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**Article**

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Maria Demertzis, André Sapir, Guntram B. Wolff

## Europe in a New World Order

**The EU is a relatively open economy and has benefited from the multilateral system. We argue that the EU should defend its strategic interests. The Singapore ruling has offered a useful clarification on trade policy. Addressing internal imbalances would also increase external credibility. Finally, strengthening Europe's social model would provide a counter-model to protectionist temptations.**

The United States is the most important partner of the EU in trade and bilateral investment and has, up to now, supported a multilateral trade system. It has supported European integration and has provided a security guarantee to the countries of the EU. But its relative importance has fallen, as has that of other advanced economies. The US administration appears to be on a course aiming at replacing multilateralism with bilateral deals. In trade, it aims to secure new trade deals in order to reduce bilateral trade deficits and to protect in particular the domestic manufacturing sector. In climate policy, commitments to the Paris agreement are questioned. In defence, the security umbrella appears less certain than previously. The overall promise that seems to stand behind this change of direction is to put "America first" and deliver better results for US citizens.

### Policy challenge

The EU is a relatively open economy and has benefited from the multilateral system. We argue that the EU should respond to the US changing from its previous course with a three-pronged strategy to defend its interests. First, it should collaborate with partners around the world in defence of the World Trade Organisation (WTO). Second, it should establish deeper economic relations with emerging

economies, including China, who support the rules-based multilateral system. As far as China is concerned, the EU should continue its negotiations toward a bilateral investment treaty while insisting on reciprocity and the use of public courts for dispute settlement. Collaboration in support of the Paris agreement is also essential. Third, the EU must be reformed to increase its external credibility. This concerns trade governance and addressing internal imbalances. Moreover, strengthening Europe's social model would provide a counter-model to protectionist temptations.

### Trends and breaks since 2017

From Europe's perspective, the world since 2017 looks very different from how it looked before. But despite significant upsets resulting from elections and/or referendums, not all of the changes that are taking place are breaks from previously trodden paths. Some are continuations of previous trends that have now become more visible or more entrenched.

One major trend, which started some 20 years ago, is the diminishing relative economic importance of advanced countries. This trend became evident around 2010, when advanced countries started to account for less than half of global GDP in purchasing power terms. This reduction in economic importance is associated with what is known as "diminished giant syndrome".<sup>1</sup> This syndrome is otherwise known as the curse of declinism: previous world hegemony pursue "myopic and self-indulgent ... 'what's in it for us' economic policies in the world arena", that end up undermining their roles as world leaders.<sup>2</sup> In the case of the United States, this trend emerged during the Clinton administration (1993-2001), when the question of "what's in it for us?" first arose in terms of "regaining competitiveness". Donald Trump's victory in November 2016 seems to have made this principle into the underpinning of all of the new administration's policies.

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<sup>1</sup> J. N. Bhagwati: The Diminished Giant Syndrome, in: Foreign Affairs, Vol. 72, 1993.

<sup>2</sup> Ibid.

Other advanced economies have also seen their shares in global trade and income decline, leading to calls for protectionism. The European Union remains unsure about its role in the world, not least in terms of its security and its ability to do new trade deals. Brexit will diminish the EU's size, and possibly influence, in both trade and security. By contrast, China's position in the world has strengthened during the last 20 to 25 years. President Xi Jinping's Davos speech in January 2017<sup>3</sup> was more like that of a "growing giant", and reminiscent of presidents' speeches calling for an open global economic system during the heyday of US hegemony. But China has also been criticised, rightly in our view, for the gap between rhetoric in Davos and action on the ground, with insufficient or even backtracking on the opening of its own economy.

Trump's election also marks a trend break in terms of the US's global role with regard to defence, trade and the spreading of cultural values. Importantly, the current administration does not only aim to reduce the US's role as an anchor of the global multilateral system; it may be on course to openly challenge it, either by threatening to withdraw from it unilaterally or by imposing protectionist measures such as high tariffs. Culturally, the US may draw back from liberal values. Meanwhile, the US's military commitment to NATO is being questioned. The underlying rationale of "what's in it for us?" is well captured by President Trump's "America first" rhetoric.

