

DIRECTORATE-GENERAL FOR EXTERNAL POLICIES
POLICY DEPARTMENT



WORKSHOP

**TRADE
AND
ECONOMIC
RELATIONS
WITH ASIA**

INTA



WORKSHOP

Trade and economic relations with Asia

WORKSHOP
POLICY DEPARTMENT, DG EXPO FOR THE
COMMITTEE ON INTERNATIONAL TRADE (INTA)

Thursday, 10 December 2015 – **15:00-17:30**
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Trade and economic relations with Asia



Chairman:
Bernd LANGE

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Table of contents

Workshop programme	7
Workshop summary	8
Part I: Asia as a new global engine: foreign trade and regional cooperation	11
Executive summary	12
1 The growing importance of Asia in world growth and trade	15
2 The role of global value chains in Asia	18
3 Trade and investment strategies of major APEC countries	28
3.1 New FTAs entered into force in 2014	31
4 The status of the preferential agreements being negotiated in the Asia/Pacific region	32
4.1 Bilateral agreements	32
4.2 Regional agreements	36
5 The expected impact of TPP on EU trade	39
6 The economic and trade impact of the One-Belt-One-Road initiative	41
7 Asia and the WTO	43
8 Conclusions	44
References	45
Appendix	46

Part II: EU external trade strategy <i>vis-à-vis</i> Asia	54
Executive summary	55
1 The Asian century and its economic and trade implications for the EU	59
2 The status of EU engagement in the Asia-Pacific region compared with Asian emerging powers and the US	64
3 The flourishing of regional and plurilateral FTA initiatives in Asia and its implications for EU-Asia trade	68
4 The EU's current external trade approach to Asia	72
4.1 South Korea	73
4.2 India	74
4.3 Japan	76
4.4 ASEAN	77
4.5 China	79
4.6 Australia and New Zealand	80
5 Geostrategic and security issues linked to trade and economics in Asia	81
5.1 Flow of Energy and Goods in the Indian Ocean East and South China Seas	82
5.2 Other Strategic Issues	83
6 EU-Singapore FTA: Institutional deadlock and future of the EU Common Commercial Policy	84
6.1 The Dispute – exclusive competence or mixed agreement?	84
6.2 The impact: for EU-Singapore relations and EU trade policy?	85
6.3 An EU-ASEAN/Asia trade shipwreck?	86
7 How the EU should streamline and improve its strategy <i>vis-à-vis</i> Asia	87

References	89
Part III: Implementation of the EU-Republic of Korea FTA	90
Executive summary	91
Introduction	94
1 Overall assessment	95
2 Sector-by-sector assessment	99
3 Trade performance of European and Korean auto firms	108
4 Comparison of sector specific provisions	110
4.1 Analysis of the EU-ROK FTA from an institutional angle	110
4.2 Overview of the key issues under discussion in the implementation bodies	113
5 A comparative analysis of the EU-Korea FTA and the KORUS FTA from both a trade and institutional angle	114
6 Conclusions: Lessons from the EU-Korea FTA	118
References	121

Workshop programme

DIRECTORATE-GENERAL FOR EXTERNAL POLICIES
POLICY DEPARTMENT



For the Committee on International Trade (INTA)

WORKSHOP

Trade and economic relations with Asia

Thursday, 10 December 2015
Brussels, Paul-Henri Spaak Building, **Room (P4B001)**
15.00-17.30h

PROGRAMME

- 15.00** **Welcome and introductory remarks by Bernd LANGE**, Chair of the Committee on International Trade (INTA)
- Panel 1:** **Trade and economic relations with Asia**
- Asia as a new global engine: foreign trade and regional cooperation**
- 15.10** Presentation by **Prof. Rodolfo HELG**, ISPI Senior Associate Research Fellow and Full Professor of Economics, Università Carlo Cattaneo - LIUC
- 15.25** Address by **Diana ACCONCIA**, acting Head of Unit, Trade Relations with South and Southeast Asia, Australia and New Zealand, DG Trade, European Commission
- The EU external trade strategy vis-à-vis Asia**
- 15.40** Presentation by **Prof. Alessia AMIGHINI**, Senior Associate Research Fellow at ISPI Institute, Assistant Professor of Economics and International at Università del Piemonte Orientale (UPO, Italy)
- 15.55** Address by **Peter BERZ**, Head of Unit, Trade Relations with the Far East, DG Trade, European Commission
- 16.10** First round of questions and answers
- Panel 2:** **The EU-Korea FTA: implementation and lesson learning**
- 16.30** Address by **Chong Ghee AHN**, Ambassador of the Republic of Korea
- 16.35** Presentation by **Prof. Alessia AMIGHINI**, ISPI Institute and UPO
- 16.50** Address by **Marjut HANNONEN**, Adviser to the Director in charge of bilateral trade relations with Asia and Latin America, DG Trade, European Commission
- 17.05** Second round of questions and answers
- 17.25** **Concluding remarks by Bernd LANGE**, Chair of the Committee on International Trade (INTA)

Workshop summary

Panel 1: Trade and economic relations with Asia

Speaker 1: Prof. Rodolfo Helg, ISPI Senior Associate Research Fellow and Full Professor of Economics, Università Carlo Cattaneo

Prof Helg presented the major results from the study on 'Asia as a new global engine'. Asia has considerably increased its regional share on world GDP over the past decade, and this trend is expected to continue. It has become the most dynamic region in international trade and the rapid industrialisation of the area can potentially impact the Asian pattern of trade: a doubling of the share of manufactures in world exports is predicted by 2030, while the share of primary products in world imports is expected to rise. Moreover, regional participation on global value chains has substantially expanded, with the leading role of China. The European Union is among the most important partners of Asian countries in these GVCs, but it has been generally less active in cultivating economic ties in the area compared to large countries in the region or with stronger links with the region such as the USA. Starting from 2001, there has been a proliferation of RTAs/FTAs among APEC countries, culminating with the TPP, a mega-regional agreement including the US and other 11 countries of the area.

Speaker 2: Diana ACCONCIA, acting Head of Unit, Trade Relations with South and Southeast Asia, Australia and New Zealand, DG Trade, European Commission

Ms Acconcia presented a summary of the EU trade strategies with South and Southeast Asia, Australia and New Zealand. She also raised the issue of the implications of China's rebalancing of trade relations between China and ASEAN and the rest of the world. As the rebalancing towards more sustainable growth implies an increase in consumption and a reduction in fixed investment, this could imply either more or less trade with partner countries, depending on whether consumption will be more or less oriented towards imported goods compared to investment. As China is the more important trading country in the region, the trade and economic impact of its rebalancing could be substantial and could be either conducive to higher or lower weight of China in Asian trade.

Speaker 3: Prof. Alessia Amighini, Senior Associate Research Fellow at ISPI Institute, Assistant Professor of Economics and International at Università del Piemonte Orientale (UPO, Italy)

Prof. Amighini presented the results from the study on 'The EU external trade strategy vis-à-vis Asia', which argued why it is more and more important for the EU to secure good trade relations with Asia, the most dynamic area in world trade. It is therefore important for the EU to adopt a coherent approach in its future trade strategy vis-à-vis the different Asian economies. This is important for a range of trade reasons but also because these countries are participating in regional value chains where the EU is highly and increasingly involved. As countries participating in 'Factory Asia' have grown more integrated with one another, regional trade agreements have flourished in recent years in order to make production networks in the region work as smoothly as possible.

The TPP opens a potentially new phase for EU external trade strategy towards Asia. China's de facto marginalisation in current mega-regional deals (TPP and TTIP) has weakened its position in terms of bargaining power vis-à-vis the leading world economies of the United States and Japan. The latter are China's most important trading partners, but are trying to counter the ongoing trend towards a more central role of China in APEC trade. In this context, the EU is in a delicate position. Although it is marginalised by the TPP, its bargaining power towards the other marginalised actor, China, has been strengthened. As a consequence, the EU might exploit this position by initiatives in its trade strategy to overcome the current inertia in its policy towards different Asia. This would entail ending the internal deadlock on the EU-Singapore FTA, ensuring a well-functioning FTA with Korea and moving ahead in the

postponed negotiations for an FTA and BIT with China. Overcoming the institutional stalemate in the EU-Singapore FTA would not only improve the EU's reputation as a trade partner vis-à-vis the whole of Asia, but would also favour improved trade relations with the major hub in Southeast Asia, which is also a TPP member country, covering 40 % of global trade.

Speaker 4: Peter Berz, Head of Unit, Trade Relations with the Far East, DG Trade, European Commission

Mr Berz summarised the EU trade agenda in Asia, which he argues has been clear since 2002. The EU signed FTAs or entered into trade negotiations with all the most important trading economies in Asia, including India, Korea, Singapore, Japan and China, and it is still committed to start negotiating a bloc-to-bloc EU-ASEAN FTA. Investment talks – not FTA – are planned with Taiwan and Hong Kong, but only after negotiations will be launched with China.

First round of questions and answers

Panel 2: The EU-Korea FTA: implementation and lesson learning

Speaker 1: Chong Ghee AHN, Ambassador of the Republic of Korea

Ambassador Ahn of the Republic of Korea expressed his appreciation of the implementation period of the EU-ROK FTA, although expectations on the part of Korea had indicated a higher positive impact of the FTA on the bilateral trade balance of Korean trade with the EU.

(The Ambassador Ong of Singapore asked about news and perspectives on the ratification process of EU-Singapore FTA. EU Services Forum asked about market access in Myanmar).

Speaker 2: Prof. Alessia Amighini, Senior Associate Research Fellow at ISPI Institute, Assistant Professor of Economics and International at Università del Piemonte Orientale (UPO, Italy)

Prof. Amighini presented the results from the study on 'The EU-Korea FTA: implementation and lessons', which shows that the FTA has so far been beneficial to both parties, although relatively more so for the EU, because the EU market was already a more open market than that of Korea. The benefits have been partly due to the trade liberalisation in the FTA and partly due to macroeconomic factors, such as the slow GDP growth and thus sluggish demand in the EU, and the Euro depreciation vis-à-vis the Korean Won over the last 5 years.

Sectorial developments have also been at work, such as the reduction in Korean output and thus exports in key sectors, due to global overcapacity and reorganisation of production in sectors that are important in EU-Korea competition.

The most important increase in exports from the EU to Korea has been in transport equipment, more specifically cars and trucks, but the size of the increase is substantially lower than that forecast. There was also a significant increase in EU agricultural and food product exports (food and beverages), with the greatest increases in meat and dairy products. Concerning the auto industry, EU imports from Korea increased by 16 % from 2010 to 2014. On the export side, the EU exported 6 million motor vehicles in 2014, worth EUR 124 billion, which is 27 % up on 2010 and the largest increase was indeed to Korea.

The EU-Korea FTA is the first comprehensive FTA completed with a fully industrialised and developed economy. As such, it serves as a test for the EU's ability to implement beneficial FTAs with economies characterised by important non-tariff barriers to trade (technical barriers to trade, regulatory provisions in the services sector, a lack of access to government procurement markets) and other less evident trade barriers (such as anti-competitive practices that restrict access to markets by companies from the other party).

Speaker 3: Marjut HANNONEN, Adviser to the Director in charge of bilateral trade relations with Asia and Latin America, DG Trade, European Commission

Ms Hannonen reported on the results of the EU-ROK FTA after four years of implementation. Overall, the impact of trade liberalisation has been beneficial to both parties, relatively more so for the EU, whose trade deficit with Korea in the years before the entry into force of the FTA turned into a trade surplus of EUR 4.4 billion in 2014. Comparing figures between the fourth year after the FTA was implemented, with the year before the entry into force, bilateral trade increased substantially in both directions with a stronger performance of EU exports to (compared to imports from) South Korea. EU goods exports to Korea increased by 55 % from EUR 30.6 billion to EUR 47.3 billion (EU exports of fully liberalised goods increased by 57 %). EU imports from South Korea in the third and fourth year of FTA implementation increased annually by 5-6 % (imports of fully liberalised goods from Korea increased by 35 %). As a result, Korea increased its importance as an importer from the EU, but decreased its weight as a supplier to the EU. Korea is currently the 8th largest trade partner for the EU, both on the export and import sides, accounting respectively for 2.5 % of extra-EU exports and 2.3 % of extra-EU imports.

Second round of questions and answers

Concluding remarks by Bernd LANGE, Chair of the Committee on International Trade

Part I:

Asia as a new global engine: foreign trade and regional cooperation

ABSTRACT

Asia has considerably increased its regional share on world GDP over the past decade, and this trend is expected to continue. It has become the most dynamic region in international trade and the rapid industrialisation of the area can potentially impact the Asian pattern of trade: a doubling of the share of manufactures in world exports is predicted by 2030, while the share of primary products in world imports is expected to rise. Moreover, regional participation on global value chains (GVCs) has substantially expanded, with China playing a leading role.

The European Union is among the most important partner for Asian countries in these GVCs, but it has been generally less active in cultivating economic ties in the area compared to large countries in the region and to the USA. Starting from 2001, we report a proliferation of RTAs/FTAs among APEC countries, culminating with the TransPacific Partnership (TPP), a mega-deal including the US and other 11 countries of the area. The growth of preferential trade agreements is likely to continue in the future, given the centrality of Asia in the world markets.

Executive summary

Asia has become a new engine of global growth: East Asian GDP on average expanded by 5.4 % per year and South-East Asian by 5.9 % per year in the past decade. As a result, Asia has considerably increased its regional share of world GDP over the past decade compared to other world regions. As the economic dynamism of Asian economies is expected to continue, the Asian share on world GDP is projected to reach 29.4 % in 2030 (up from 22.6 % in 2004). At the same time, the shares of Western Europe and the United States are both projected to decrease to 25.1 % in 2030 (from 33 % and 28.5 % respectively in 2004). Within Asia, all countries but Japan are expected to increase their weight on world GDP.

Asia is also the most dynamic region in world trade. Since the 1970s the vast majority of world trade has progressively moved from the Atlantic to the Pacific, and today the 21 economies of the largest trans-Pacific grouping, the Asia-Pacific Economic Cooperation (APEC), account for nearly half of global trade. The centre of gravity of intra-APEC trade has substantially changed over the last 15 years. In 2000 intra-APEC trade was rather balanced (1/3 intra-America, 1/3 intra-Asia and 1/3 America-Asia). Today, trade linkages between the two sides of the Pacific have lost ground (as the share of America-Asia trade declined from 31 % to 26 % of intra-APEC trade), while intra-Asia trade increased to 41 % and intra-America trade declined to 21 %. Within Asia, China has become the largest trading country: the first exporter in the region (with 22 % of intra-regional exports), as well as worldwide, and the first regional importer (with 17 % of intra-regional imports) and the second worldwide.

Given the rapid industrialisation trends in developing Asian economies, as well as the projected increase in per capita income, the product composition of Asia trade is expected to change quite substantially, with developing Asia's share of manufactures in world exports doubling by 2030. Developing Asia's share of primary products in world imports will also rise substantially though, due to expected continuing rapid industrialisation. Given the political sensitivity of farm products, it is worth noting that regional shares of global trade in just agricultural and food products are projected to undergo substantial changes. While developing countries' share of exports of these goods is projected to remain virtually unchanged, their share of global imports of farm products rises dramatically, mainly due to the rise in China and India.

