified those EU MS that exported more than US \$10 million in each year to a given export destination in Asia.<sup>13</sup> This eliminates those EU MS from the calculations whose industry in a given sector have not established a stable and substantial habit of exporting to the export destination in question. The remaining calculations are computed for each sector and each of the five Asian export destinations considered here.

Fourth, for a given sector and export destination, I ranked the EU MS by their export intensity, by calculating the ratio of their exports of a given sector's products to the destination in question to the total value of their exports of that sector's products to the world. The EU MS with the highest export intensity is the one thought to have the highest export competitiveness in the sector and the export destination in question.

Fifth, for EU MS whose export intensities were not the highest, I calculated the actual increase in their exports that would occur if that MS's export intensity rose to that of the EU's most competitive exporter. For example suppose that, in sector SITC 5, Germany has the highest export intensity (of say 0.03) to Korea and the comparable calculation for the UK reveals an export intensity of 0.01. Suppose further that the UK exports U.S. \$200 million of sector 5's goods to Korea. This last calculation would reveal that, if the UK industry caught up with the export intensity of its German counterpart, that its exports would be U.S. \$400 million higher to Korea. (Note  $\$400 \text{ million} = ((0.03 -$

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<sup>13</sup> Taken together with the statements in the last paragraph, this implies that for a given industry and given export destination the only EU MS included in the calculations are those that are OECD members and where the exports of the good in the industry in question to the export destination in question exceed U.S. \$10 million. Together both requirements reduce the number of EU MS included in the comparisons of export competitiveness, again reducing the headline findings from this empirical exercise.

0.01)/0.01) multiplied by \$200 million). Sixth, the total estimated increase in exports that would have occurred if each MS had an export intensity equal to the maximum for that sector was calculated and expressed as a percentage of the actual observed export flow in that sector.<sup>14</sup> After this calculation was performed on a sector-by-sector basis, the total predicted export increase for all sectors taken together was calculated in absolute terms and relative to the observed total level of EU exports to a given export destination.

Finally, some may think that catch up with the most competitive European exporting nation (of a given product to a given export destination) is unlikely, at least in the near term. Consequently, I repeated the analysis for two other less demanding cases, specifically, (i) catch up to the EU MS with the second highest export intensity (or competitiveness), assuming no change in the exports of the top two EU MS in terms of export intensity, and (ii) catch up to the average<sup>15</sup> export intensity of the MS for a given sector, assuming no change in the exports of those EU MS whose export intensity exceeded the average. The resulting calculations are reported for EU exports to Korea, India, Malaysia, Thailand, and Vietnam in Tables 1 through 5 respectively.

The results are quite striking and indicate how much more European exporters could use the Asian market access that is already available to them. Take the case of Korea, a potential FTA partner for the EU (see Table 1). The annual average value of exports from the EU to Korea since 2000 exceeds U.S. \$18 billion. European exports to Korea would be 129 percent higher (that is, more than U.S. \$23 billion higher in absolute terms) if the less competitive European firms in the Korean market caught up with their most competitive European rivals. An increase of 129 percent is more than three times the upper estimates of the impact of signing FTAs on bilateral trade. If, however, the intra-EU catch up was only to the second most competitive European rival, the estimated increase in exports would be 53 percent or approximately U.S. \$10 billion. Finally, if lagging European firms could only ship as many goods as the average of their European rivals then exports would still increase by 23 percent, which just over U.S. \$4 billion in additional sales. Comparable estimates are found when the analysis was

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<sup>14</sup> That is, the value of exports in that sector from all the EU MS (whether or not they were part of the competitiveness comparison) to the Asian destination in question.

<sup>15</sup> Here the median was used to calculate the average, a step that too tends to depress the calculated export increases from catch up.

restricted only to non-agricultural goods (SITC Classifications 5 through 9), as shown in the last row of Table 1.<sup>16</sup> What do these findings imply? Even a modest amount of European-wide catching up in competitiveness in the Korean market would likely generate an export increase of over 20 percent. If catch-up to the second most competitive EU MS happened on an industry-by-industry basis, then the export increase would far exceed the traditional estimated effects of a FTA on export flows. In short, as far as export impact is concerned, European trade negotiators can do far less for European firms than those firms can do for themselves. Another implication of these findings is that better access to the Korean market is not a pre-requisite for substantially increasing European exports to Korea.