In this paper, we consider what the EU's strategic reaction should be to the diminishing giant policies of the US, and the EU's role in a world of declining hegemony and shifting balances, in particular the rise of China. We start by exploring the geopolitical reasons for the new US administration's "America first" orientation. We then discuss the central elements of the emerging US policies and possible consequences for Europe. Lastly, we discuss how Europe should respond, how it could sustain a multilateral system and what partnerships it could build. Our focus is on the economic aspects, although cultural and security aspects also play central roles in the broader picture.

### Reasons behind Trump's "America first"

Since the Second World War, the US has played a clear leadership role in building, supporting and policing the global system. This sense of responsibility for maintaining the world order was supported by a view that it was beneficial to the US. This view is not shared by the new US president. On the contrary, President Trump argues

that the rules-based multilateral system has not benefited US citizens, and in fact has hurt them. While this view was not necessarily shared by the majority of Americans in the election, it was shared by a sufficient number to make a difference. There are two versions of this argument. The first is that the open multilateral system has benefitted foreign countries at the expense of America. The second is that the possible benefits that the US might have enjoyed, deriving for instance from the US dollar's exorbitant privilege, accrue to Wall Street at the expense of Main Street. The multilateral system is seen as having favoured the financial sector at the expense of the manufacturing jobs that "ordinary folk" lost.

Supporting and protecting the multilateral system was politically easy for the US when it was considerably richer than everyone else. However, as the level of income in the rest of the world increased, the US began to see other countries as competitors. China's economic advance is a case in point. Chinese growth and its emergence as a major trading partner for the US have led to the belief that it is now a competitor and threatens US economic interests. The Trump administration's view of Mexico and even Europe also fits this narrative.

This zero-sum view of economic relations is not new. It was already part of the "diminished giants" narrative in the 1980s when Japan, rather than China, was viewed as the emerging threat. But it has certainly taken on a new dimension with Trump's insistence on "America first". The United States has experienced a long period during which real wages for most American citizens have not increased. The sense of unfairness has been reinforced by a welfare system in which healthcare expenditure has risen rapidly, leaving many citizens without protection.<sup>4</sup> Trump's central argument to address these woes and to "make America great again" is to turn away from globalisation, while rejecting the notion of building a welfare state.

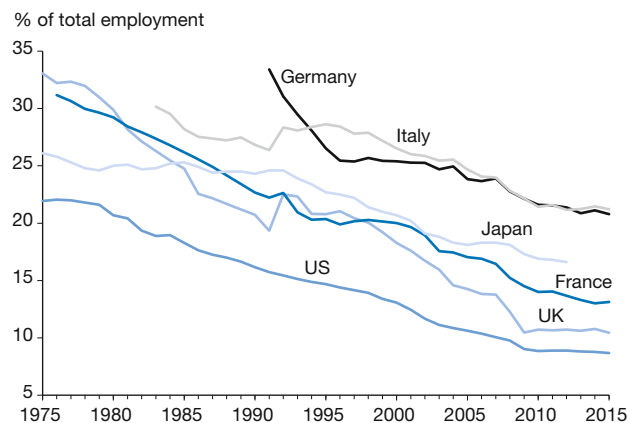
Trade, in particular regarding manufactured goods, is very much at the heart of Trump's zero-sum view of international relations, and it contrasts with the typical view of economists of trade as a positive-sum game. Trump blames trade for the real wage stagnation observed primarily in manufacturing, and intends to bring manufacturing jobs back to the US because they are supposedly highly paid.<sup>5</sup> A major theme of the presidential campaign was therefore about introducing protectionist measures

3 President Xi's speech to Davos in full, World Economic Forum, Davos, 17.1.2017, <https://www.weforum.org/agenda/2017/01/full-text-of-xi-jinping-keynote-at-the-world-economic-forum> (20.2.2018).

4 The recent introduction of "Obamacare" apparently was not enough to change the sentiment.

5 P. Navarro, W. Ross: Scoring the Trump Economic Plan: Trade, Regulatory & Energy Policy Impacts, 2016, Mimeo.

Figure 1  
Employment in manufacturing



Notes: Total activity is from Labour Force Survey where available, and from official estimates otherwise. Manufacturing is measured with Rev. 4, otherwise Rev. 3 or Rev. 2 measures are used upon availability.