The relevance and diffusion of **global value chains (GVC)** has been growing rapidly in the past decade, and this is particularly evident in the case of Asia, which is a key player in the new international division of labour in a number of industries. Two main trends can be observed in the GVC structure and participation of Asian countries. While the area as a whole grew in its relevance for GVC, the choice of Asian partners in production sharing by advanced countries (Europe, North America, Japan) has changed over time, moving in part away from China and towards smaller and less advanced countries in the region, especially in the more traditional sectors. At the same time, an extensive process of delocalisation of various production phases has occurred within the region, from the newly industrialised countries toward the relatively less advanced ones.

Involvement in GVC is measured using two indicators that compute the share of foreign value added embodied in a country's export (FVX, backward indicator), and the share of domestic value added of a given country embodied in the export of another country or of the rest of the world (DVFX, or forward indicator). A country, which is downstream in a production chain, will display a high value of the FVX index, while upstream countries should have a high value of the DVFX index.

As a region, East and South East Asia backward involvement in GVC is growing at a fast rate, moving from 10.2 % in 1995 to 18.1 % in 2011. In this time frame, this indicator for China remained stable at about 32 %, while it increased for some countries, especially for Malaysia, Taiwan, Vietnam, Cambodia, and Korea.

The reasons for these changes are very different. Some countries received production phases previously delocalised from advanced countries in other countries in the region (for example this was frequently true Cambodia and Vietnam). Other countries started themselves to delocalise production abroad and in this way saw an increase of foreign value added in their export, this was the case for the newly industrialised countries like Korea and Taiwan.

For the area as a whole (excluding within area flows), forward involvement in GVC, i.e. Asian value added in foreign export at the world level, remained constant at around 16 % from 1995 to 2011. But the position of different countries in the region changed markedly. Chinese value added in foreign exports grew from 9.5 % to 15.6 % over the period, Indonesia went to 16.2 % to 31.5 %, Japan reach 32.8 %, and Philippines 27.4 %, showing the scattering of the GVCs among countries of the area. Elsewhere in South Asia, India, increased its share from 13.6 % to 19.1 % between 1995 and 2011.

European Union Member States are among the most important partners of Asia in these GVC. At the world level, the Euro Area involvement in GVC (considering only flows outside of Euro area) measured in terms of FVX is approximately 20 %, higher than the similar measure for other advanced economies, and growing over time.

In 2011, for the Euro Area taken as a whole, GVCs were as important as in China and more important than in the US and Japan. GVC tend to be geographically concentrated, and for the Euro Area the largest contributions to production come from the rest of Europe. The Eastern EU Member States (Bulgaria, Czech Republic, Hungary, Lithuania, Latvia, Poland and Romania) have increased their relevance as origins of value added in Euro Area exports. But, in spite of the distance, Asia plays an important and growing role, and in 2011 Asian value added embodied in Euro Area exports was approximately equivalent to the value added coming from other European Member States. Asia (excluding China) shows a stable share (average of 1.8 % in the period), while China recorded a very significant increase (from 0.6 per cent in 2000 to 2.1 per cent in 2011), surpassing that of Eastern EU Member States. Still, being at a level below 2 % of the value added for many European Member States, the role of China should not be overestimated.

In terms of sectors, the indices show that Asian involvement in European GVC is particularly relevant in electronics and electrical equipment, in textiles, apparel and leather goods, as well as in transport equipment.

Influenced by the growing weight of Asia - and specifically China - in global trade and the shift of the centre of gravity of intra-APEC trade to Asia – and China in particular - a **proliferation of RTA/FTAs has started since the 2000s in Asia-Pacific**, which now accounts for around 53 % of all RTA/FTAs. Compared to 2000, when 40 agreements had been signed by APEC economies (most of which with third countries), the total number of agreements signed by APEC economies has almost quadrupled (from 40 to 157 signed by December 2014), of which half (58) are intra-APEC and half (59) between APEC economies and third countries. Overall, the number of RTA/FTAs signed and in force by APEC economies has increased by more than 20 times since the 1990s.

The difficulties encountered during the **WTO multilateral trade negotiations** known as the Doha Development Agenda (DDA) Round, and the failure to successfully conclude these negotiations by the original 2005 deadline, were some of the main drivers explaining the sudden increase in RTA/FTAs. As multilateral negotiations showed no sign of progress, more bilateral, plurilateral and regional initiatives started to emerge around the world. In parallel with bilateral negotiations for free trade agreements, India has been a pro-active player within the WTO, often promoting the interest of emerging countries. China has so far not been a very pro-active negotiator within the WTO, but its entry into the organisation has certainly contributed to the expansion of its trade.

Besides bilateral agreements, **regional mega-deals** have been signed or are currently being negotiated among Asia-Pacific countries. As many of the countries involved in regional agreements are already linked with one another by bilateral agreements, the potential impact of RTAs is likely to be limited in terms of further concessions granted. However, these mega-deals are changing the landscape of international trade agreements to a major extent, with important implications for global economic relations.

Some of the major mega-deals – most notably the **Trans-Pacific Partnership (TPP)** – appear to be more political initiatives aimed at reshaping the future patterns of economic integration. More specifically, the TPP, announced on 5 October 2015, is unprecedented in scope, because the 12 signatory countries (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam) represent 800 million inhabitants and account for around 2/5 of world GDP. The impact of trade liberalisation will be fairly limited however, also for European exporters, due to the fact that the signatory countries already have in place a number of bilateral FTAs between one another and over 3/4 of trade between TPP members is already duty free. According to some studies, the auto industry is perhaps the single sector for which tariff cuts included in the agreement are of major importance. Import duties on cars exceed 30 % in three major TPP markets. But the TPP contains much more than just tariff reductions. It also includes ‘deeper integration’ policies that may have major implications for multinational car-makers. The scope of TPP will go far beyond the traditional chapters included in RTAs. Most importantly, it will foster economic integration among selected partner countries – most notably United States and NAFTA more in general with Japan – to the detriment of other important trade partners, such as China and South Korea (which will thus have an incentive to sign their own FTAs with third countries). The overall landscape of trade agreements does not seem to be heading towards multilateralism, but towards balkanisation of trade relations.

Unlike Europe or North America, regional economic integration in East and Southeast Asia was **more market that institution-driven**, in the sense that integration was prompted by actors seeking economic gains from deepening regional economic interdependence through trade and investment liberalisation, without regional institutions in the form of RTAs. Recently, however, the major actors in Asia-Pacific have been very active in negotiating institution-driven RTA/FTAs. Both intra- and interregional trade agreements are proliferating in recent years. After 2000, China put into force seven intra-APEC RTA/FTAs with 13 APEC members. Japan has done the same with 12 intra-APEC RTA/FTAs covering 11 APEC members. Similarly, Korea enforced six intra-APEC RTA/FTAs with 11 APEC economies. Other APEC economies also started to actively engage in RTA/FTAs.

China has also signed new free trade agreements with Korea and Australia on 1 June 2015 and 17 June 2015, respectively, and which are expected to be implemented shortly.

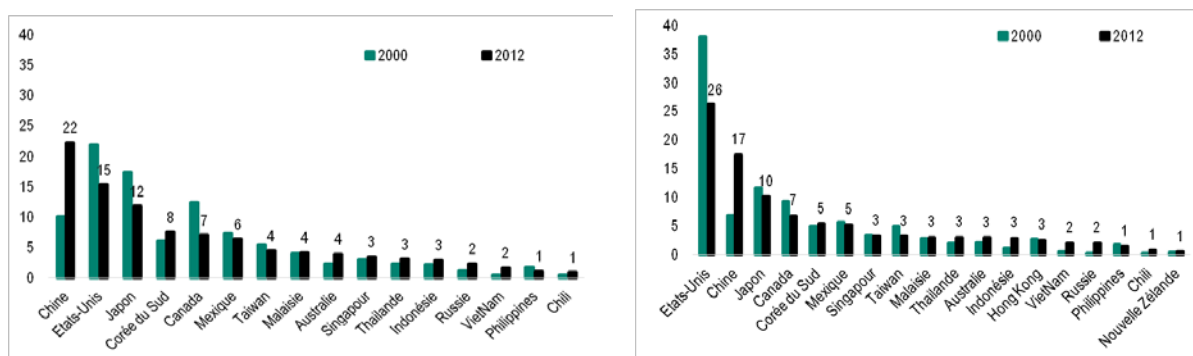
A recent initiative that could activate further trade links is the **One-Belt-One-Road (OBOR) initiative**, including six corridors across Eurasia, where a number of China-led infrastructure facilities are already in place. The OBOR initiative has a major strategic logic, which is to reduce China’s dependence on US secured chokepoints. In fact, China's economy is dependent on foreign trade, 90 % of which travels by sea.

The economic logic that lies at the heart of OBOR is one of supporting China's economic rebalancing. OBOR has the aim to reinvigorate China's slowing economy by shifting its industry away from the coast to the relatively underdeveloped inland provinces. The economic impact beyond trade, though, is likely to be important. The OBOR initiative is intended to open up new markets for Chinese goods and services.

1 The growing importance of Asia in world growth and trade

Asia has become a new engine of global growth: whereas the United States' economy grew by an average of 1.6 % a year over the past decade, the European Union's by 1.7 % and Latin America's by 4.6 %, East Asia expanded by 5.4 % and South-East Asia by 5.9 %. As a result, Asia has considerably increased its regional share on world GDP over the past decade compared to other world regions. As the economic dynamism of Asian economies is expected to continue (OECD, 2015), the Asian share on world GDP is projected to reach 29.4 % in 2030 (up from 22.6 % in 2004, according to ADB, 2015). At the same time, the shares of Western Europe and the United States are both projected to decrease to 25 % in 2030 (from 33 % and 28.5 % respectively in 2004). Within Asia, all countries but Japan are expected to increase their weight in world GDP, the faster-growing Asian developing economies will account for considerably larger shares of the projected global economy over the next 2 decades (from 11 % to 22 %).

Figure 1. Country shares of intra-APEC exports and imports



Source: Lemoine (2014), <http://www.cepii.fr/BLOG/bi/post.asp?IDcommuniqu=346>

Asia is also the most dynamic region in world trade. Since the 1970s the vast majority of world trade has progressively moved from the Atlantic to the Pacific, and today the 21 economies of the largest trans-Pacific grouping, Asia-Pacific Economic Cooperation (APEC), account for nearly half of global trade. According to a CEPII study (Lemoine, 2014), for all APEC countries but Russia, intra-APEC trade is higher than 60 %. The three largest APEC countries – United States, Japan and China – account for half of intra-APEC trade and trade among those three countries represent 2/3 of total trade by all 21 APEC countries (Figure 1). The centre of gravity of intra-APEC trade has substantially changed over the last 15 years. In 2000 intra-APEC trade was fairly balanced (1/3 intra-America, 1/3 intra-Asia and 1/3 America-Asia).

Today, trade linkages between the two sides of the Pacific lost ground (as the share of America-Asia trade declined from 31 % to 26 % of intra-APEC trade, while intra-Asia trade increased to 41 % and intra-America trade declined to 21 %). Within Asia, China has become the largest trading country as the largest exporter in the region (with 22 % of intra-regional exports) and the largest importer (with 17 % of intra-regional imports). Therefore, China has become a central actor, certainly within APEC (replacing the United States) but also worldwide, given the importance of APEC trade in world trade.

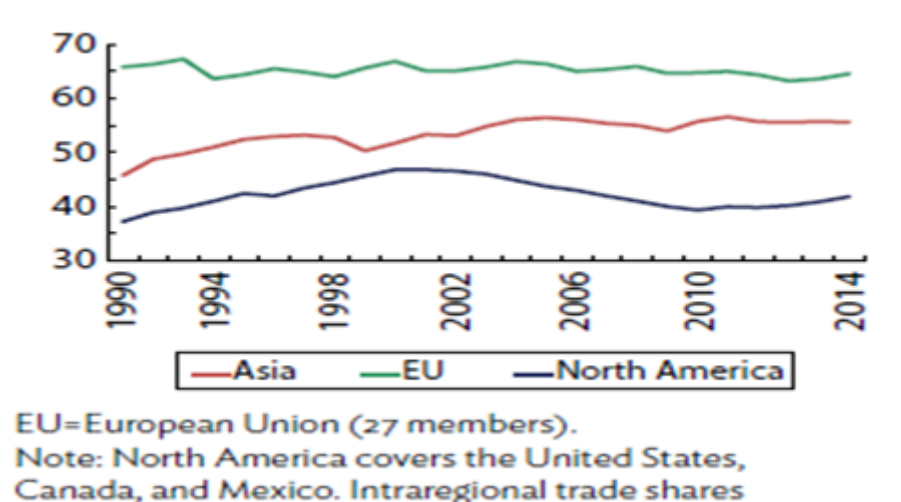
Focusing on Asia as a whole, its share of world **merchandise** exports has increased from 19.1 % in 1983 to 32 % in 2014 and its share of world merchandise imports from 18.5 % in 1983 to 31.5 % in 2014.

Within Asia, China has become the largest trading country. In 2014, it has been the world largest exporter of merchandise, with a share of 15.6 %, ahead of EU28, with a share of 15.1 % (intra-EU exports excluded). On the import side China in 2014 was the third largest importer of merchandise with a world share of 13 %, behind the US (16 %) and the EU (14,6 %).

For **commercial services**, Asia in 2014 had a relevant share of world exports (25.4 %) compared to Europe (48.3 %) and the North American (16.3 %). Similarly for commercial services imports, the Asian share was 28.5 %, compared to 42 % of Europe and 12.5 % of North America.

Asian intra-regional trade (measured as imports plus exports) as a share of total area trade has increased from 45 % in 1990 to 55 % in 2014 (Figure 2). Over the same period EU intra-regional trade has remained stable around 65 % and the North American one has slightly increased from 35 % to 40 %.

Figure 2. Intra-regional trade shares (%)



Asian countries are important **partners** for EU international trade. On EU's export side, China is the second partner (with a share of 9.7 %) behind the US (18.3 %). Other important Asian partners are Japan (sixth with 3.1 %), South Korea (eighth with 2.5 %), India (eleventh with 2.1 %) and Hong Kong (thirteenth with 2 %).

On the import side, China is the first supplier of goods to the EU (share of 17.9 %); Japan is the sixth (3.3 %), South

Table 1. Manufacturing export share by technology level (% of country total exports)

+3 Economies	1990	2000	2014	1990	2000	2014	1990	2000	2014	1990	2000	2014
PRC	10.9	22.4	30.6	12.4	19.0	24.4	11.2	13.4	15.8	54.3	41.0	28.0
Japan	29.8	31.7	18.5	50.4	48.8	54.1	12.5	11.2	17.4	5.5	4.2	3.5
Korea, Rep.	27.1	36.8	27.0	26.1	26.4	39.5	19.1	20.9	28.1	26.4	15.1	4.9
India	4.1	4.7	8.6	11.5	13.5	18.0	8.9	13.2	32.4	58.8	61.0	35.0
ASEAN-4												
Indonesia	1.0	13.2	5.1	3.3	10.3	15.0	11.9	10.8	11.2	35.6	36.6	35.0
Malaysia	31.3	58.5	33.0	6.9	10.1	16.4	8.9	8.2	19.0	24.3	13.4	16.0
Philippines	52.3	70.7	43.6	8.2	7.3	18.9	7.2	4.5	8.5	27.9	14.9	18.1
Thailand	17.2	31.1	19.2	8.5	20.2	35.9	6.2	10.5	16.9	55.8	30.8	22.5

PRC = People's Republic of China.