Tables 2-5 report the comparable calculations for India, Malaysia, Thailand, and Vietnam. Comparing the results in these tables with those in Table 1 reveals that, with just one exception, the estimated increases in exports to Korea are lower bounds for the comparable increases to the other four countries. The same qualitative finding emerges: sizeable increases in European exports could be accomplished if the differences in competitiveness among European firms selling to the same country could be narrowed. At stake are billions of dollars worth of exports from Europe to Asia.

What are the implications of these findings for the conduct of EU trade policy? One reaction might be to argue that, since the benefits to be had from better exploiting existing market access far exceed the likely benefits of additional market access, then Europe's priority should be the former and not to launch new FTA negotiations. I have some sympathy with this view but feel that it is akin to slamming shut the stable door after the horse has bolted. There are, however, important tactical implications of these empirical findings. Perhaps the most significant of which is that Europe does not need these FTAs for its exporters to thrive in Asia. European trade negotiators and MS could make it clear to each Asian counterpart that while they want an ambitious FTA they certainly do not need a cosmetic, face-saving FTA with limited commercial impact. Instead, the argument might proceed, Europe's energies could be devoted to promoting catch-up among its exporters.

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<sup>16</sup> This is not surprising as U.S. \$17 billion of the total EU exports to Korea of U.S. \$18.5 billion are non-agricultural products.

To reinforce the seriousness Europe attaches to any new FTA negotiations two further steps should be taken. The first is to insist that the most senior political leaders in the potential FTA partners publicly state their desire for an ambitious FTA with the EU, statements that can be used to deflate any claims that the EU is the demandeur in the negotiation. Given the strengthen of nationalism in many Asian nations, in particular in some of the countries identified by the EC as potential FTA partners, it is important for both parties to commit up front to a collective effort to negotiate an ambitious outcome. The second step is for the ECM to give the EC a time-limited mandate to negotiate each FTA. The mandate could be two-years long, which is enough time to negotiate a detailed FTA and would allow for results to be delivered before the end of the Barroso commission's term. Another advantage is that any prevarication on either side would eat into precious negotiating time, and would focus attention on the incentives for negotiating a successful outcome and the other options which party has. (As argued above, Europe has an important alternative option if a FTA negotiation is not brought to a satisfactory conclusion). A time-limited mandate would also enable to the EU and its trading partner to end a negotiation that is going nowhere, rather than let it drag on and on to the mutual embarrassment of both parties.

What can realistically be expected from Europe's decision to join the scramble for Asian market access? In short less than some might think, not least because the EC has only targeted a fraction of Asian market potential for FTAs in the first place. (Another way of looking at this is that, once China and Japan are ruled as off limits for FTAs, then the market potential of Asia shrinks quite dramatically). Moreover, on the basis of their prior negotiating positions, the countries the EC has targeted have shown either low levels of market access ambition or revealed offensive interests that are likely to be pretty sensitive within the EU.<sup>17</sup> The latter factors discount the probability that European commercial interests will actually see any of the market opportunities that the EC is seeking to negotiate. (This is not to say that limited FTAs could be signed with the current set of EC targets, but almost by definition their impact on European commercial presence in Asia would be minor). Is this a disaster? Not really because the alternative to no FTA or to weak FTAs with Asian trading partners need not be stagnant Europe export growth to that region. European firms can make much more of the market access that they already have, almost certainly resulting in export growth far in

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<sup>17</sup> For a recent account of the difficulties the United States is having in its negotiations with Korea see STOKES (2006).

excess of what most FTAs can deliver. As far as the scramble for Asian markets is concerned, much more can be accomplished across European board rooms than across the negotiating tables in trade ministries. In the final analysis Europe's FTA negotiating partners in Asia should be led to appreciate that Europe does not need these FTAs to make *quantum* increases in its exports to the fastest growing region of the world economy. A preference for such FTAs does not translate into a necessity for them.