Sources: International Labour Organization Database (ILOSTAT); Federal Reserve Economic Data (FRED).

to correct a system which, in the view of many Trump supporters, led to the US trade deficit.<sup>6</sup>

### The contours of Trump's "America first"

Trump's "America first" vision is thus very much about bringing manufacturing jobs back to the US. Clearly, there has been a big decline in US manufacturing employment since the 1970s. But this decline is part of a common trend in all advanced economies, rather than specific to the US (Figure 1). However, the US has always had the lowest share of manufacturing jobs during the past 40 years, compared to the main industrialised countries. But high manufacturing employment shares do not necessarily correlate with trade surpluses. Japan, Germany (countries with persistent trade surpluses) and Italy (broadly in trade balance over time) currently have similar manufacturing shares in employment. Employment share differences rather suggest variations in specialisation. Moreover, there is little difference in the wage levels in manufacturing and services in the US.<sup>7</sup> Nevertheless, it is correct that the trade balance at the margin can matter for the relative size of the manufacturing sector. If an economy is at full employment and increases its net exports, its tradable sector (or manufacturing sector) would increase. Manufacturing therefore has a zero-sum dimension, but this operates at the margin and cannot explain the long-term decline in employment in manufacturing.

<sup>6</sup> Ibid.

<sup>7</sup> G. Wolff: Manufacturing in the US: Will Trump's strategy repatriate highly-paid jobs?, Bruegel, blog post, 6.1.2017.

One way Republicans in the House of Representatives have discussed improving the US trade balance is through a "destination-based cash-flow tax" (DBCFT). This would impose a 20 % tax on all imports, while providing a special tax exemption for income generated from exports.<sup>8</sup> Such an approach to taxation is known as "border adjustment".

The DBCFT would be levied on producers not consumers, and would act as a penalty on imports and a subsidy for exports. Unlike a value added tax, it would therefore discriminate against foreign producers<sup>9</sup> and would (depending on its precise formulation) be incompatible with WTO rules.<sup>10</sup> A levy on imports and a subsidy for exports would both increase the value of the US dollar. A more expensive US dollar would then counteract the benefits of this tax in terms of promoting exports and reducing imports. Whether the tax and the rise in the value of the US dollar would totally offset one another remains a point of empirical debate because exchange rates are also affected by other factors.<sup>11</sup> DBCFT would generate significant tax revenues in countries with a trade deficit, like the US, while countries with trade surpluses would lose tax revenues.

Beyond taxes, President Trump appears also to see bilateral trade deals, rather than regional or multilateral ones, as the instrument of choice for promoting US interests. Bilateral deals, in his view, could maximise US leverage in negotiations. In particular, they are seen as the right approach to reduce trade deficits that supposedly destroy jobs. The Trump administration has therefore started to renegotiate the North American Free Trade Agreement (NAFTA) and has abandoned earlier plans by the Obama administration for the Trans-Pacific Partnership, a regional trade agreement.

Figure 2 shows that the US has a trade deficit with most countries, certainly in goods and in particular in manufacturing. The biggest deficit is with China, followed by the EU, Japan and Mexico. Among EU countries, the trade deficit with Germany is particularly high. However,

<sup>8</sup> See Auerbach et al. for an academic discussion and Mitchell for the proposal discussed among Republicans. A. Auerbach, M. P. Devereaux, M. Keen, J. Vella: Destination-Based Cash Flow Taxation, Oxford University Centre for Business Taxation, Working Paper, No. 1, January 2017; D. J. Mitchell: Concerns About the 'Border Adjustable' Tax Plan From the House GOP, Part I, Forbes, 3.1.2017.

<sup>9</sup> G. Davies: The Worrying macro-economics of US border taxes, Financial Times Blog, 15.1.2017.