Note: Starting year for the Republic of Korea is 1994; the PRC 1992; and the Philippines 1996. See Table 3 for list of industries belonging to each technological level

Source: ADB (2015)

Given the rapid industrialisation trends in developing Asian economies as well as the projected increase in per capita income, the **Asian pattern of trade** will change quite substantially. In manufacturing products the pattern of trade of Asian countries has already changed considerably over the last twenty-five years (Table 1), typically moving up the value chain toward products with higher technology intensity. For example, in 1990 more than 50 % of exports from China, India and Thailand were in low technology products. By 2014, this share had gone down to less than 30 % in China and Thailand and to 35 % in India. Indonesia, on the contrary, has maintained a stable high share of low technology exports at around 35 %. Overall, this a considerable modification in the pattern of specialisation, even if one should keep in mind that these shares are based on gross exports and not domestic value added in exports.

Developing Asia's share of primary products in world imports can be expected to rise substantially, due to expected continuing rapid industrialisation. Given the political sensitivity of farm products, it is worth noting that regional shares of global trade in agricultural and food products are projected to undergo substantial change. While the developing countries' share of exports of these goods is projected to remain virtually unchanged, their share of global imports of farm products is expected to rise dramatically, mainly due to the rise in China and India.

These economic growth trends, together with the structural changes and industrialisation occurring in developing Asia and the rest of the world, are likely to exert profound changes on trade patterns over the next two decades. A key feature will be the changes in the importance of Asia's intraregional trade and its trade with the rest of the world. Specifically, according to some estimates based on the GTAP model (Anderson and Strutt, 2011) the developing country share of global exports of all products will almost double, rising from 33 % in 2004 to 55 % by 2030, and the share of developing Asia will increase from 21 % to 40 % over the same years. China's share alone is projected to grow from 7 % to 20 %, entirely at the expense of high-income countries. Developing Asia's import share also rises from 18 % to 29 %.

This increasing weight of Asia – and specifically China - in global trade and the shift of the centre of gravity of intra-APEC trade to Asia – again specifically China –, has been accompanied by a proliferation of RTA/FTAs in Asia in the 2000s.

2 The role of global value chains in Asia

The relevance and diffusion of global value chains (GVC) has been growing rapidly over the past decade, and this is particularly evident in the case of Asia, which is a key player in the new international division of labour in a number of industries.

To substantiate this evidence, we consider the GVC participation index, based on the use of foreign inputs embodying foreign value added in the domestic production of exported goods and services. This indicates the extent to which a country is involved in a vertically fragmented production process (see De Backer and Miroudot, 2014; Koopman et al, 2014). In Table 2, one can observe that, measured with this index, the involvement in this type of organisation of production has increased worldwide since 1995. The expansion was particularly significant between 1995 and 2005. There was a decline in 2009 related to the international crisis and the trade collapse, followed by a rebound.

Table 2. GVC participation index

Backward participation index + Forward Participation index (%)							
	1995	2000	2005	2008	2009	2010	2011
Brunei Darussalam	28.3	38.0	42.5	47.2	40.8	45.8	47.0
Cambodia	30.7	46.5	50.8	51.5	46.6	48.7	48.7
Indonesia	28.8	40.2	42.0	42.2	39.2	41.8	43.5
Malaysia	46.1	63.6	62.2	60.4	58.8	61.2	60.4
Philippines	42.9	51.7	60.1	59.1	53.8	55.2	51.0
Singapore	54.7	63.6	60.6	59.0	60.7	61.2	61.7
Thailand	36.3	46.9	53.1	54.9	50.6	53.3	54.4
Vietnam	34.4	46.7	49.2	52.9	49.7	51.5	52.3
ASEAN (Intra + extra)	42.4	54.9	55.5	54.9	53.0	54.8	54.8
China	42.9	48.1	50.7	48.5	45.4	47.2	47.8
Hong Kong	37.5	39.0	42.1	46.2	42.5	44.2	43.6
Japan	29.4	37.3	43.1	47.6	43.8	45.7	47.5
Korea	39.4	50.6	57.7	63.7	59.0	61.3	62.2
Taiwan	46.5	53.5	64.5	69.7	64.2	67.2	67.7
East Asia (intra + extra)	35.7	44.2	50.5	52.2	48.6	50.6	51.5
East and South East Asia (intra + extra)	37.3	46.9	51.6	52.8	49.6	51.6	52.3
India	23.0	29.6	36.9	42.0	38.6	41.1	43.2
EU28 (intra + extra)	37.9	44.6	46.7	49.9	45.5	48.5	51.0
USA	30.9	37.0	38.1	40.4	35.8	38.3	39.9

Source: Authors' elaboration on OECD-WTO TiVA database

Involvement in GVC is measured by the sum of two indicators that compute the share of foreign value added embodied in a country's export (FVX, backward indicator), and the share of domestic value added of a given country embodied in the export of another country or of the rest of the world (DVFX, or forward indicator). A country downstream in a production chain will display a high value of the FVX index, while upstream countries should have a high value of the DVFX index.

As a region, East and South East Asian backward involvement in GVC is growing at a fast rate, moving from 19.5 % in 1995 to 31 % in 2011 (see Table 3).

Table 3. Backward and Forward Participation in GVC

	Backward participation			Forward participation		
	FVA embodied in exports (% of total gross exports)			DVA embodied in foreign exports (% gross exports)		
	1995	2008	2011	1995	2008	2011
Brunei Darussalam	7.3	3.8	4.3	21.0	43.4	42.7
Cambodia	12.7	42.0	36.8	18.0	9.5	11.9
Indonesia	12.6	14.6	12.0	16.2	27.6	31.5
Malaysia	30.5	41.2	40.6	15.6	19.2	19.8
Philippines	30.1	31.9	23.6	12.8	27.2	27.4
Singapore	42.4	37.5	41.8	12.3	21.5	19.9
Thailand	24.3	39.3	39.0	12.0	15.6	15.4
Viet Nam	21.3	35.4	36.3	13.1	17.5	16.0
ASEAN (extra area)	24.4	29.3	28.2	12.5	20.2	20.5
China	33.4	31.8	32.2	9.5	16.7	15.6
Hong Kong	21.7	22.0	20.4	15.8	24.2	23.2
Japan	5.6	15.8	14.7	23.8	31.8	32.8
Korea	22.3	41.8	41.7	17.1	21.9	20.5
Taiwan	30.7	44.2	43.6	15.8	25.5	24.1
East Asia (extra area)	10.0	20.2	21.2	17.9	19.1	18.2
East and South East Asia (extra area)	10.2	17.7	18.1	15.1	16.8	16.0
East and South East Asia (intra + extra area)	19.5	30.6	31.0	17.8	22.2	21.3
IND: India	9.4	22.7	24.1	13.6	19.3	19.1
FRA: France	17.3	24.8	25.1	17.9	21.6	21.9
DEU: Germany	14.9	24.8	25.5	20.7	23.6	24.1
ITA: Italy	17.2	25.8	26.5	15.4	20.3	21.1
ESP: Spain	19.2	27.6	26.9	14.3	18.6	19.7
GBR: United Kingdom	18.3	19.5	23.1	19.0	25.5	24.7
EU28 (extra area)	7.4	13.4	14.3	14.5	19.1	19.4
EU28 (intra + extra area)	20.0	28.0	28.6	17.9	22.0	22.4
USA: United States	11.5	15.6	15.0	19.4	24.8	24.9

Source: Authors' elaboration on OECD-WTO TiVA database

In this time frame, the indicator for China stayed stable at about 32 %, while it increased especially for Vietnam, Cambodia, Malaysia, Taiwan and Korea, showing that for the last three countries, the foreign value added embodied in their exports constitutes more than 40 % of the total value of gross exports. This indicates that these countries are very important in downstream production phases, as assembly and export platforms for other countries. Japan shows a remarkable increase as well, but it stays on much lower levels.

Table 3 presents also the forward participation index. The reading of the forward indicator needs some care, as this index tends to be very high for countries that export large amounts of raw materials and commodities that enter in downstream manufacturing production, and therefore it cannot be directly understood as a sign of participation in GVCs as such. This is the case for Brunei, and to some extent also for Indonesia and Malaysia. Leaving these countries aside, the DVFX index is high and growing for the most industrialised countries of the area, first of all Japan, but also for Hong Kong, Taiwan, Korea and Singapore. For East and South East Asia as a whole (excluding within area flows), upstream involvement in GVC, i.e. Asian value added in foreign export at the world level, remained constant at around 16 % between 1995 to 2011. But the position of individual countries in the region changed remarkably. Chinese value added in foreign exports grew from 9.5 % to 15.6 % in the same period (still relatively low),

Japan reaches 32.8 %, and Philippines 27.4 %, showing the diffusion of the GVCs among countries of the area. These countries are becoming important suppliers of intermediate inputs for stages of production taking place in other countries. Outside the above-mentioned group there is India, which increased from 13.6 % to 19.1 % between 1995 and 2011.

The reasons for these changes are very different, and also related to a partial geographic reorganisation of the GVCs concerned. While the area as a whole grew in its relevance for GVC, the choice of Asian partners in production sharing on the part of advanced countries (Europe, North America, Japan) has changed over time, moving in part away from China and toward smaller and less advanced countries in the region (see the dynamic of the backward participation index in Table 3). Some countries increased their role as recipient of inputs, receiving production phases previously delocalised from advanced countries to other countries in the region (this appears to be the case for Cambodia and Vietnam). At the same time, an extensive process of delocalisation of stages of production has also occurred within the region, from the newly industrialised countries toward the relatively less advanced ones, as the increase in the intra-area indicators in Table. 2 suggests. Asian countries, such as Korea and Taiwan, started themselves to delocalise production abroad and in this way saw an increase of foreign value added in their export.

Backward integration of East and South East Asia was, in 2011, slightly higher than in the EU (excluding intra-area trade) and in the USA (respectively, 18.1 % versus 14.3 % and 15 %). On the other hand as might be expected, forward integration is higher in the USA (24.9 %) and the EU (19.4) than in East and South East Asia (16 %).

For India the degree of backward integration has increased considerably over the last fifteen years (from 9.4 % in 1995 to 24.1 % in 2011), but it is still lower than that of the other dynamic Asian countries (for example, in 2011, backward integration for China was 32.2, for Korea 41.7 and for Taiwan 43.6). But India is more forward integrated than China (in 2011, respectively, 19.1 versus 15.6) and slightly less than Korea and Taiwan (respectively, 20.5 and 24.1).

Also because of these changes, Asian GVC experienced an increase in intensity of regional flows, and countries of the region are the main source of foreign value added for exports of Asian countries (Tab. 4). While in 1995 the main country in Asian GVCs was Japan (for example, accounting for 27.7 % of ASEAN foreign value added in exports), today China in particular plays a pivotal role, being for many countries in the region the single most relevant source of foreign value added, even if Japan is still in a key position as a source of value added. For example, China accounts for 12.6 % of ASEAN foreign value added in exports, compared to 13 % of Japan. China stands out also in terms of forward links for many countries, confirming its key position as an assembly point for the region. In fact, China represents 30.2 % of ASEAN and 31.8 % of Japanese domestic value added contained in foreign exports (Tab. 5)¹.

¹ More detailed information for single East and South East Asian economies are contained in Appendix A.

Table 4. Foreign Value Added in Exports (geographical origin), selected countries, 1995-2011

Exporter	ASEAN (extra)		East ASIA (extra)		China		Japan		India	
	1995	2011	1995	2011	1995	2011	1995	2011	1995	2011
DVA in Exports (% of gross exp.)	75.4	71.6	89.9	78.6	66.7	67.9	94.4	85.4	90.7	76.0
FVA in Exports (% of exports)	24.6	28.4	10.1	21.4	33.3	32.1	5.6	14.6	9.3	24.0
<i>Geographical distribution (origin of value added)</i>										
FVA in Exports (=100)	100	100	100	100	100	100	100	100	100	100
ASEAN	-	-	12.6	13.6	6.3	9.6	11.8	11.8	5.5	7.6
East Asia	41.9	35.2	-	-	46.7	30.6	14.4	21.7	13.1	14.5
China	2.0	12.6	-	-	-	-	3.8	14.7	1.4	8.5
Hong Kong	2.0	1.3	-	-	4.7	1.6	1.2	0.6	1.1	0.7
Japan	27.7	13.0	-	-	23.7	14.7	-	-	7.0	2.6
Korea	5.7	4.7	-	-	8.9	8.3	5.8	4.2	2.5	1.8
Taiwan	4.5	3.6	-	21.1	9.4	6.0	3.6	2.3	1.1	1.0
East and South East Asia	41.9	35.2	12.6	13.6	53.0	40.2	26.2	33.5	18.6	22.1
India	1.1	3.8	0.9	2.7	0.4	2.0	0.8	1.2	-	-
USA	17.6	11.2	26.3	13.0	11.9	9.4	22.8	10.8	11.0	9.2
EU28	20.1	16.3	27.4	21.2	17.1	17.0	20.8	12.8	25.0	14.2
Australia	3.6	4.0	5.2	6.4	2.2	3.9	5.1	6.5	3.3	3.9
Rest of the world	15.8	29.4	27.6	43.1	15.4	27.4	24.2	35.2	42.2	50.5

Source: Authors' elaboration on OECD-WTO TiVA database

Among the large countries, much less relevant is the role of India, whose backward and forward links with the rest of 'factory Asia' appear much weaker.

At the same time, East and South-East Asia considered as a whole have also become more globalised, as we can see in Table. 3. Excluding intra-regional flows, foreign value added coming from the rest of the world has increased remarkably over time (from 10.2 % in 1995 to 18.1 % in 2011), indicating that production ties with other regions have also expanded.

The production links with Asia confirm the growing involvement of the EU in GVCs. At the world level, the EU involvement in GVC (considering only flows outside the EU) measured in terms of FVX is approximately 14.3 % in 2011, compared to 7.4 % in 1995 (Table. 3).

European Union Member States are today among the most important partners of Asia in these GVC. For many Asian countries, EU28 is the most important source of foreign value added. On average, about one fifth of extra area foreign value added embodied in Asian exports is originated in Europe (for East Asia in 2011, 21.2 % of the foreign value added embodied in exports originates in the EU, higher than the 13 % originated in the US) (Table. 4). The share of European value added in exports is especially high for Singapore (19.1 %), Malaysia (13.5 %), Hong Kong (15.7 %) and China (17 %) (Table. 4, A1b and A2b). But the role of the EU, however, has been decreasing since 1995 due to the strong increase of value added originated in the rest of the world.

The EU is even more relevant in terms of forward linkages. As a foreign recipient of Asian value added, the EU share is about one third (32.4 % of East Asian value added in 2011), about 2.5 times the USA (Table. 5). Within the EU, most of these production links are with the older EU Member States, where the largest share of European production capacity and demand are concentrated. Germany in particular operates as hub for other EU countries in connecting the continent with Asia.