## 5 "Global Europe" and the Multilateral Trading System

Perhaps the weakest aspect of the October 2006 Communication relates to Europe's policies towards the multilateral trading system. There may have been good reasons in mid-to-late 2006 for the Communication's cursory treatment of the WTO and the Doha Development Agenda. After all, there is the hope (if maybe not the serious expectation) that substantial progress on the Doha Round could be made in the first quarter of 2007. Moreover, a significant EC initiative on the WTO in late 2006 might have been seen only through the fractious negotiating *calculus* of the Doha Round. For these reasons, any such initiative on the WTO should wait until the likely 2007-2009 pause in multilateral trade negotiations becomes a reality.<sup>18</sup> At that point, Europe should suggest that WTO members reflect on the very purpose of the system that they have done so much to create and failed to effectively utilise in the Doha Round. Before spelling out what I mean, I should acknowledge that there may be considerable reluctance within the EC and the MS in pursuing such an initiative. After all, many European proposals during the Doha Round were hastily rebuffed by other WTO members, including the Singapore issues and the 2003 joint proposal with the Americans on agriculture. Some may perceive little market for anything that the EC proposes, tainted precisely because it comes from Europe that has been demonised so much (and arguably so unfairly) during the Doha Round. Others may argue differently, noting that if Europe attempts to start a discussion at the WTO, other leading trading partners (in particular India and China) will not step forward and argue for revitalising a system that is in their interests too. In which case, a European initiative should not crowd out potential proposals from

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<sup>18</sup> See EVENETT (2006) for an account of the political-economy factors on both sides of the Atlantic and the respective electoral timetables that are likely to make completing the Doha Round negotiations in 2006 and 2007 extremely difficult. The recent U.S. Congressional elections, in which a significant number of pro-trade legislators were replaced by what are at best described as sceptics towards international trade and further trade reform, adds to the pessimism about concluding the Doha Round soon. For details of the latter see EVENETT AND MEIER (2006).

others. A final, quite distinct view could be that Europe's biggest contribution to the multilateral trading system's future is to enhance its own economic performance which, in turn, might make European public opinion and their political leaders more confident about undertaking external trade reform. Each of these arguments for doing nothing have some merit, but ultimately are not persuasive.

Should the 2007-2009 pause in the Doha Round negotiations come to pass, the EU could advocate undertaking a broad-based WTO member-led reflection on the merits of, and mechanisms necessary to generate support for, current multilateral arrangements, in particular those relating to the negotiation of binding commitments. During this process the assumptions underlying each major trading partner or group of countries' priorities should be spelled out. For example, Europe should insist that although not every WTO member may want new disciplines on non-tariff barriers or on trade-related domestic policies, a number of WTO members do. Questions would then arise about the role of the Single Undertaking, plurilateral accords inside and outside the WTO, etc. This type of discussion could usefully indicate how determined different WTO members are to seek multilateral accords on a range of matters. We used to assume that putting more issues on the negotiating table generally created more trade-offs across subjects, but did we incorrectly infer from this observation that final agreement would be any easier to come by? One set of discussions should, therefore, consider the scope of WTO disciplines, bearing in mind that the WTO need not be the only "multilateral reference point."

A frank discussion is needed concerning the incentives different WTO members have in seeking further multilateral reforms. It would be worth discussing the merits of establishing a principle that no WTO initiative should materially undermine the incentive of any WTO member to seek future multilateral trade liberalisation. The purpose of this principle is to keep "everyone in the game" or at least to discourage them from using their veto. This principle could have significant implications. For example, it would cast doubt on the wisdom of proposals to extend duty-free quota-free market access to the Least Developed Countries. Or, taking a very different tack, should we seek arrangements that reduce the use of vetoes by WTO member states? For example, should Least Developed Countries be exempted from all but the most fundamental multilateral obligations (such as MFN and national treatment) in return

from a commitment from those nations not to veto progress by others? More generally, is the price for seeking development-motivated derogations reduced veto rights for WTO members? This discussion should not be taken to imply that developing countries have been the principal impediment to completing the Doha Round, after all much of the blame for the July 2006 suspension was laid at the door of one industrialised country.