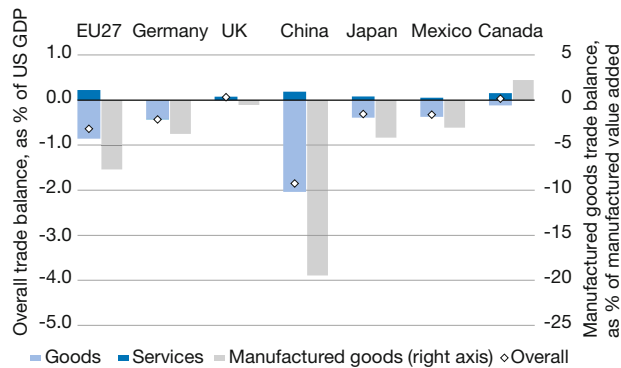
<sup>10</sup> R. S. Avi-Yonah, K. Clausing: Problems with Destination-Based Corporate Taxes and the Ryan Blueprint, Law and Economics Research Paper Series, No. 16-029, January 2017.

<sup>11</sup> K. Pomerleau: Exchange rates and the Border Adjustment, Tax Foundation, 15.12.2016. The DBCFT can have benefits in terms of promoting efficiency and would not distort trade if others also implemented it. See A. Auerbach, M. P. Devereaux, M. Keen, J. Vella, op. cit.

Figure 2

**US bilateral trade balances with major partners, 2015**

Total (goods and services) as a share of US GDP (lhs) and manufactured goods as % of manufactured value added (rhs)



Note: Manufactured goods comprise sector 5 to 8 (less 667 and 68) of the Standard International Trade Classification (SITC Rev. 3). Manufacturing value added and gross output measures are, instead, based on the BEA industry economic accounts (based on 2007 NAICS code structure). Since the former is product-based while the latter is sector-based, potential mismatches between the two classifications cannot be excluded.

Sources: Bruegel, based on US Bureau of Economic Analysis and data on manufacturing based on UN Comtrade and Bureau of Economic Analysis, U.S. Department of Commerce.

the deficits are much smaller when measured on a value added basis.

**Consequences of “America first” for global trade and investment**

The new US administration's attempts to backpedal on multilateral trade arrangements will have profound implications for global trade and investment because of interlinkages between the US and its partners. Tables 1 to 3 show this interdependence. As far as goods trade is concerned, the top five sources of US imports are, in descending order, China, the EU27 (the EU without the UK), Canada, Mexico and Japan. On the export side, the top five destinations are Canada, the EU27, Mexico, China and Japan. For the EU27, the US is the number one destination for exports, just before China, and the number two source of imports, just behind China. The close relationship between the EU27 and the US is even more intense for trade in services, where the EU27 and the US are each other's largest export destination and import source. The close interconnectedness between the EU27 and the US is even more important as far as FDI stocks are concerned. Table 3 shows that 44 % of US FDI comes from the EU27, and 31 % of the EU27 FDI comes from the US.

The EU reaction to possible US trade measures will depend crucially on the size of the measures and their effects on the EU economy (as well as on geostrategic considera-

Table 1

**Bilateral imports (goods) in 2015 for selected partners**

US\$ billion

To:	US	EU27	UK	China	Japan	Mexico	Canada
US	.	249.4	58.1	150.5	68.3	187.3	223.2
EU27	376.5	.	340.0	190.4	64.8	41.4	40.9
UK	58.7	188.5	.	18.9	6.5	2.3	7.2
From							
China	502.6	366.3	63.0	.	160.6	70.0	51.4
Japan	134.8	72.3	10.2	143.1	.	17.4	11.6
Mexico	297.5	21.2	2.1	10.1	4.8	.	24.4
Canada	301.0	18.7	10.7	26.3	9.2	9.9	.
World	2306.8	1978.8	630.3	1681.7	625.6	395.2	419.2

Note: Bilateral trade relies on import statistics, which are considered more accurate given the custom system in place to collect tariff revenues.

Source: Bruegel, based on UN Comtrade data available at <https://comtrade.un.org/data/> (20.2.2018).

Table 2

**Bilateral imports (services) in 2014 for selected partners**

US\$ billion

To:	US	EU27	UK	China	Japan	Mexico	Canada
US	.	214.1	38.5	n.a.	57.9	n.a.	62.0
EU27	119.0	.	105.6	n.a.	23.2	n.a.	13.3
UK	49.8	160.0	.	n.a.	12.6	n.a.	5.8
From							
China	14.4	28.7	1.7	.	11.9	n.a.	2.1
Japan	31.2	15.9	4.3	n.a.	.	n.a.	2.0
Mexico	19.5	4.2	0.9	n.a.	0.3	.	2.4
Canada	30.1	12.4	2.8	n.a.	2.1	n.a.	.
World	477.4	849.3	214.9	452.8	192.1	33.5	110.3

Note: Data on the EU27 are estimated by subtracting UK imports from all the bilateral import flows of the EU28. In particular, EU27 (EU without the UK) total imports are equal to (EU28 total imports – UK total imports from ExtraEU28 + EU27 imports from UK).