Table 5. Domestic Value Added in Foreign Exports (geographical distribution), selected countries

Country of origin	ASEAN (extra)		EASIA (extra)		China		Japan		India	
	1995	2011	1995	2011	1995	2011	1995	2011	1995	2011
DVA in Foreign Exports (% of gross exports)	12.5	20.5	17.9	18.2	9.5	15.6	23.8	32.8	13.6	19.1
<i>Geographical distribution (foreign exporter)</i>										
DVA in Foreign Exports	100	100	100	100	100	100	100	100	100	100
ASEAN (intra + extra)	-	-	26.2	24.1	11.7	13.7	18.8	14.9	15.4	15.3
East Asia	38.5	57.3	-	-	36.1	23.4	29.9	51.5	16.8	25.6
China	9.1	30.2	-	-	-	-	9.8	31.8	3.7	14.7
Hong Kong	2.6	1.2	-	-	14.0	2.2	1.9	0.8	1.5	1.0
Japan	9.7	7.6	-	-	7.6	6.3	-	-	4.3	1.8
Korea	8.0	11.3	-	-	8.2	9.6	7.5	10.6	4.1	5.4
Taiwan	9.0	7.0	-	-	6.2	5.4	10.7	8.3	3.3	2.7
East and South East Asia	38.5	57.3	26.2	24.1	47.8	37.1	48.7	66.4	32.2	40.9
India	0.6	4.2	0.4	3.2	0.4	3.0	0.2	1.0	-	-
USA	17.1	5.0	24.8	13.1	13.5	10.1	18.4	6.8	8.5	5.8
EU28 (intra + extra)	29.7	17.7	29.7	32.4	23.9	27.9	20.6	13.3	36.0	33.3
Australia	2.8	4.4	1.6	1.6	1.1	1.2	1.1	0.8	1.1	0.6
Rest of the world	11.3	11.4	17.4	25.7	13.3	20.8	11.1	11.7	22.2	19.3

Source: Authors' elaboration on OECD-WTO TiVA database

From the point of view of the EU, as for many other areas, GVCs tend to be geographically concentrated, and for EU Member States most foreign value added trade is intra area (see Amador et al. 2015). An imperfect measure of this is the domestic value added in total exports. In 2011 domestic value added in the EU is 85.7 %. It is very high, but decreasing with compared to the 92.6 % it was 1995 (see Table 3; these numbers are obtained calculating the complement to one hundred of the corresponding number in the table). For Europe also, an intensification of regional ties has developed together in parallel to the greater globalisation of production chains (Los et al. 2015).

Even more important for the EU is the role of Asia as a destination of its own domestic value added. In 1995, the US was the most relevant individual partner in terms of backward participation, accounting for 15.7 % of EU value added embodied in foreign exports, with the region of East and South-East Asia accounting for 31.6 % (Table 6). In 2011 the most important single partner is China, with a share of 20 % and East and South-East Asia exports accounted for 42.2 % of EU value added in foreign exports.

Table 6. DVA in foreign exports and FVA in exports for EU28 (geographical distribution)

	EU DVA in foreign exports		FVA in EU exports	
	1995	2011	1995	2011
total	14,5	19,4	7,4	14,3
	<i>destination of VA</i>		<i>origin of VA</i>	
total	100	100	100	100
ASEAN	11,8	10,4	5,4	3,9
East Asia	19,7	31,8	20,4	17,8
China	6,1	20,0	1,8	9,5
Hong Kong	1,3	0,8	0,9	0,6
Japan	4,2	3,1	13,2	4,5
Korea	3,8	5,3	2,6	2,1
Taiwan	4,3	2,7	2,0	1,1
East and South East Asia	31,6	42,2	25,7	21,7
India	0,7	2,9	1,0	3,2
USA	15,7	10,4	25,8	18,0
Australia	1,8	1,3	1,4	1,1
Rest of the world	50,2	43,2	46,0	56,0

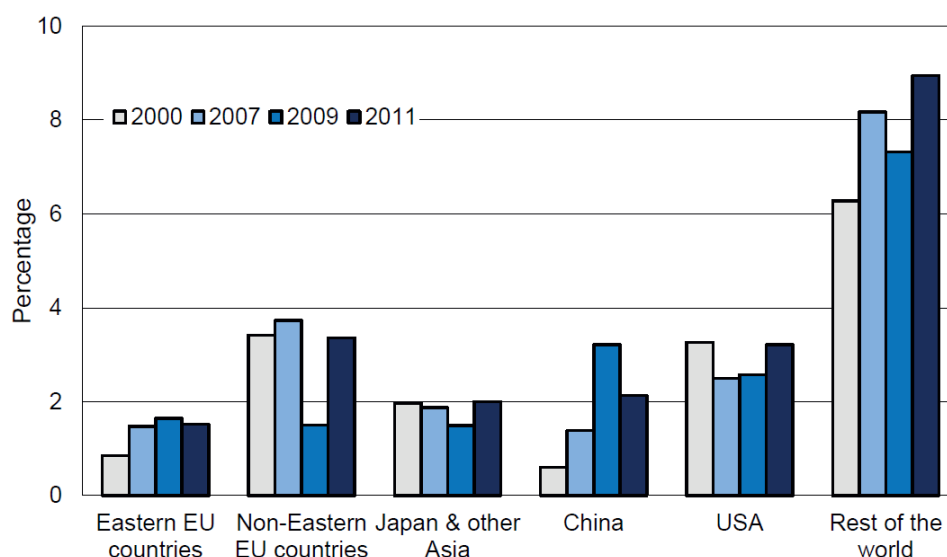
Source: Authors' elaboration on OECD-WTO TiVA database

Table 6 shows also the percentage composition of foreign value added in EU exports. Between 1995 and 2011 there has been a substantial change in the relative contribution of the partner countries. Even if the US remains the largest contributor, their share dropped from 25.8 % to 18 %. China increased substantially its share from 1.8 % to 9.5 %. Notwithstanding this, the East and South East Asian share dropped from 25.7 % to 21.7 %, due to the reduction in the Japanese share from 13.2 % to 4.5 %.

Taking a slightly different perspective and using the Euro Area as a reference, Amador et.al. (2015) show that the Eastern EU Member States (Bulgaria, Czech Republic, Hungary, Lithuania, Latvia, Poland and Romania) have increased their relevance as sources of total value added in the Euro Area exports at least up to 2009 (Figure 3). The strengthening of supply chains with eastern economies has been driven by increasing investment flows from Eurozone multinational firms into these countries, which became EU members in either 2004 or 2007.

Nevertheless, Asia plays an important and growing role, and in 2011 Asian value added embodied in Euro Area exports was approximately 4 % slightly lower than the 6 % value added coming from other EU Eastern Member States (Figure 3). The growth is due in particular to China. Between 2000 and 2011, Chinese value added in Eurozone exports recorded such a significant increase (from 0.6 % in 2000 to 2.1 % in 2011) that it surpassed that of eastern EU Member States. Still, at a level below 2 % of the value added for many European countries, the role of China should not be overestimated.

Figure 3 Eurozone as whole: foreign value added in export by origin



Note: Eastern EU countries: Bulgaria, Czech Republic, Hungary, Lithuania, Latvia, Poland and Romania; non-eastern EU countries: The UK, Denmark and Sweden; Japan & other Asia: Japan, Indonesia, India, Korea and Taiwan.

Source: Amador et al. 2015

At world level, among the **industries most involved in GVCs** are electrical and optical equipment, textiles, apparel and leather goods, and transport equipment (see De Becker and Miroudot, 2014). This is confirmed also for Asian countries. Tables 6, 7 and 8 report backward and forward participation indices for the above mentioned industries in 1995 and 2011.

Table 7. Textiles, textile products, leather and footwear: backward and forward linkages

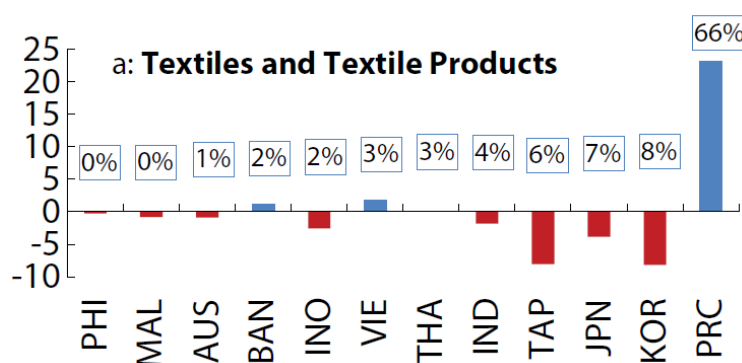
BACKWARD LINK	1995					2011				
	FVA (% of exports)	of which:				FVA (% of exports)	of which:			
		EU28	USA	ASEAN	EASIA		EU28	USA	ASEAN	EASIA
Indonesia	17.1	18.7	10.5	7.2	46.4	18.2	9.0	5.2	13.9	37.0
Malaysia	37.4	18.4	9.1	13.9	40.3	49.2	13.7	7.4	16.2	38.5
Philippines	32.7	12.0	10.2	9.6	56.3	15.6	9.5	6.6	12.5	42.8
Thailand	18.1	20.4	11.2	8.9	39.6	25.9	14.3	7.3	12.0	31.9
Viet Nam	35.5	9.7	3.7	9.7	69.2	37.5	11.6	5.8	13.7	45.0
China	43.3	12.3	10.1	4.8	56.0	26.5	17.8	10.7	9.4	25.0
Japan	7.8	24.1	14.5	10.4	32.9	24.0	13.7	7.8	8.5	46.3
Korea	21.3	21.9	15.7	7.3	31.9	35.3	13.1	9.6	9.4	30.6
India	9.8	25.6	10.8	6.4	15.3	19.8	20.1	10.8	8.7	21.3
FORWARD LINK	1995					2011				
	DVA in foreign exports (%)	of which:				DVA in foreign exports (%)	of which:			
		EU28	USA	ASEAN	EASIA		EU28	USA	ASEAN	EASIA
Indonesia	6.3	36.6	12.3	13.0	19.8	8.7	23.6	11.2	13.4	33.4
Malaysia	5.8	22.7	11.4	32.2	20.0	4.8	13.6	5.8	27.9	34.0
Philippines	3.3	26.4	39.8	4.2	14.0	7.0	20.0	18.9	7.8	37.0
Thailand	6.6	31.6	13.4	11.8	26.0	12.4	17.1	4.9	13.8	36.6
Viet Nam	4.9	53.9	1.7	4.2	29.4	5.1	24.9	11.5	7.5	41.5
China	3.3	24.1	12.9	6.4	36.3	4.8	34.5	10.3	10.5	19.6
Japan	22.9	3.7	9.9	12.0	63.4	23.0	7.5	2.8	9.0	73.7
Korea	6.9	9.4	6.4	13.6	51.8	13.2	9.8	3.7	14.5	59.9
India	3.8	45.7	8.5	5.4	10.3	4.3	38.4	7.3	6.8	22.6

Source: Authors' elaboration on OECD-WTO TiVA database

Note: Backward linkage: FVA (all industries) in textile exports. Forward linkage: DVA (textile) in total foreign exp.

Notwithstanding these changes if we consider only intra area trade, and here China still plays a very important role. China's shares of domestic value added in total intra area exports was 66 % in 2011 an increase with respect to 2000 (Figure 4a). It is interesting to note the rising role of Vietnam and Bangladesh in the last ten years. On the other hand the share of most other Asian players declined.

Figure 4a. Shares of intraregional domestic value added exports (2011 vs 2000)



Source: ADB (2015);

Note: y-axis = difference in shares 2011 vs 2000; box numbers = shares as of 2011

The case of the backward links in the electronics sector is especially striking, as for many Asian countries foreign value added contributes to over half to the gross value of exported goods (Table 8). For China this share has decreased from 72.5 % in 1995 to 53.8 % in 2011. This is observed also for the exports in motor vehicles for a number of Asian countries (Table 8). In both these industries, the indicator of backward participation has increased for many countries, but again not for China.

Table 8. Electrical and optical equipment: backward and forward linkages

BACKWARD LINK	1995					2011				
	FVA (% of exports)	of which:				FVA (% of exports)	of which:			
		EU28	USA	ASEAN	EASIA		EU28	USA	ASEAN	EASIA
Indonesia	34.1	30.6	12.8	7.7	30.9	26.7	12.8	6.9	14.1	38.6
Malaysia	46.8	19.1	14.9	11.0	42.4	66.4	15.0	14.7	14.2	39.8
Philippines	50.0	13.8	22.7	7.7	45.6	28.4	10.0	17.1	13.4	41.5
Thailand	48.6	16.2	16.3	10.3	44.3	62.5	12.0	8.4	11.3	46.9
Viet Nam	55.3	14.0	6.2	15.2	56.4	69.2	11.1	6.4	11.5	50.7
China	72.5	20.0	12.3	4.1	49.9	53.8	17.3	9.7	10.9	40.1
Japan	6.8	19.0	27.6	12.6	18.1	16.9	13.3	13.0	11.4	33.3
Korea	27.8	13.7	22.1	6.7	42.4	41.8	13.3	12.0	9.1	40.8
India	15.3	27.9	10.5	4.2	12.7	32.5	19.1	8.1	7.4	24.1
		1995					2011			
FORWARD LINK	DVA in foreign exports (%)	of which:				DVA in foreign exports (%)	of which:			
		EU28	USA	ASEAN	EASIA		EU28	USA	ASEAN	EASIA
Indonesia	9.8	15.3	22.9	45.1	11.0	18.5	13.8	6.0	22.6	47.1
Malaysia	11.7	21.7	26.0	30.7	15.2	8.4	10.0	5.7	8.0	66.3
Philippines	9.6	19.2	34.0	18.5	22.1	25.8	9.5	4.9	10.9	65.9
Thailand	9.0	19.4	23.6	33.6	17.4	9.3	11.5	5.5	13.8	58.4
Viet Nam	10.0	13.2	5.7	53.3	19.7	6.4	16.0	4.4	12.6	56.1
China	5.9	29.1	30.1	10.3	21.0	5.9	26.3	12.2	13.4	26.4
Japan	16.0	21.7	24.7	19.0	26.7	24.9	10.9	5.3	13.2	62.1
Korea	10.6	20.6	29.7	17.5	22.2	17.8	11.3	4.7	8.6	65.1
India	13.4	38.5	13.0	24.0	11.3	11.0	31.9	7.8	14.4	23.0

Source: Authors' elaboration on OECD-WTO TiVA database

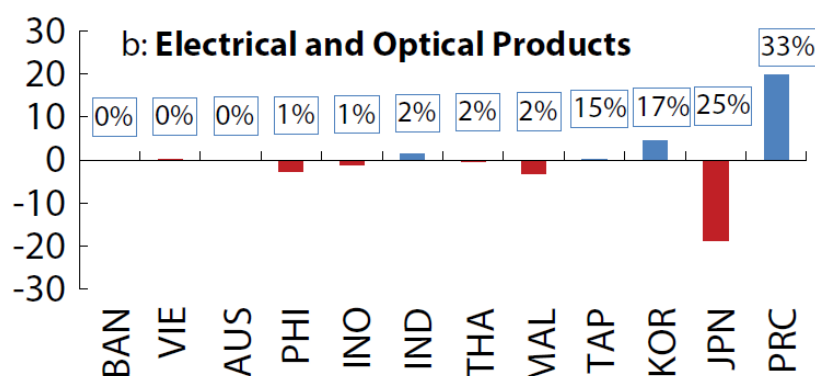
Note: Backward linkage: FVA (all industries) in exports of electrical and optical equipment.