Looking forward, one consideration policymakers should bear in mind is that the substantial rates of export growth experienced by almost every major trading power since 2000 may not continue and, should a slowdown occur, the demand for further multilateral action may grow markedly. In this respect it is interesting to note that the WTO member which made and stuck to the most ambitious proposals for market opening during the Doha Round – namely, the United States – is the only major trading power whose aggregate exports have stagnated since 2000. With the exception of Japan, whose exports grew on average four percent per year since 2000, all the remaining major trading powers and groups of countries, including the Least Developed Countries, have experienced annual average rates of export growth of 10 percent or more.<sup>19</sup> The willingness of the larger WTO members to bear pain in the process of securing improved multilateral disciplines may well revive for economic (or business cycle-related) reasons than from institutional reforms. Even so, the former should not be taken for granted and discussions about the latter contain enough interesting matters for WTO members to chew over.

Another important confidence-building measure relates to the fears of adjustment that more international commerce can induce. I interpret the fear that many developing and industrialised countries have of China's rise to a fear of adjustment, specifically that labour markets and national private sectors are unable to respond fast or adequately enough to import surges and to export opportunities abroad. Trade ministers and their officials want to know, for example, what happens if 5,000 people are laid off in a given sector? How quickly will they find comparable paying jobs etc? Does the domestic private sector create enough new jobs to absorb displaced workers? The fact that these

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<sup>19</sup> According to WTO figures, the annual average growth rate of US merchandise exports during the five years 2000-2004 was 1 percent. Comparable figures for China, the European Union, Brazil, India, and the Least Developed countries were 24 percent, 11 percent, 15 percent, 11.5 percent, and 14 percent, respectively. The comparable figure for the world as a whole was nine percent.

questions are not new does not make them any less pertinent. Quite the opposite, as the willingness to engage in further liberalisation may increasingly depend on having convincing answers to these questions and, more importantly, domestic policies in place to facilitate economic restructuring. Worse, it has been my experience that many trade diplomats know precious little about the private sector works in their own economies and its capacity to expand and absorb displaced workers. The tendency, instead, is to emphasise the negative consequences of trade reform and imports, so finding another reason to oppose progress at the multilateral level. Discussing these fears, getting a sense of the magnitudes at stake, exploring case studies of adjustment to import growth and associated restructuring, and identifying the appropriate domestic and international policy responses may not be the bread-and-butter of trade negotiators' work but, there again, if it had been then perhaps we might not have had such a difficult negotiating round.

The EC and the MS should not overdo the pessimism that is almost certain to set in if the Doha Round is not concluded in 2007. Having a positive non-negotiating agenda for revitalising interest in the WTO may help mitigate some of this pessimism and reinforce other factors that are likely to lead policymakers back to multilateral negotiations. Some of these factors have been mentioned in passing already and are worth stating clearly here. For example, the EU is likely to find, just like the United States, that there is much less to the scramble for Asian markets than initially meets the eye. Over time this is likely to revise down the attractiveness of the preferential alternative to multilateralism. Second, the larger WTO members may – at the end of the day – still prefer not to deal with each other through FTAs. Third, smaller WTO members may find negotiating FTAs with larger counterparts too demanding and seek reform elsewhere, including in the WTO. And, finally, as rules of origin and the other costs associated with regionalism multiply pressure may grow to "multilateralise regionalism." It is not a forgone conclusion, therefore, that the Doha Round is the last substantial multilateral trade negotiation. It may be the last multilateral trade negotiation on such a diffuse, unwieldy, and ambiguous agenda, but that is another matter.

## 6 Concluding Remarks

The goal of this paper was to assess certain important elements of the European Commission's October 2006 Communication on its external trade policy. Considerations of space necessitated some selectivity of matters to discuss on my part and readers are encouraged to peruse the other contributions to this Special Issue which, together, cover almost all of the proposals contained in the Commission's recent Communication. My analysis has the three following implications for policymaking.