Sources: Bruegel, based on ITC Trade Map and OECD Statistics on International Trade in Services by partner country. Both sources follow the Extended Balance of Payments Services Classification (EBOPS 2010).

Table 3

**Foreign Direct Investment stocks 2015**

US\$ billion

To:	US	EU27	UK	China	Japan	Mexico	Canada
US	.	2156.3	433.0	116.6	51.6	222.0	280.0
EU27	1382.3	.	679.9	257.9	58.4	184.1	150.0
UK	484.0	1248.6	.	42.3	13.2	20.5	24.8
From							
China <sup>1</sup>	25.9	97.1	20.6	.	8.4	3.8	26.7
Japan	411.0	115.3	67.7	180.7	.	13.4	15.9
Mexico	16.6	43.4	n.a.	0.1	0.0	.	1.0
Canada	269.0	214.3	34.4	15.8	1.2	28.1	.
World	3130.0	6863.6	1550.0	2580.0	171.0	509.0	555.0

<sup>1</sup> including Hong Kong.

Sources: BCDIS (Coordinated Direct Investment Survey); IMF.



tions, to which we will return later). There are preliminary attempts to measure the effects of such actions,<sup>12</sup> but the real effects will not be understood before US plans become clearer and the rest of world decides how to react.

### How can the EU defend a multilateral system?

Trump's "America first" policy threatens to upset the global trading system and even put the WTO in danger. This will naturally precipitate reactions from other global players, in particular the EU and China. The EU has a strong economic and political interest in preventing the demise of the multilateral trading system. Openness, measured as exports in terms of a country's GDP, is far greater in the EU (43.8 %) than in China (22.1 %) or the US (12.6 %). The rules-based system allows all players, including the weaker ones, to trade with each other based on high and comparable standards that have to be followed by all. Protectionism would reduce EU and global welfare, hurt global growth, and could mean lower standards and unfair competition. In particular, in the EU with its strong trade relationships around the world, many jobs could be at stake.

However, though the EU is the largest trading bloc in the world, it cannot sustain a strong multilateral system on its own. The EU's inability to replace the US as a global hegemon is partly due to internal reasons (the state of the economy, a weak defence and security policy) and partly to external reasons (the world balance has changed with the increasing economic relevance of China and other emerging countries). At the same time, all three leading global trade players have expanded the number of regional trade agreements. The world therefore is evolving from a multilateral system centred around the US into a more multipolar system resting on the three strong trading poles of China, the EU and the US, each with several bilateral and regional trading arrangements. This has been criticised for undermining existing multilateral frameworks.<sup>13</sup>

This raises two questions: whether the poles of the system are collectively interested in supporting at least the core of the existing multilateral system, and whether the EU and China are willing and able to jointly support the multilateral system as the US steps back from its central role. While the EU and China each clearly have an interest in supporting the multilateral trading system, it is an open

question whether they can act in a coordinated manner as the EU and the US have done in the past. This is not a trivial question, because the European and Chinese economic systems are much more different from each other than the European and American economic systems, raising significant frictions in their bilateral relations. Nevertheless, in certain areas, such as support for the WTO, EU-China collaboration should be relatively straightforward. The EU should also seek other partners for collaboration in support of the WTO.

### Stepping up trade relations with partners

Strategically, the EU should continue its bilateral trade and investment negotiations with other partners. The bilateral deals should be designed as stepping stones rather than obstacles to the multilateral system, including in investment matters, where the ultimate goal could be an expansion of the WTO into a "WITO" (to include investment). An obvious objective is to continue ongoing bilateral investment treaty (BIT) negotiations with China while insisting on core EU economic interests. The EU differs most from China in terms of the role of state-owned enterprises (SOEs) in manufacturing. It is natural, therefore, that the role of SOEs is at the heart of the BIT negotiations that both the EU and the US are pursuing with China. An additional priority is bridging the gap between different approaches to state aid, competition policy and market access. All three represent major obstacles to deepening economic relations with China.<sup>14</sup> Only after an EU-China BIT has been agreed, say by 2020, should the two partners start negotiations on a bilateral investment and trade agreement.