Forward linkage: DVA (electrical and optical equipment) in total foreign exports

In terms of the origin of such value added, the relevance of neighbouring countries is confirmed in the selected industries. The strongest backward links are with East Asia and with ASEAN countries. In particular, the role of ASEAN countries has increased over time, while the share of value added from East Asia has declined, for almost all the Asian economies considered, with the important exception of Japan.

Considering only intra area exports in the electrical and optical equipment sector between 2000 and 2011, the role of China as a source of value added increased by 19.8 percentage points compensating for a 18 percentage points decrease of Japan's share. In 2011, China had the largest share of the region's intra area domestic value added exports (33 %) followed by Japan with 25 % (Figure 4b).

Figure 4b. Shares of intraregional domestic value added exports (2011 vs 2000)



Source: ADB (2015)

Note: y-axis = difference in shares 2011 vs 2000; box numbers = shares as of 2011

Looking outside the area, links with the EU are also important at the industry level, and this is the case especially for the motor vehicle sector, confirming the central role of the European vehicle industry at world level (Table 9).

Table 9. Motor vehicles, trailers and semi-trailers: backward and forward linkages

BACKWARD LINK	1995					2011				
	FVA (% of exports)	of which:				FVA (% of exports)	of which:			
		EU28	USA	ASEAN	EASIA		EU28	USA	ASEAN	EASIA
Indonesia	33.3	16.1	5.7	4.4	54.8	25.5	11.3	4.6	14.2	42.3
Malaysia	38.7	18.6	5.7	7.0	60.4	59.1	16.9	9.0	42.2	41.0
Philippines	42.7	10.6	8.1	7.2	59.7	40.3	7.1	5.6	33.1	39.0
Thailand	42.9	19.5	8.7	6.5	48.6	56.4	11.4	5.2	45.1	43.3
Viet Nam	45.9	12.0	3.8	7.0	59.2	55.0	10.4	4.6	44.6	45.8
China	58.2	27.7	10.0	3.5	43.2	33.1	28.4	8.3	5.7	30.2
Japan	6.5	30.8	23.5	9.1	12.8	13.9	19.3	11.0	12.1	24.6
Korea	24.5	18.3	17.0	5.4	34.7	37.7	18.0	10.0	6.6	34.3
India	12.8	28.5	11.5	4.0	16.0	32.5	20.6	7.0	6.0	20.3
FORWARD LINK	1995					2011				
	DVA in foreign exports (%)	of which:				DVA in foreign exports (%)	of which:			
		EU28	USA	ASEAN	EASIA		EU28	USA	ASEAN	EASIA
Indonesia	8.2	13.9	14.0	30.4	30.9	10.6	10.7	3.2	38.3	33.3
Malaysia	17.4	30.5	11.4	26.8	18.4	16.8	16.7	4.2	21.3	41.4
Philippines	10.2	18.3	8.7	26.3	36.7	5.3	10.5	3.2	45.7	32.9
Thailand	6.2	42.5	7.2	28.0	14.3	3.1	18.1	2.8	25.3	22.0
Viet Nam	43.6	15.7	2.7	35.2	33.7	8.2	17.5	8.4	11.5	48.5
China	9.5	18.3	18.1	10.3	34.4	11.2	26.0	12.5	8.8	22.5
Japan	5.9	29.3	24.8	9.9	7.6	6.8	21.4	16.9	8.5	21.7
Korea	5.4	41.3	14.1	7.3	8.7	6.3	28.0	12.9	4.8	21.3
India	7.8	37.5	7.8	10.0	8.5	7.0	42.4	7.1	10.2	14.6

Source: Authors' elaboration on OECD-WTO TiVA database.

Note: Backward linkage: FVA (all industries) in exports of motor vehicles.

Forward linkage: DVA (motor vehicles) in total foreign exports.

The share of foreign value added in Asian exports from developed countries such as EU and US has in general declined between 1995 and 2011 in the three industries considered, and this is particularly evident in exports of electronic and optical equipment. This is not observed for textile exports from China and Viet Nam, in which the share of European added value has increased.

Along with the increase of backward linkages, we observe for many Asian countries a strengthening of forward ones, with an increase of domestic value added produced in the industry concerned embodied in foreign exports as a share of those exports. Also in terms of forward linkage East Asia emerges in a key position. This is most likely due to the role of China acting as a regional hub to connect the entire area to the markets of the rest of the world.

Also in this respect, the role of the EU is far from marginal, receiving a large share of Asian domestic value added. The figures confirm that European exports are relying to a non-negligible extent on Asian production in these industries. The relative - but not absolute - importance of these production linkages between the EU and many Asian countries in these industries concerned have declined in the past de

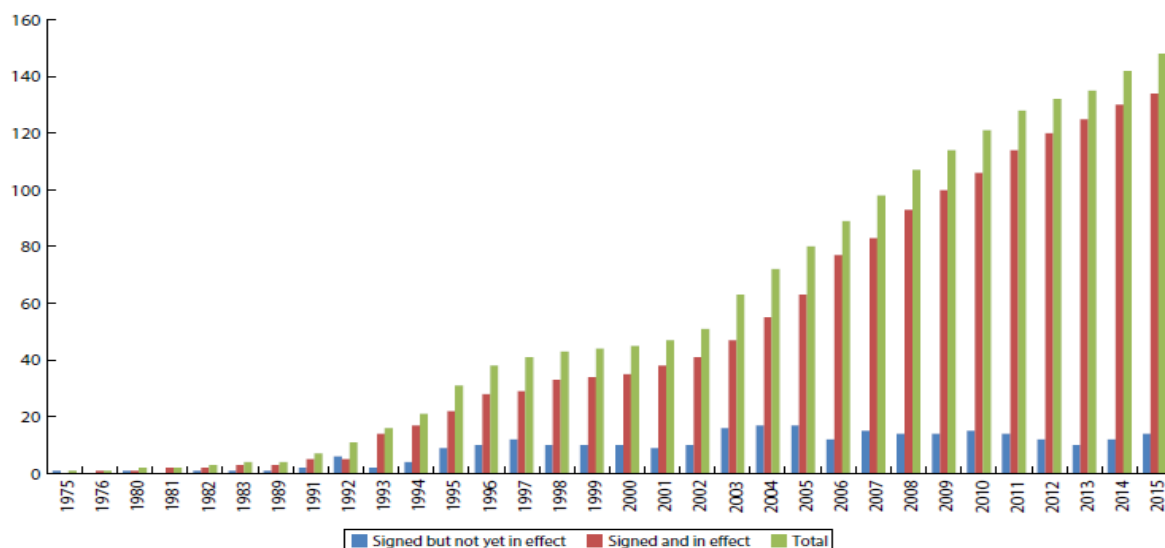
The growth of the emerging countries around the world has also affected the organisation of the GVCs, shifting the weight away from the most advanced countries. It is interesting to observe though that this did not happen in the case of the links between China and the EU. Both backward and forward linkages have increased in textiles and footwear as in motor vehicles. This seems to confirm that China is expanding its role as an intermediary for trade and production in the Asian area as a whole.

3 Trade and investment strategies of major APEC countries

Unlike Europe or North America, regional economic integration in East and Southeast Asia was more market that institution-driven, in the sense that integration was prompted by actors seeking economic gains from deepening regional economic interdependence through trade and investment liberalisation, without regional institutions in the form of RTAs. Both intra- and inter-regional trade agreements are proliferating in East Asia. Deepening regional interdependence through trade and investment, and the necessity for stability and revitalisation of the regional economy since the East Asian financial crisis in the late 1990s, led the East Asian countries to adopt preferential RTAs.

Since then, East Asian countries have been active in free trade initiatives with countries in and outside the region. A considerable number of bilateral and plurilateral RTAs have been formed, including the China-Thailand FTA, the Japan-Indonesia EPA (Economic Partnership Agreement), the Korea-Singapore FTA, and the five ASEAN+1 RTAs: the ASEAN-China FTA, the ASEAN-Japan CEPA (Comprehensive Economic Partnership Agreement), the ASEAN-Korea FTA, the ASEAN-Australia and New Zealand FTA, and the ASEAN-India FTA. Furthermore, RTAs among the three Northeastern Asian countries have been under consideration and negotiation, in particular the Korea-China FTA, the Korea-Japan FTA, the China-Japan FTA, and the Korea-China-Japan FTA.

Figure 5. Free Trade Agreements signed by Asian countries (cumulative number)



FTA – free trade agreement.

Note: Includes bilateral and plurilateral FTAs with at least one of ADB's 48 regional members as signatory. 2015 covers January to August. Signed but not yet in effect refers to FTAs where the parties sign the agreement after negotiations have been completed, but the agreement has yet to become effective. Signed and in effect refers to FTAs where provisions become effective, after legislative or executive ratification.

Source: ADB (2015)

The new Asian wave of RTA/FTAs started in 2001 after China and ASEAN agreed to establish a FTA within 10 years. Compared to 2000, when approximately 40 agreements had been signed by Asian economies, the number of total agreements signed by these countries quadrupled to almost 160 in August 2015 (Figure 5).

Before 2000 the largest trading economies in the region – China, Japan, and Korea – were not a party to any RTA/FTA. As a result some important bilateral trade flows within APEC were not covered by RTA/FTAs, for instance trade between China and Hong Kong, China; Korea and the United States; Singapore and China; and Japan and Thailand. After 2000, China negotiated seven intra-APEC RTA/FTAs with 13 APEC members. Japan did the same with 12 intra-APEC RTA/FTAs covering 11 APEC members. Similarly, Korea enforced six intra-APEC RTA/FTAs with 11 APEC economies. Other APEC economies also started to actively engage in RTA/FTAs. For example, after 2000, Chile and Peru implemented nine intra-APEC RTA/FTAs; Australia and Singapore enforced eight new intra-APEC RTA/FTAs; and New Zealand participated in seven new intra-APEC RTA/FTAs. By 2014, 54 intra-APEC RTA/FTAs had already entered into force and the trade flows among the corresponding RTA/FTA signatory parties accounted for USD 3.7 billion, or 59 % of intra-APEC trade. However, despite the proliferation of RTA/FTAs within APEC, there are still some important bilateral trade relationships that are *not* covered by any trade agreement. The two notable ones are the trade flows between China and the United States and China and Japan, which are the fourth and fifth most important bilateral intra-APEC trade flows after those between Canada and the United States, China and Hong Kong, China, and Mexico and the United States.

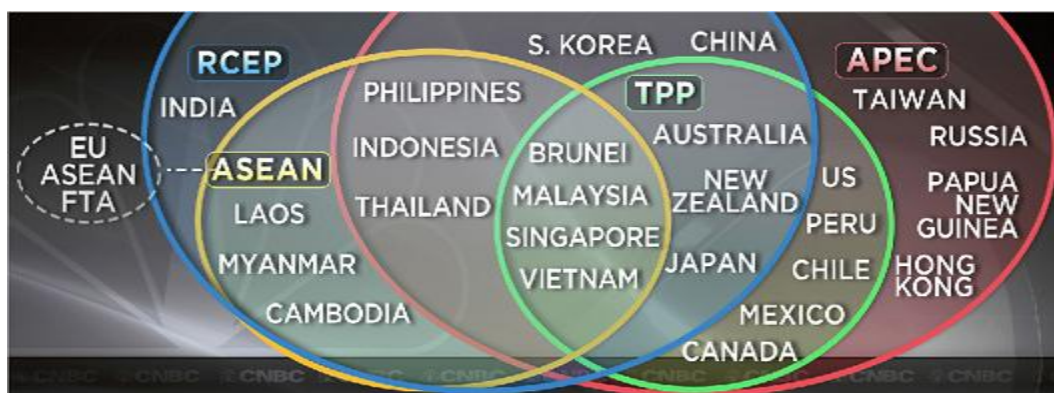
In the last three years four of the new FTAs proposed are between the EU and Asian countries (China, Japan, the Philippines and Thailand).

It is important to highlight some important bilateral flows that were not under RTA/FTAs in 2014 but will be covered by RTA/FTAs in the near future. For example, Australia and Japan just implemented a trade agreement on 15 January 2015. China also signed new free trade agreements with Korea and Australia on 1 June 2015 and 17 June 2015 respectively, which are expected to be implemented shortly.

Moreover, considering the harmful ‘spaghetti bowl effect’ of overlapping RTAs and deepening production networks in this region, mega-regional RTAs have been proposed and negotiated among APEC countries. These proposals include the EAFTA (East Asian Free Trade Area) preferred by China that encompasses the ASEAN+3 countries (10 ASEAN countries plus China, Japan, and Korea); the CEPEA (Comprehensive Economic Partnership for East Asia) preferred by Japan that includes the ASEAN+6 countries (10 ASEAN countries, China, Japan, Korea, Australia, New Zealand, and India); the ASEAN-driven RCEP (Regional Comprehensive Economic Partnership, RCEP) that includes the ASEAN+6 countries; the US-led TPP (Trans-Pacific Partnership) including Brunei Darussalam, Singapore, Malaysia, Vietnam, Australia, New Zealand, Chile, Peru, the USA, Canada, Mexico, and Japan; and a FTAAP (Free Trade Area of the Asia Pacific) that includes the 21 Asia Pacific Economic Cooperation (APEC) member countries. Should these negotiations be concluded successfully, the percentage of intra-APEC trade covered by RTA/FTAs would increase significantly. Recently, 12 APEC economies signed the TPP agreement. There are also 12 APEC economies (plus Cambodia, India, Laos and Myanmar) are involved in the RCEP negotiations (Figure 6).

As many of the countries involved in regional agreements are already linked with one another by bilateral agreements, the potential impact of RTAs is likely to be limited in terms of further concessions to be granted.

Figure 6. The network of FTA/RTA in Asia



Source: CNBC

However, these mega-deals are changing the landscape of international trade agreements to a major extent, with important implications on global economic relations and doing so for a number of reasons. First, the actors involved are among the world’s largest trading nations, accounting for sizeable population, important shares of world GDP, with potentially high trade diversion effects vis-à-vis third countries. Second, these mega-regional deals include non-traditional chapters and brand new provisions and rules significantly beyond the scope of existing RTAs, and this will increase the potential for trade diversion. Third, the range of regional initiatives in the Asia-Pacific is not necessarily fostering global economic integration by stepping up from regional integration to multilateralism. Although it is too early to be able to understand the economic and trade impact of RTAs in Asia Pacific, there are reasons to believe that they may actually act as an obstacle, rather than a stepping-stone, to global economic integration.

Some of the major mega-deals – most notably TPP – appear more as political initiatives to reshape the future patterns of economic integration. More specifically, the TPP, announced on 5 October 2015, is unprecedented in scope, because the 12 signatory countries (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam) represent 800 million inhabitants and account for around 37 % of world’s GDP and 28 % of global trade. The TPP has been at the centre of US trade policy for years, and its achievement is a political and diplomatic success for Barack

Obama. It will also have important implications for international economic relations and potential consequences for the European Union. The impact of trade liberalisation will be fairly limited, due to the fact that signatory countries have already signed a number of bilateral FTAs between one another, but the scope of TPP will go far beyond the traditional chapters included in RTAs, and, most importantly, it will foster economic integration among selected partner countries – most notably United States or NAFTA in general - with Japan to the detriment of other important trade partners, such as China and South Korea (which will then have an incentive to sign their own FTAs with third countries).