First, the apparent desire of the EC to join the scramble for market access in Asia is probably unstoppable, but it is likely to yield less than some might think. For better or for worse, the two largest economies in Asia (China and Japan) are not on the EC's list of potential partners to negotiate free trade agreements with. Of equal importance is the fact that, given the current asymmetries across EU MS in export performance to India, Korea, and several ASEAN nations, evidence was presented here which strongly suggests that the boost to the EU's exports from the less competitive European firms catching up with their more successful European rivals could be multiples of the increases in trade that typically follow from signing FTAs. Europe can make much more of the market access that it already has and is not beholden to these FTA initiatives to increase markedly its exports to the fastest growing region of the world economy.

This finding might lead some to oppose the launch of negotiations on FTAs between the EC and selected Asian nations, a view with which I have a certain amount of sympathy. However, the horse has almost certainly bolted and slamming the stable door in disgust has only theatrical value. There are, however, tactical implications of the empirical finding mentioned above. Although European commercial interests may eventually benefit from these FTAs, they are not the only way in which Europe can make inroads into Asian markets. As a result Europe should be prepared to walk away from cosmetic, face-saving FTAs and drawn out negotiations. This point could be communicated to potential FTA partners at the beginning of the negotiations and, to demonstrate its seriousness of purpose, the Council of the European Union should give the European Commission a fixed two-year mandate to complete the negotiations of each FTA. Two years is long enough to negotiate a complex deal if the partners are willing. Foreign prevaricators would, thus, be put on notice. Plus, this timetable would ensure that any results are secured before the end of the BAROSSO Commission's term. There may be an

instinctive reaction within the EC against the loss of discretion implied by a fixed-term mandate, but consideration should be given to the tactical and strategic value of this constraint as well as to the harm and bad blood created by never-ending FTA negotiations.

The second conclusion of this paper relates to the multilateral trading system. Here the recent EC Communication has very little constructive to say. Arguably, for a number of good reasons, the second half of 2006 was not the right time to propose a wide-ranging initiative on the WTO. Yet, once the fiction of reviving the Doha Round in the first quarter of 2007 has become plain for all to see, and given that serious negotiations are unlikely to revive (if they do so at all) until after the next U.S. president takes office, then the EC should think seriously about how to make the best use of the two year *interregnum*. Without steps being taken to restore confidence in a rules-based multilateral trading system and a discussion of the merits of potential reforms to WTO negotiating processes, conventions, and the Single Undertaking, a dangerous period of drift may ensue. In contrast a period of dialogue between WTO members, which is not distorted by the prism of ongoing negotiations, and that engages leaders outside of the narrow circles of trade technocrats, is needed to ascertain what different members really want from the WTO in the years to come and a number of topics that could be usefully broached were described in the last section. The EC and interested MS could play an important part in these discussions. I appreciate that this is not the hard-core negotiation of text that some may prefer, but this process could identify where future opportunities lie, do much to lay the groundwork for serious negotiations to resume (hopefully) in the closing year of this decade, and begin to counter the deep-seated dissatisfaction that many WTO members feel and which has so often prevented negotiations developing further during the Doha Round.

The third conclusion relates to the treatment of non-tariff barriers and trade-related domestic policies. The EC has rightly identified many such government measures as impediments to European exporters but what is unclear is how to deal with these challenges. The proliferation of FTAs in the last ten years surely provides a wealth of experience and approaches upon which to draw – understanding what types of negotiated binding provisions have bite and which matters ought to be dealt with in other non-binding international *fora*. Careful consideration should also be given here to

designing provisions that strengthen the enforcement capacities, and immunity from political pressure, of the relevant agencies in trading partners and ensuring that such agencies have the resources to follow and implement the latest international standards. Bearing in mind that tackling these non-tariff barriers and trade-related domestic policies has been a leading objective of European trade policymakers since at least 1996, and in particular given the unfortunate repudiation of the Singapore Issues during the Doha Round, the next set of free trade agreements that the European Commission negotiates may well demonstrate just how far binding commitments beyond tariffs and other relatively more straightforward market access matters can go – and just how much negotiating "capital" the Commission is prepared to allocate to designing a new set of rules for international trading relations.