The aim of the EU-China bilateral deal should be to improve market access and set high environmental, corporate governance, consumer safety and workers' rights standards. It should ensure fair competition and reciprocity. A deal that would materially lower standards in the EU is not in its interest and should therefore be rejected.

The EU should also seek new and complete bilateral deals with other countries, including India and the Mercosur bloc. The recent completion of a deal with Japan in December 2017 is a sign that the EU is already more forceful in reaching out to partners at a time when TTIP with the US has been dropped. Similarly, it is positive that a deal with Canada came into fruition in September 2017. The aim must be to ensure high standards for EU citizens, because otherwise support for such deals will be lacking. It is also crucial to do the deals in a way that strengthens rather than weakens the global system. In trade and in-

<sup>12</sup> See Vandenbussche et al. for preliminary estimates of the impact of a Trump tariff on European employment and output. H. Vandenbussche, W. Connell, W. Simons, E. Zaurino: "America First!" What are the Job losses for Europe?, KULeuven (VIVES), Discussion Paper, No. 57, January 2017.

<sup>13</sup> See, for example, Lamy on the importance of structuring bilateral deals in a way that they do not undermine the multilateral trading system, 2006, [https://www.wto.org/english/news\\_e/sppl\\_e/sppl46\\_e.htm](https://www.wto.org/english/news_e/sppl_e/sppl46_e.htm).

<sup>14</sup> The European Union Chamber of Commerce: European Business in China – Position Paper 2016/2017, China, 1.9.2016.

vestment matters, the EU has an opportunity to not only uphold but even strengthen the global system according to the EU's high standards and values.

### The EU needs to step up internally to become more credible externally

For the EU to assume a bigger role in promoting and safeguarding multilateralism, and in forming new and deepening old alliances, a number of reforms would be required. We see three main areas in which reforms would increase the credibility of Europe's claim to a bigger global role.

- First, addressing distributional concerns domestically is a key prerequisite for entering new trade arrangements. Europe's social model is a major factor in reducing inequality and is rightly thought of as a way to soften the impact of rapid changes on citizens in an age of globalisation and technological change. But many EU countries still need to reform their social systems to deliver inclusive growth and better social protection.<sup>15</sup> The EU's role should primarily be to empower its members to achieve desired levels of redistribution by effectively combatting tax evasion and social fraud that relate to the single market.<sup>16</sup>
- Second, the governance of EU trade and investment policy has become cumbersome. The recent difficulties in signing CETA have increased partners' doubts about the EU's ability to deliver. We consider it imperative that EU institutions regain citizens' trust so that they can negotiate trade agreements on citizens' behalf. We consider it positive that the European Commission president has announced greater transparency with regard to the way negotiations are carried out. The European Court of Justice's opinion on the EU-Singapore free trade agreement has clarified which parts of the agreement belong to the EU's domain of exclusive competence (essentially everything which deals with trade) and which can only be concluded by the EU and the Member States jointly (essentially certain foreign investment clauses).<sup>17</sup> Based on this

opinion, the Commission has decided to split the EU-Singapore agreement into two separate agreements: a trade-only agreement to be concluded solely by the EU, and therefore to be ratified by the Council and the European Parliament, and an investment-only agreement to be concluded by both the EU and the Member States, and therefore to be ratified by the Council and the national parliaments. We agree that this is a sensible strategy, also for future trade agreements, in order to avoid a situation whereby individual Member States hold the EU hostage in an area such as trade policy, where the EU has exclusive competence.

- Third, the EU as a large open economy cannot sustainably run large current account surpluses. The large surpluses, and in particular Germany's surplus, are a result of imbalances in the euro area that need to be resolved irrespective of the global environment. Strengthening domestic demand in Germany is pivotal.<sup>18</sup> Structural reforms at the national level, for example by addressing the debt overhang and remaining banking problems in other countries, would further boost demand. Such actions in surplus and former deficit countries will help speed up the normalisation of European Central Bank policy and strengthen the euro, thereby also helping to address the large euro-area surplus.