- The major reasons for this proliferation of RTAs in the region are the following:
- First, RTAs are expected to provide positive gains from regional trade and investment liberalisation through regional production networks, and this in the context of increasing interdependence among national economies.
- Second, following the need to foster economic activity following the East Asian financial crisis in 1997, the three Northeast Asian countries - China, Japan, and Korea - have shifted their policy stance from favouring a global approach to favouring a regional approach (among the 77 RTAs implemented or signed including ASEAN+6 countries, 71 (94.7 %) RTAs have been implemented or signed after the crisis). In particular, China has been very actively seeking bilateral RTAs since her entry into the World Trade Organization (WTO). Japan needs to regain its leadership role in the region in competition with China, and to provide a market-friendly regional business environment for its multinational corporations. Korea's traditional outward-oriented economic growth strategy through trade and investment liberalisation is now revitalised by its ambition to become an East Asian business hub.
- Third, ASEAN and more specifically some ASEAN countries, especially Singapore and Thailand, are also very actively trying to become a hub for regionalism in East Asia. This helps to explain why ASEAN as a whole is aggressively seeking to initiate multiple RTA negotiations.
- Fourth, this shift to regionalism has been accelerated due to the slow progress of multilateral negotiations, such as the stalled Doha Development Agenda (DDA) within the WTO, and the sluggish progress toward the Bogor Goals within the trade and investment liberalisation section of the APEC.

As regards the characteristics of Asian RTAs, most of them have taken the form of bilateral agreements. This is consistent with the global trend to seek cheaper and more straightforward negotiations even though the gains from freer trade are limited. Among the 71 RTAs that have been implemented and that include the ASEAN+6 countries, 56 (78.9 %) agreements are bilateral agreements and 15 (21.1 %) are plurilateral agreements. Furthermore there appears to be indifference between intra- and inter-regional partnerships. Among the 71 RTAs implemented including ASEAN+6 countries, 45 (63.3 %) agreements are inter-regional agreements. Another prominent feature of Asian RTAs is their form of overlapping hub-and-spoke RTAs that could create a spaghetti bowl phenomenon. Last but not least, with the exception of the TPP there has been a very slow progress in plurilateral RTAs negotiations, with the proposed China-Japan-Korea trilateral RTA and RCEP still under negotiation.

3.1 New FTAs entered into force in 2014

Six new FTAs entered into force in Asia-Pacific in 2014: Australia-Korea, Canada-Honduras, Chile-Hong Kong (SAR), China-Iceland, China-Switzerland, and Singapore-Taiwan. The structure of RTA/FTAs implemented in 2014 is one that includes all the traditional chapters in trade agreements, such as trade in goods, rules of origin, customs provisions/administration and dispute settlement. Other traditional chapters, such as those on sanitary and phytosanitary measures (SPS) and technical barriers to trade (TBT), appear in all of the agreements, except the China-Iceland agreement, which includes specific provisions on those matters in the trade in goods chapter. There is a positive trend in recent years

regarding the inclusion of chapters on cross-border trade in services. The six RTA/FTAs entering into force in 2014 include commitments on a list of specific services, or comprehensive commitments on national treatment, market access and local presence with a list of exceptions (i.e. non-conforming measures). Some agreements such as the Australia-Korea FTA and the Canada-Honduras FTA, also include chapters on specific services sectors, such as financial services, telecommunications and e-commerce. Similarly, these agreements have a specific chapter for mode 4 of services provision (i.e. movement of natural/business persons).

This new round of FTAs also shows the increasing interest of including investment chapters in RTA/FTAs. Five of the RTA/FTAs entering into force in 2014 (except Chile-Hong Kong) include a specific chapter on Investment.

As for the other topics, all the six recent RTA/FTAs mentioned above include a chapter on competition (or competition policy). Most of them include provisions related to cooperation between competition authorities and consultations. Others go further and deal with issues concerning the interpretation and application of competition laws, monopolies and state enterprises, among others. Chapters on government procurement, environment, transparency and intellectual property also appear in four out of these six RTA/FTAs. However, the depth of their provisions differs. Topics such as cooperation and labour appear as individual chapters in only three and two of the agreements, respectively. All agreements include clauses promoting cooperation among relevant authorities can be found the other individual chapters. For example, chapters on customs procedures include provisions on the strengthening of cooperation among border agencies in mutually agreed areas.

4 The status of the preferential agreements being negotiated in the Asia/Pacific region

4.1 Bilateral agreements

China-Gulf Cooperation Council (GCC). In July 2004, China and the Gulf Cooperation Council (GCC) announced the launch of China-GCC Free Trade Agreement negotiations. To date the two parties have held five rounds of negotiations and have reached agreement on the majority of issues concerning trade in goods. Negotiations on trade in services have also started. 'The FTA is in the fundamental and long-term interests of both sides and will help deepen their mutually beneficial cooperation and achieve common development,' Hu said during a meeting with GCC Secretary General Abdul Rahman Al-Attiya in Riyadh, where the council is headquartered. China and Gulf Cooperation Council (GCC) carried out FTA talks in Riyadh from 22 to 24 June 2009. A Chinese delegation of officials from MOFCOM, MFA, MIIT, MPS, MOF, MOA, MOC, GAC, SBQTS, SPCA, NTA, CAAC, and SATCM participated in the negotiations. The two sides exchanged views on such issues as trade in goods, rules of origin, technical barriers to trade, sanitary and phytosanitary measures, economic and technological cooperation and text of free trade agreements, and positive progress was made.

GCC is a regional organisation of significant international influence and economic strength. It has as member states Saudi Arabia, UAE, Kuwait, Oman, Qatar and Bahrain. In recent years, economic and trade relations between China and GCC members have developed rapidly. The GCC has become China's eighth largest trading partner, and is a newly emerging market which China is making efforts to exploit. The China – GCC FTA would be China's second largest Free Trade Area to be established, to which the leaders of both parties attach great importance.

China-Norway. Norway is one of China's important trading partners in Northern Europe as well as one of China's main suppliers of fertilizer, aquatic products and oil from Europe. In recent years the two

countries have carried out increasingly intensive cooperation and exchange in such fields as trade, investment and technology. In 2007, leaders of the two countries reached an agreement to launch of a joint FTA feasibility study. After half a year's research, both sides agreed that the establishment of the China-Norway FTA will further deepen bilateral relations and cooperation in economy and trade, promote the economic development of the two countries, and improve the living standards of the two peoples. On this basis, the first round of negotiations on the China-Norway FTA was successfully held in Oslo, on 18 September 2008.

China-Japan-South Korea. The Chief Negotiators Conference of the 8th Round of the China-Japan-Korea Free Trade Area was held in Beijing on 24 September 2015. The Vice Minister of Commerce Wang Shouwen led the Chinese delegation attending the conference. During the two-days of negotiation, the three parties exchanged views on issues such as trade in goods and services, investment and the general scale of the potential agreement. This followed the consensus reached at the fifth China-Japan-Korea Leaders' Conference in May 2012, the China-Japan-Korea Free Trade Area negotiation was officially launched in November 2012. The views of the parties are that the signing and negotiating of the China-Japan-Korea Free Trade Agreement will build a comprehensive institutional framework for the trade, investment and cooperation within the three countries, promote the opening of each other's market and pushing forward the integral development and prosperity of the regional economy. After months of anticipation, China, Japan, and South Korea recently held their first trilateral summit after 2012. The 10th ROK-Japan-China Economic and Trade Ministers' Meeting was held in Seoul on 30 October 2015. The three sides held in-depth talks on trade and economic issues of common concern, and reached consensus on a number of issues aimed at enriching the trade and economic benefits of the ROK-Japan-China Summit. Chinese Premier Li Keqiang and Japanese Prime Minister Shinzo Abe travelled to Seoul to meet with South Korean President Park Geun-hye on 1 November. After this meeting the three leaders issued a Joint Declaration for Peace and Cooperation in Northeast Asia. Most notably, the three leaders agreed to continue their work on economic integration by making 'further efforts towards the acceleration of the trilateral FTA negotiations.' There are also plans for a wealth of trilateral meetings to advance economic ties and market integration in specific areas, including a Trilateral ICT Ministers' Meeting, a Trilateral Ministerial Conference on Transport and Logistics, a Tripartite Customs Heads' Meeting, and a Trilateral Ministerial Meeting on Science and Technology Cooperation. If the wealth of upcoming meetings is any indication, trilateral cooperation has indeed been 'completely restored' — at least on economic and social issues.

China-ASEAN. The Sixth Meeting of the China-ASEAN Free Trade Area Joint Committee and the first round of upgrading negotiations of the China-ASEAN FTA were held in Hanoi, Vietnam, on 23-24 September 2014. The discussions focused on the working arrangements for negotiations of the China-ASEAN FTA. There were meetings of four working parties on investment, economic cooperation, rules of origin and customs procedures and trade facilitation. It was decided that the seventh meeting of the Joint Committee and the second round of negotiations would be held at the beginning of 2015 in China. Upgrading the China-ASEAN FTA was an important initiative proposed by Premier Li Keqiang during the China-ASEAN Leadership Summit in October 2013. After consultations between the two sides, the China-ASEAN Economic and Trade Ministers' Meeting agreed on some basic documents on the China-ASEAN FTA Upgrading Negotiations and officially announced the launch of negotiations.

China-Sri Lanka. The second round of China-Sri Lanka FTA negotiations was held in Beijing on 26-28 November 2014. The two sides exchanged views on issues concerning trade in goods and services, investment, economic and technological cooperation, rules of origin, customs procedures and trade facilitation, technological barriers, sanitary and phytosanitary (measures), trade remedies and dispute settlement. Generally speaking positive progress was made in the negotiations. The launch of the China-Sri Lanka FTA negotiations was jointly announced Chinese President Xi Jinping and Sri Lankan President Mahinda Rajapaksa during Xi's visit to Sri Lanka in September 2014. China-Sri Lanka bilateral trade has

been expanding in recent years. The bilateral trade amounted to US\$ 3.62 billion in 2013, up 14.3 % year on year. In the period January-September 2014 China-Sri Lanka bilateral trade totalled US\$ 2.737 billion, up 5.93 % year on year.

China-Maldives. On 7-9 September 2015 Vice Minister Gao presided over the 2nd meeting of China-Maldives Joint Committee of Economy and Trade together with the Maldives Minister of Economic Development Mohammed Saeed. The two parties held an in-depth exchange views and reached an extensive consensus on expanding bilateral trade and investment, on launching China-Maldives FTA negotiation, and on strengthening infrastructure construction and promoting human resources cooperation. Following the 1st meeting of Joint Committee on Economic and Trade in December 2014, China-Maldives economic and trade relations have gained in momentum. In the first half year of 2014, China-Maldives bilateral trade volume was over USD 73 million, up 62.1 year on the previous year. Cooperation in project contracting and tourism has been developing smoothly, and China remains the largest source of tourists travelling to the Maldives.

China-Georgia. The Chinese Ministry of Commerce signed the joint declaration launching the feasible study of a China-Georgia free trade agreement negotiations with the Ministry of Economy and Sustainable Development of Georgia in Beijing on 9 March 2015 and agreed to set up a joint experts group as soon as possible. At the same time, the two sides signed a memorandum of understanding on the strengthening of the construction of the Silk Road Economic Belt. This is to be furthered by the work of the China-Georgia trade and economic cooperation committee. The objective is to raise the level of trade, investment, and economic and technological cooperation and infrastructure interconnection. Before the signing of the documents, Chinese Minister of Commerce Gao Hucheng held talks with visiting Vice Premier and Minister of Economy and Sustainable Development of Georgia Giorgi Kvirikashvili in Beijing on the same day. Gao said that President Xi Jinping, when visiting Kazakhstan in September 2013, had proposed the building the Silk Road Economic Belt, which won the positive and strong response of all countries along the road including Georgia. The launch of the feasible studies is an important measure for both sides to jointly build the economic belt, which will not only inject new power into bilateral trade and economic relations, but will also play a strategic role in expanding trade and economic cooperation between China and the Eurasian region. Kvirikashvili said that the construction of the economic belt proposed by President Xi Jinping not only provides new opportunities for bilateral cooperation between China and countries along the road, but also builds a road of friendship and cooperation to unite all countries along the road. It is a great 'Initiative of the Century'. The launch of the feasible studies is a milestone in the development of the trade and economic relations between the two countries. Georgia is willing to strengthen the coordination with China under the framework of the trade and economic cooperation committee, and will strive to complete the feasible studies early, enrich the practical results of jointly building the economic belt and enable Georgia to be one of the important hubs between China and Europe. In recent years, the trade and economic relations between China and Georgia have maintained solid development. In 2014, the trade volume between the two countries reached USD 0.96 billion, Chinese direct non-financial investment in Georgia totalled US\$ 0.53 billion and China became the third largest trade partner and the largest investor of Georgia. On 10th December, the MOFCOM International Trade Representative and Vice Minister Zhong Shan signed the Memorandum of Understanding Launching China-Georgia Free Trade Agreement negotiations between the Ministry of Commerce of the People's Republic of China and the Ministry of Economic Affairs and Sustainable Development of Georgia with the Minister of the Economic Affairs and Sustainable Development of Georgia Kumsiashvili officially launching the China-Georgia FTA negotiations. In March 2015, China and Georgia announced to start the feasible studies for the FTA negotiations.

India. India has been one of the more active parties in negotiating economic partnership and trade agreements in Asia at least in terms of the number of FTAs signed or under negotiation (28 at the moment) followed by Japan with 24. Currently India is engaged in FTA negotiations with Australia, Egypt,

the EU, New Zealand: a preferential trade agreement with Israel and the South African Customs Union; economic partnership agreements with Canada; a custom union with Russia, Belarus and Kazakhstan; Common Economic and Cooperation Agreements with Indonesia and Mauritius. India is also included in the negotiations for the Regional Common Economic Partnership (RCEP).

South Korea. South Korea has also been fairly active in establishing preferential and free trade agreements (23 in total). It is currently negotiating FTAs with Japan, Indonesia and Mexico, the GCC, Central America and joint with China and Japan. It has recently signed FTAs with China, Colombia, New Zealand and Vietnam and is also included in the negotiations of the Regional Common Economic Partnership (RCEP).

Japan. Japan is negotiating 8 Economic Partnership and Free trade agreements, with ASEAN (Services and investment chapters, substantially concluded), Canada, Colombia, China and South Korea (see above), the EU, and Turkey. At wider plurilateral level, it is negotiating RCEP and is a partner in the recently signed TPP.

Japan-EU Economic Partnership Agreement (EPA). The benefits of the Japan-EU FTA will be substantial. Japan and the EU are important global partners that share fundamental values such as democracy, rule of law, and basic human rights. The EU has a population of 500 million and accounts for approximately 24 % of the world GDP. The EU is a major major trading and investment partner of Japan and contributes approximately 10 % of Japan's total trade volumes. The Japan-EU EPA will promote trade and investment for both parties through the elimination of tariffs and improvement of trade and investment rules. It will contribute to boosting economic growth, creating employment and strengthening business competitiveness both in Japan and the EU. It will also promote inroads into the European market by Japanese companies. An economic partnership agreement between the two advanced market economies will contribute to the stable growth of the world economy and to global rulemaking in trade and investment. The Japan-EU EPA is one of the mega regional agreements along with the TPP (Trans-Pacific Partnership) and TTIP (Transatlantic Trade and Investment Partnership), which are aimed at further deepening of the economic relations among Japan, the US and the EU.