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**Table 1: The effect of catch-up on European Exports to Korea.**

Trade flow from Europe to Korea.	Value of trade flows (U.S. \$ million)	Estimated percentage increase in exports if the less competitive EU exporters catch up with...		
		Exporters from the most competitive EU MS.	Exporters from the second most competitive MS.	The average competitiveness of EU exporters.
Total exports of all products.	18484	129%	53%	23%
Total exports of SITC 5 products.	2979	57%	57%	17%
Total exports of SITC 6 products.	2399	50%	69%	12%
Total exports of SITC 7 products.	8551	142%	50%	12%
Total exports of SITC 8 products.	2806	128%	22%	12%
Total exports of SITC 9 products.	290	1016%	0%	508%
Total exports of SITC 5-9 products.	17025	127%	49%	21%

**Table 2: The effect of catch-up on European Exports to India.**

Trade flow from Europe to India.	Value of trade flows (U.S. \$ million)	Estimated percentage increase in exports if the less competitive EU exporters catch up with...		
		Exporters from the most competitive EU MS.	Exporters from the second most competitive MS.	The average competitiveness of EU exporters.
Total exports of all products.	16403	240%	136%	39%
Total exports of SITC 5 products.	1607	57%	54%	23%
Total exports of SITC 6 products.	7235	313%	190%	49%
Total exports of SITC 7 products.	5421	100%	72%	11%
Total exports of SITC 8 products.	1087	420%	266%	50%
Total exports of SITC 9 products.	259	1656%	242%	461%
Total exports of SITC 5-9 products.	15612	243%	141%	40%

**Table 3: The effect of catch-up on European Exports to Malaysia.**

Trade flow from Europe to Malaysia.	Value of trade flows (U.S. \$ million)	Estimated percentage increase in exports if the less competitive EU exporters catch up with...		
		Exporters from the most competitive EU MS.	Exporters from the second most competitive MS.	The average competitiveness of EU exporters.
Total exports of all products.	9083	287%	90%	34%
Total exports of SITC 5 products.	923	86%	50%	20%
Total exports of SITC 6 products.	814	144%	59%	29%
Total exports of SITC 7 products.	6070	307%	75%	20%
Total exports of SITC 8 products.	547	80%	79%	28%
Total exports of SITC 9 products.	145	29213%	14036%	738%
Total exports of SITC 5-9 products.	8527	297%	93%	34%

**Table 4: The effect of catch-up on European Exports to Thailand.**

Trade flow from Europe to Thailand.	Value of trade flows (U.S. \$ million)	Estimated percentage increase in exports if the less competitive EU exporters catch up with...		
		Exporters from the most competitive EU MS.	Exporters from the second most competitive MS.	The average competitiveness of EU exporters.
Total exports of all products.	7264	157%	55%	22%
Total exports of SITC 5 products.	1208	175%	97%	27%
Total exports of SITC 6 products.	1236	58%	34%	9%
Total exports of SITC 7 products.	3344	115%	42%	12%
Total exports of SITC 8 products.	560	290%	24%	25%
Total exports of SITC 9 products.	139	360%	15%	123%
Total exports of SITC 5-9 products.	6597	134%	48%	18%

**Table 5: The effect of catch-up on European Exports to Vietnam.**

Trade flow from Europe to Vietnam.	Value of trade flows (U.S. \$ million)	Estimated percentage increase in exports if the less competitive EU exporters catch up with...		
		Exporters from the most competitive EU MS.	Exporters from the second most competitive MS.	The average competitiveness of EU exporters.
Total exports of all products.	2247	134%	71%	25%
Total exports of SITC 5 products.	356	331%	86%	55%
Total exports of SITC 6 products.	315	84%	31%	16%
Total exports of SITC 7 products.	1229	121%	96%	24%
Total exports of SITC 8 products.	120	30%	9%	9%
Total exports of SITC 9 products.	37	0%	0%	0%
Total exports of SITC 5-9 products.	2056	144%	78%	27%