### Concluding remarks

It remains an open question to what extent Trump and his presidency constitute an acceleration of a trend or a real break from past US policies. In either case, but particularly in case of a strong break, the EU should rethink its position in the global order. The US will remain the EU's most natural partner in economic, cultural and probably military terms. But if differences grow significantly in the course of the current administration, not least because of different social models, the EU needs to stand ready to defend its interests.

The EU should prioritise measures that help to sustain the multilateral trading system. It should be firm in its response to the US, based on the principle of multilateralism. Building coalitions with as many players as possible will be important to defend the system. The EU could also support smaller partner countries in their WTO complaints against unilateral trade measures.

<sup>15</sup> See, for example, Z. Darvas, G. Wolff: Europe's social model and its implications for economic growth, Bruegel Policy Brief, 2014/03. A model that combines flexibility and security, as some EU countries have implemented, appears particularly suited to the challenge, see A. Sapir: Globalisation and the reform of European social models, Bruegel Policy Contribution, September 2005.

<sup>16</sup> V. Aussiloux, A. Benassy-Quéré, C. Fuest, G. Wolff: Making the best of the European single market, Bruegel Policy Contribution, Issue 3, 2017.

<sup>17</sup> Court of Justice of the European Union: The free trade agreement with Singapore cannot, in its current form, be concluded by the EU alone, Press Release, No. 52/17, Luxembourg, 16.5.2017 <https://curia.europa.eu/jcms/upload/docs/application/pdf/2017-05/cp170052en.pdf> (20.2.2018).

<sup>18</sup> We would consider a combination of public investment, tax reforms incentivising corporate investment and lowering the tax burden for low-income households, structural reforms to increase home ownership, and wage increases in sectors with skilled labour shortages.

Strengthening the collaboration between the EU and China in support of multilateralism is one important but also difficult step. But beyond China, the EU would benefit from forging alliances with other countries. Promoting multilateralism would protect smaller countries which naturally rely on established frameworks, and it would help for adhering to existing agreements. This is of crucial importance for issues like upholding commitments to the Paris agreement on climate change or combating tax evasion and fraud at the global level.

Maintaining domestic support for trade in the EU depends on ensuring that trade and financial flows do not undermine environmental standards and countries' capacities to deliver adequate social systems. To the extent that multilateralism helps the latter, it also helps support the pursuit of free trade. The EU itself needs to reform. Real or perceived, the EU's credibility on trade matters has suffered and needs to be restored. The opinion by the European Court of Justice on the EU-Singapore trade deal is a useful clarification of EU competences. We agree that it would be wise in the future to have two separate agreements, one that covers trade and falls under the exclusive competence of the EU, and one that covers in-

vestment and falls under the joint competence of the EU and the Member States. Moreover, the EU, and in particular the euro area, must address their internal imbalances by reducing external trade surpluses and strengthening domestic growth.

Also important is determining what type of relationship the EU should foster with the UK once it leaves the EU. The arrival of President Trump has arguably increased the need for the two sides to reduce the Brexit-related damage that both could suffer. Such an agreement should preserve Europe's ability to weigh in on world affairs, at a time when European values such as liberal democracy and the social market economy are threatened. In particular, the EU and the UK should be natural partners in supporting the multilateral system in areas such as trade, climate and financial regulation.

Finally, the EU remains a weaker global player than its size would suggest, not only because of its internal divisions but also because of its dependence on the security guarantee that the US provides and its dependence on energy imports. We consider recent attempts to increase EU security cooperation as strategically important.

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**Title:** *Europe in a New World Order*

**Abstract:** *The EU is a relatively open economy and has benefited from the global multilateral system. We argue that the EU should defend its strategic interests with three steps. First, it should collaborate with partners around the world in defence of multilateralism. Second, it should establish deeper economic relations with emerging economies. Collaboration in support of the Paris agreement is also essential. Third, the EU must be reformed to increase its external credibility. The Singapore ruling has offered a useful clarification on trade policy. Addressing internal imbalances would also increase external credibility. Finally, strengthening Europe's social model would provide a countermodel to protectionist temptations.*

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