Japan's main areas of interest in the negotiations are:

- the elimination of high tariffs on industrial products (e.g. motor cars: 10 %, electrical machinery: 14 % being the highest) to improve competitive conditions for Japanese products in the European market;
- addressing the regulatory issues facing Japanese companies in Europe.

The EU's main areas of interest are:

- the Non-Tariff Measures (NTMs) that hinder access to the Japanese market in automobiles, chemicals, electrical machinery, food safety, processed food, medical devices, and pharmaceuticals, among others;
- better access to government procurement markets (such as in railways and the thresholds in construction contracts) and
- the elimination of tariffs on the main export products to Japan.

4.2 Regional agreements

ASEAN Plus Free Trade Area (FTA) Agreements

ASEAN have inked agreements establishing Free Trade Areas with some of the world's major economies as part of its efforts to go beyond its borders and strengthen its participation in the global supply chain. The ASEAN Plus FTAs are as follows:

- ASEAN-China Free Trade Area (ACFTA)
- ASEAN-Japan Comprehensive Economic Partnership (AJCEP)
- ASEAN-Korea Free Trade Area (AKFTA)
- ASEAN-Australia-New Zealand Free Trade Area (AANZFTA)
- ASEAN-India Free Trade Area (AIFTA).

Regional Common Economic Partnership (RCEP)

The RCEP was conceived in 2013 and is being negotiated between the 10 member states of the Association of Southeast Asian Nations (ASEAN), established on 8 August, 1967, that comprises Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Myanmar and Cambodia) plus countries including Australia, China, India, Japan, New Zealand and South Korea.

The RCEP aims to establish deeper economic cooperation between ASEAN and its regional trading partners, with a focus on trade in goods, services and investment. If signed, the regional free trade agreement will create an economic bloc with a combined population of 3.4 billion and trade volume of US\$ 10.6 billion, accounting for nearly 30 % of the world's trade, according to a statement recently released by South Korea's trade ministry.

China has been seen as the key driver of this regional trade pact, which is viewed as an alternative to the U.S.-led TPP agreement, from which China, the world's second-biggest economy, was excluded. Within the RCEP, though, seven countries - Australia, Japan, Malaysia, New Zealand, Singapore, Vietnam and Brunei - are also part of the 12-nation TPP deal recently signed.

Free Trade Area of the Asia-Pacific (FTAAP)

Discussions on the possible pathways to a Free Trade Area of the Asia-Pacific (FTAAP) continue. In November 2014, APEC Leaders endorsed the Beijing Roadmap for APEC's Contribution to the Realisation of the Free Trade Area of Asia-Pacific (FTAAP) to translate the vision of the FTAAP into reality. The roadmap provides for a Collective Strategic Study on Issues related to the realisation of the FTAAP to be concluded by end of 2016, as well as enhanced information sharing and capacity building. The study will provide an analysis of potential economic and social benefits and costs, analyse the various pathways towards a Free Trade Area of the Asia-Pacific, and identify challenges economies may face in realising the FTAAP.

Trans-Pacific Partnership (TPP)

On 5 October, 2015, Ministers of the 12 Trans-Pacific Partnership (TPP) countries – Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam – announced conclusion of their negotiations: 'The result is a high-standard, ambitious, comprehensive, and balanced agreement that will promote economic growth; support the creation and retention of jobs; enhance innovation, productivity and competitiveness; raise living standards; reduce poverty in our countries; and promote transparency, good governance, and enhanced labour and environmental protections. We envision conclusion of this agreement, with its new and high standards

for trade and investment in the Asia Pacific, as an important step toward our ultimate goal of open trade and regional integration across the region'.

TPP text was released in November 2015 and the next step is ratification by the respective legislatures of the 12 participating economies. This should be done within the next two years.

The TPP includes 30 chapters (Table 10) covering trade and trade-related issues, beginning with trade in goods and continuing through customs and trade facilitation; sanitary and phytosanitary measures; technical barriers to trade; trade remedies; investment; services; electronic commerce; government procurement; intellectual property; labour; environment; 'horizontal' chapters meant to ensure that TPP fulfils its potential for development, competitiveness, and inclusiveness; dispute settlement, exceptions, and institutional provisions.

In addition to updating traditional approaches to issues covered by previous free trade agreements (FTAs), the TPP incorporates new and emerging trade and crosscutting issues. These include issues related to the Internet and the digital economy, the participation of state-owned enterprises in international trade and investment, the ability of small businesses to take advantage of trade agreements, and other topics.

Five defining features make the Trans-Pacific Partnership a landmark 21st-century agreement, setting a new standard for global trade while taking up next-generation issues. These features include:

a) Comprehensive market access. The TPP eliminates or reduces tariff and non-tariff barriers across substantially all trade in goods and services and covers the full spectrum of trade, including goods and services trade and investment, so as to create new opportunities and benefits for our businesses, workers, and consumers.

b) Regional approach to commitments The TPP facilitates the development of production and supply chains, and seamless trade, enhancing efficiency and supporting the goal of creating and supporting jobs, raising living standards, enhancing conservation efforts, and facilitating cross-border integration, as well as opening domestic markets.

c) Addressing new trade challenges. The TPP promotes innovation, productivity, and competitiveness by addressing new issues, including the development of the digital economy, and the role of state-owned enterprises in the global economy.

d) Inclusive trade. The TPP includes new elements that seek to ensure that economies at all levels of development and businesses of all sizes can benefit from trade. It includes commitments to help small- and medium-sized businesses understand the Agreement, take advantage of its opportunities, and bring their unique challenges to the attention of the TPP governments. It also includes specific commitments on development and trade capacity building, to ensure that all Parties are able to meet the commitments in the Agreement and take full advantage of its benefits.

e) Platform for regional integration. The TPP is intended as a platform for regional economic integration and designed to include additional economies across the Asia-Pacific region.

Table 10. TPP's 30 chapters and previous agreements

Coverage \ FTA	TPP (Negotiations concluded 2015)	Trans-Pacific Strategic EPA (2005)	Japan-Australia (2014)	US-Singapore (2004)	US-[Republic of] Korea (2012)	NAFTA (1994)
Customs Administration and Trade Facilitation	Yes	Yes	Yes	Yes	Yes	Yes
Sanitary and Phyto-sanitary Measures	Yes	Yes	Yes	No	Yes	Yes
Technical Barriers to Trade	Yes	Yes	Yes	Yes	Yes	Yes
Trade Remedies	Yes	Yes	Yes	Yes	Yes	Yes
Investment	Yes	No	Yes	Yes	Yes	Yes
Services	Yes	Yes	Yes	Yes	Yes	Yes
- Financial Services	Yes	No	Yes	Yes	Yes	Yes
- Temporary Entry for Business	Yes	Yes	Yes	Yes	Yes	Yes
Telecommunications	Yes	No	Yes	Yes	Yes	Yes
Electronic Commerce	Yes	No	Yes	Yes	Yes	Yes
Government Procurement	Yes	Yes	Yes	Yes	Yes	Yes
Competition Policy	Yes	Yes	Yes	Yes	Yes	Yes
Intellectual Property	Yes	Yes	Yes	Yes	Yes	Yes
Labor	Yes	No	No	Yes	Yes	No
Environment	Yes	No	No	Yes	Yes	No
Cooperation and Capacity Building	Yes	Yes	Yes	No	No	No
Competitiveness and Business Facilitation	Yes	No	No	No	No	No
Development	Yes	No	No	No	No	No
Small and Medium Enterprises	Yes	No	No	No	No	No
Regulatory Coherence	Yes	No	No	No	No	No
Transparency and Anti-corruption	Yes	Yes	Yes	Yes	Yes	Yes
Dispute Settlement	Yes	Yes	Yes	Yes	Yes	Yes

EPA – Economic Partnership Agreement; FTA – Free Trade Agreement; NAFTA: North American Free Trade Agreement; TPP – Trans-Pacific Partnership; US – United States;

Source: ADB (2015)

5 The expected impact of TPP on EU trade

Although some prominent economists have downplayed the economic and trade impact of the TPP - in the words of Paul Krugman (2015), '[t]his is not a trade agreement'; Stiglitz and Hersh (2015) claim it is a 'charade' to argue that the TPP is about free trade, a number of studies have tried to estimate the impact of TPP on EU trade. Trade integration in a region is often at the expense of the rest of the world (as the products exchanged between members of the region benefit from a price reduction, via lower tariffs, or easier market access that make them more competitive than products from countries outside the region). In the short term, European exporters probably should not worry about the TPP, because signatory countries are already integrated through an extensive network of trade agreements. As of October 2015 there were 21 agreements among TPP parties, which means that out of 66 bilateral trade relations among TPP countries, 40 already benefit from trade preferences (Guimbard, 2015a). Intra-TPP trade was worth US\$ 1876.3 billion in 2013 (10.2 % of world trade). Seventy six percent of intra-TPP trade is already tariff-free (81 % is the amount of trade covered by the 21 agreements in force in the area). The share of NAFTA in intra-TPP trade is quite substantial (US\$ 1056 billion, i.e. 56 % of intra-TPP trade) and is already within free trade regime.

Before the official text was released in November 2015, some simulations were produced with very stylised hypotheses about the detailed provisions of the TPP: complete dismantling of tariff lines and limited reduction of NTBs among the 12 signatory countries (included in the simulations a 10 % reduction in trade costs). According to these estimates, the macroeconomic impact on the EU would be negligible (-0.01 % in GDP and real income in 2025). The decline in EU exports to the TPP area was estimated at -0.7 % in 2025, amounting to USD\$ 7.1 billion; EU exports to the rest of the world (including intra-UE28) would be slightly reduced (-0.03 %); total EU exports would fall by -0.12 % or US\$ 9 billion. Agricultural exports are those that would fall the most - 6.2 %. Industry (manufactures), whose economic weight is larger, has a smaller drop (-1.0 %) (Table 11).

Table 11. Initial size of EU export to TPP and estimated impact of TPP in 2025

sector	EU exports to TPP			EU exports to the World		
	Initial size	Change (\$)	Change (%)	Initial size	Change (\$)	Change (%)
Total	1,035,404	-7,109	-0.7	7,860,463	-9,040	-0.1
Agriculture	47,440	-2,964	-6.2	681,477	-3,303	-0.5
Industry	665,208	-6,574	-1.0	5,517,210	-8,256	-0.1
Services	322,757	2,429	0.8	1,661,776	2,518	0.2

Source: Guimbard (2015b)

The greatest impact is therefore predicted to be in the agricultural and food sector: the white meat sector would see its exports to the TPP area decrease by 41 % (or nearly US\$ 1.5 billion), European exporters would be squeezed out by US and Canadian exporters. Exports of dairy products would also decrease by 20 % (about US\$ 650 million with the EU facing market share loss to New Zealand and the United States in this sector). There would be a 10 % decrease in cereals exports with a smaller monetary loss of approximately US\$ 14 million.

Overall, in the agricultural sector, the TPP is likely to imply a major change in global patterns of trade in meat and dairy products, with beef and dairy products criss-crossing the Pacific from the United States to Asia and from Australia to Canada. TPP could also significantly boost US output of staple crops like corn and soybeans. Beyond simple changes in trade patterns, TPP also codify a major conflict between the United States and Europe over philosophical approaches to regulation, with the United States trying to convert Asia to their lighter-touch approach compared to the more stringent European regulatory framework (Head and Mayer, 2015).

In the industry sector, the relative changes are less important, but the monetary losses are substantial (Guimbard, 2015b). It is worth noting that these studies could under-estimate the potential losses for the EU, because they do not take into account some of the more innovative aspects of TPP. For example, the possibility of cumulation (of value-added) for rules-of-origin purposes across TPP countries could affect multinational enterprise (MNEs) international production strategies. The strengthening of the intellectual property right protection (length of patents in certain sectors) could also have an impact.

The deterioration of the competitive position of European exporters due to trade diversion could be more severe in some sectors where tariffs are currently very high in some TPP countries. In 2013, the average level of tariffs among TPP countries was 1.9 % (compared to 2.7 % vis-à-vis the rest of the world, the world average being 4.5 %). There are however important sector variations, with a limited number of tariff peaks in politically sensitive sectors. Although nearly 70 % of tariff lines (about 5000 products at HS 6) are already at zero tariffs, the remaining tariffs are quite high at an average of nearly 8 %. These can be found mostly in the agricultural sector, but not only. The 12 TPP countries all have tariff peaks for products of than 30 %. Canada still protects its dairy products (including vis-à-vis the United States), with an average tariff of nearly 130 % and applies a system of tariff quotas. Apart from rice (around 220 % on average), Japan applies high tariffs on beef (38.5 %) and pork (almost 50 %). Some industrial sectors are potentially sensitive for Australia (37 % applied to Japanese cars) and New Zealand (84 % on items of thrift stores). While tariff peaks in the United States are predominantly in agricultural products, there are also some sector issues are in certain industries, notably in the automotive sector. The vehicle industry would lose US\$ 3.7 billion market in the TPP area (but would wins over Japan); machinery would lose USD 1.2 billion (but wins again in Japan). For less developed countries, concessions may be just as problematic as the high tariffs are many. Vis-à-vis all the members of the TPP, Mexico has 2663 customs duties higher than 30 % (textiles, cars ...), Malaysia 2337 (textiles, vehicles rolled products of iron or steel ...), while Vietnam has 1672 (tobacco, cars and textiles) (Guimbard, 2015a).

Table 12. Average tariffs among TPP countries in 2013 (%)

Imp.	Exporter											
	Aus	Br	Can	Chil	Jap	Mal	Mex	NZ	Per	Sing	Viet	USA
Aus		0.0	2.1	0.1	4.6	0.0	3.9	0.0	0.6	0.0	0.6	0.4
Br	0.3		2.0	2.9	0.2	0.0	2.5	0.6	0.6	0.0	0.0	2.9
Can	1.7	0.1		0.9	1.9	1.1	0.2	24.0	0.1	1.7	5.3	0.9
Chil	6.0	0.0	0.5		0.6	5.9	0.0	2.7	0.4	0.1	6.0	0.2
Jap	4.6	0.0	2.3	1.4		0.4	0.6	17.2	0.8	0.6	2.7	2.3
Mal	4.5	0.8	6.3	8.3	14.0		15.0	2.5	6.2	0.8	2.4	8.2
Mex	12.9	3.2	0.6	0.6	4.6	6.5		22.9	7.1	4.7	9.0	0.2
NZ	0.0	0.0	0.1	0.0	2.6	0.2	2.2		0.6	0.0	2.7	1.7
Peru	3.6	0.0	1.7	0.0	1.2	1.1	2.7	1.9		0.8	2.7	1.5
Sing	0.0	0.0	0.5	0.0	0.0	0.0	6.7	0.0	0.0		0.0	0.0
Viet	1.8	0.2	5.1	6.6	4.6	1.7	4.7	3.9	6.0	4.5		5.9
USA	0.6	0.1	0.1	0.1	1.4	1.1	0.0	3.9	0.0	0.0	4.5	

Source: Guimbard (2015a)

According to some studies (Head and Mayer, 2015), the auto industry is perhaps the single sector for which tariff cuts included in the agreement are of major importance; tariff differences generate big trade differences in the industry and import duties on cars exceed 30 % in three major TPP markets. But TPP contains much more than just tariff reductions. It also includes 'deeper integration' policies that may have major implications for multinational carmakers. This is in line with Baldwin's (2011) assessment that the 'basic bargain' underlying agreements has changed from 'exchange of market access' to 'foreign factories for domestic reforms'. For example, one of the most compelling arguments heard in Canada for TPP was that without it, Japanese carmakers would stop investing in Ontario plants.

6 The economic and trade impact of the One-Belt-One-Road initiative

Although there is no official map illustrating precisely the One-Belt-One-Road (OBOR) initiative, it includes six corridors across Eurasia, where a number of China-led infrastructure facilities are already in place:

- The China-Mongolia-Russia corridor, focused on the Trans-Siberian railway;
- The New Eurasian Land Bridge, centred on a set of railways running from central China (Wuhan, Chongqing and Chengdu) to Europe via Kazakhstan, Russia and Belarus;
- The China-Central Asia-Western Asia Corridor, speculated to follow the overland Silk Road Economic Belt as depicted in maps released last year by the state-owned Xinhua News Agency, passing through Central Asia, Iran and Turkey to reach Europe;

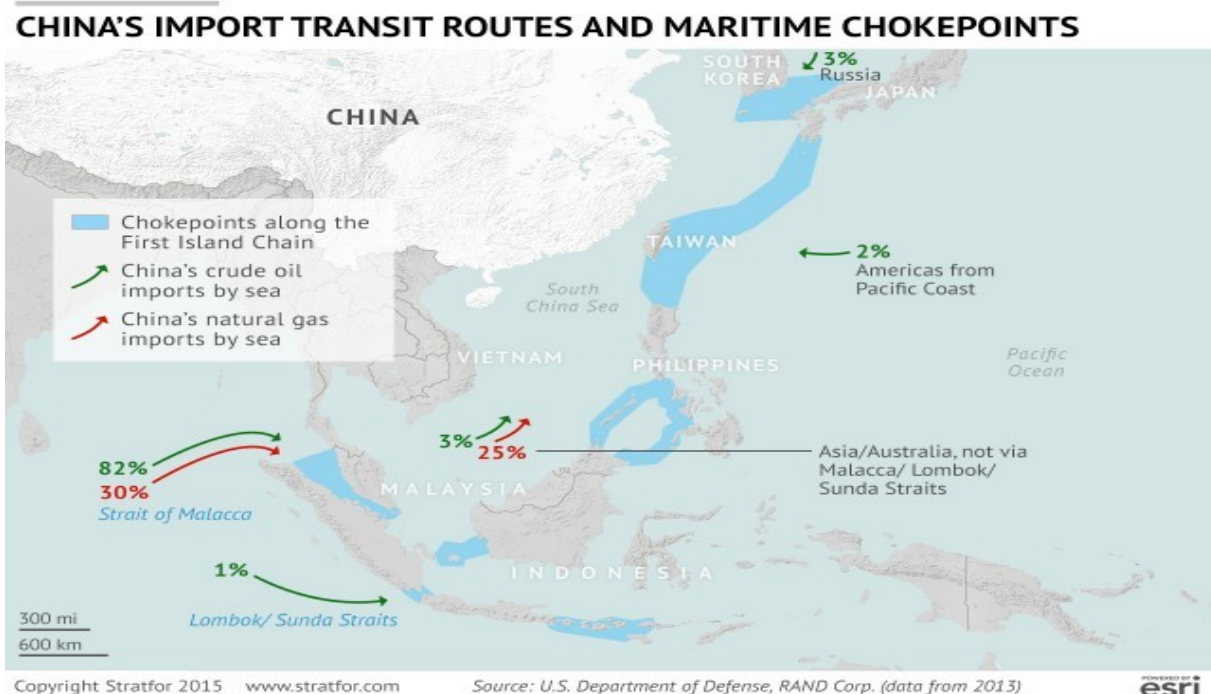
- The China-Pakistan Corridor, which would extend the Karakoram Highway, which already crosses the mountains between China and Pakistan, and build road and rail links all the way through Pakistan to the port of Gwadar;
- The Indochina Peninsula Corridor; and
- The Bangladesh-China-India-Myanmar Corridor.

The OBOR initiative has a major strategic logic, which is to reduce China's dependence on US secured chokepoints. In fact, China's economy is dependent on foreign trade, 90 % of which is transported by sea. China's near seas — the Yellow Sea, the East China Sea and the South China Sea — are bounded by the so-called 'First Island Chain,' a series of islands (many of which are controlled by U.S. allies) that stretches from Japan to the Philippines and Indonesia.

There is also an economic logic at the heart of OBOR that supports China's economic rebalancing. OBOR has the aim to reinvigorate China's slowing economy by shifting its industry away from the coast to the relatively underdeveloped inland provinces. China's ideal would be to link its inland cities to global markets with a diversified network of transit routes and energy pipelines, many of which would take inland routes and serve as alternatives to existing sea-lanes.

Although the building of alternative land and sea trade routes seems to be the major aim of the OBOR, it is in fact not likely to change the geography of trade routes between China and Europe very much. There is probably only going to be a small shift to routes entirely overland centred on existing transcontinental rail lines, such as the China-Mongolia-Russia corridor or the New Eurasian Land Bridge, to deliver relatively high value-added goods, such as electronics, which are sensitive to rapid changes in demand. The remaining trade flows will continue through maritime routes, which are much less expensive. Some minor changes in trade routes might occur, as for example investment in port infrastructure along other corridors, particularly in the Indian Ocean Region. For example, the China-Pakistan Corridor could allow some Chinese goods to travel overland to Pakistan before embarking for Europe at the Chinese-constructed port at Gwadar.

Figure 7. China's import transit routes and maritime chokepoints



Source: Stratfor (2015)

The economic impact beyond trade, though, is likely to be important. New trade routes can alter the geography of trade, but also the nature and structure of trade relationships. The OBOR initiative will open up new markets for Chinese goods and services. As overcapacity in a number of manufacturing sectors is a major determinant of the current slowdown and possibly the major impediment to soft landing, improving transit routes towards neighbouring developing countries will provide vent for these surpluses. It will also generate new demand for higher value-added Chinese goods. One of the major obstacles to the rebalancing from an investment-led to a consumption-led economy is high import dependence. Improving infrastructure networks with Southeast and Central Asia will make it more viable to integrate with Asian production networks and to create new ones. Finally, the OBOR will create physical and economic infrastructure for regional production networks. China can build the 'hardware' of infrastructure, but also try to streamline trade by pushing for new customs agreements and unified technical standards. These trade facilitation measures will complement the development of special economic zones and industrial parks along the Belt and Road corridors and will make it cost-effective for China's inland industry to access new markets.

If China were to become a regional leader in standard setting it would challenge Europe's ability to maintain independence in setting technical standards.

7 Asia and the WTO

The difficulties encountered during the WTO multilateral trade negotiations known as the Doha Development Agenda or Round, and the failure to successfully conclude these negotiations by the original 2005 deadline, are key drivers of the sudden increase in RTA/FTAs. As multilateral negotiations showed no sign of progress, more bilateral, plurilateral and regional initiatives started to emerge around the world. APEC economies have a prominent role in the proliferation of RTA/FTAs, explaining around 53 % of the global number of RTA/FTAs. Another reason for this proliferation is the 'trade diversion' effects that RTA/FTAs could have on non-signatory parties, since these would lose market share in the markets of the signatory parties. If one economy signs a trade agreement, others may be compelled to follow suit.

Still, some Asian countries, in parallel with bilateral negotiations for free trade agreements, kept strong ties with the WTO. India has historically - and recently - been an active player with the WTO, often promoting the interests of emerging countries and leading coalitions of such countries in negotiations. China so far has not been a very pro-active member of the WTO, but its entry into the organisation has certainly contributed to the expansion of its trade.

China is involved in a very large number of disputes within the WTO, as its trade capacity has put many countries under pressure. China is also still waiting to obtain so-called 'market economy status', which will make the use of anti-dumping rules against China more problematic. This status should probably be given to China next year, but it is still a controversial issue.

More recently, some further progress towards multilateralism was attained at the WTO's Tenth Ministerial Conference in Nairobi with the conclusion of the Information Technology Agreement 2 (ITA-2). After three years of negotiations, the WTO finally announced that this plurilateral agreement, covering US\$ 1.3 trillion of trade was finalised in Nairobi on 16 December 2015. In total 24 participants (53 countries) including the United States, European Union and China agreed to remove tariffs on 201 information and communications technology (ICT) products by 2024. The covered goods represent about 96 % of global trade in these ICT products, which are among the more dynamic sectors in world trade and in which regional production networks in Asia have been increasing the fastest. Because the ITA-2 was negotiated on an unconditional most favoured nation (MFN) basis, when the pact enters into force on 1 July, 2016, every WTO member (i.e., all non-participants) will benefit from the tariff liberalisation when goods are

exported to markets of the participating countries. The success of the ITA-2, along with on-going negotiations on the environmental goods agreement (EGA), points to plurilateral agreements as the way ahead for the World Trade Organization.

Moreover, at the end of the Nairobi meeting the member countries declined to reaffirm the Doha mandate. The end of the Doha round came together with the decision to open the discussion of the 'new issues'. Both decisions were opposed by India with a partial support by China.

8 Conclusions

Asia is increasingly important in the world economy for various reasons and is expected to become even more important. In the past decades it displayed the highest GDP growth rates and, in part, in terms of human development. It has become a hub in the leading region in trade and shifted the worldwide organization of production eastward. This is in part due to the exceptional performance of China and its impact on the region. But it is not only China. Most other countries in the region have followed similar paths, and some Asian countries have shown a GDP and trade dynamics even stronger than China. East and South-East Asian countries are very much connected to each other and to the developments of the Chinese economy. Therefore, the recent slowdown of the Chinese economy is creating some uncertainty in the outlook for the whole area. But the widespread nature of development and growth is such that this slowdown is not enough to change the overall long-term outlook for the region, and the forecast is that it will remain a key driver of the world economy for some decades.

The EU is a very relevant partner for these countries, with high trade shares and a high participation to GVCs. In terms of production sharing and creation of value added, the existing data suggest that European firms' links with Asian producers are strong and fairly resilient, and that the region plays a strategic role in EU production. Nevertheless, the EU has been generally less active in cultivating economic ties in the area compared to the region's large countries and to the USA. The number of EU trade agreements in the region is very small, especially considering the activism of Asian countries in this respect. As a consequence of the long-term shift in the shares of world trade, the possible trade diversionary effects of PTAs/FTAs and other factors, the EU's relative share of trade in Asia is declining.

It is strategically important for the EU to keep strong ties with Asia, both for political and economic reasons. From the economic point of view, Asia is currently a key market and it will be even more so in the near future. It is also a key supplier of intermediate and final goods to European industries. It therefore plays an important role on overall EU competitiveness and growth.

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Appendix

Table A1 a). Foreign Value Added in Exports (geographical origin),
ASEAN countries, 1995

Year 1995	BRN	IDN	KHM	MYS	PHL	SGP	THA	VNM	ASEAN (extra)
DVA in Exports (% of gross exports)	92.7	87.5	87.2	69.6	70.2	57.7	75.8	78.9	75.4
FVA in Exports (% of exports)	7.3	12.5	12.8	30.4	29.8	42.3	24.2	21.1	24.6
<i>Geographical distribution</i>									
FVA in Exports (=100)	100	100	100	100	100	100	100	100	100
ASEAN	31.0	8.3	27.3	11.6	9.2	13.3	10.6	17.1	-
Brunei Darussalam	-	0.1	0.1	0.1	0.0	0.2	0.5	0.1	-
Indonesia	2.1	-	3.7	2.3	2.0	2.9	1.5	2.4	-
Cambodia	0.0	0.0	-	0.1	0.0	0.0	0.6	0.2	-
Malaysia	13.5	2.3	3.6	-	1.8	6.3	3.3	2.7	-
Philippines	0.6	0.4	0.4	0.6	-	0.8	0.7	0.7	-
Singapore	11.4	3.9	3.4	5.5	3.1	-	3.6	6.3	-
Thailand	3.2	1.4	13.6	2.7	1.8	2.7	-	4.8	-
Viet Nam	0.1	0.2	2.4	0.2	0.5	0.4	0.4	-	-
Eastern Asia	24.3	34.0	40.1	37.4	43.9	33.3	37.6	51.3	41.9
China	2.4	2.0	4.6	1.9	1.3	1.5	2.1	3.7	2.0
Hong Kong	1.9	0.9	4.1	2.1	1.8	1.9	1.3	1.4	2.0
Japan	14.5	20.4	13.7	24.8	29.4	22.6	26.0	21.5	27.7
Korea	3.4	6.6	8.5	4.4	6.5	4.4	4.0	14.2	5.7
Taiwan	2.0	3.9	9.2	4.2	4.9	2.9	4.2	10.5	4.5
East and South East Asia	55.3	42.2	67.5	49.0	53.1	46.6	48.3	68.4	41.9
India	0.6	0.9	0.9	0.9	0.4	1.0	1.0	0.8	1.1
USA	8.7	11.3	6.3	12.3	19.1	18.6	12.4	5.0	17.6
EU28	22.4	22.1	15.6	20.1	13.9	16.0	18.6	13.3	20.1
Australia	3.2	5.2	1.1	4.8	2.1	2.5	2.8	1.8	3.6
Rest of the world	9.8	18.2	8.7	12.8	11.4	15.4	16.9	10.6	15.8

Source: Authors' elaboration on OECD-WTO TiVA database

Table A1 b). Foreign Value Added in Exports (geographical origin), ASEAN countries, 2011

Year 2011	BRN	IDN	KHM	MYS	PHL	SGP	THA	VNM	ASEAN (extra)
DVA in Exports (% of gross exports)	95.7	88.0	63.2	59.4	76.5	58.3	61.0	63.7	71.6
FVA in Exports (% of exports)	4.3	12.0	36.8	40.6	23.5	41.7	39.0	36.3	28.4
<i>Geographical distribution</i>									
FVA in Exports (=100)	100	100	100	100	100	100	100	100	100
ASEAN	27.6	15.6	17.3	17.9	14.1	10.2	12.0	15.0	-
Brunei Darussalam	-	1.8	0.2	0.1	0.1	0.1	0.1	0.7	-
Indonesia	3.2	-	1.7	5.9	4.6	4.1	3.5	3.2	-
Cambodia	0.0	0.0	-	0.0	0.0	0.0	0.1	0.3	-
Malaysia	10.7	5.1	2.8	-	2.7	3.1	3.5	3.4	-
Philippines	0.7	0.6	0.5	0.9	-	0.9	1.0	0.9	-
Singapore	10.9	4.1	2.0	6.2	3.7	-	2.9	2.3	-
Thailand	1.8	3.1	4.9	3.4	2.3	1.6	-	4.2	-
Viet Nam	0.3	0.8	5.2	1.4	0.6	0.4	0.8	-	-
Eastern Asia	23.1	26.0	54.5	31.2	30.5	21.6	32.6	40.4	35.2
China	8.9	10.4	32.5	11.2	10.2	7.4	10.4	17.4	12.6
Hong Kong	1.4	0.7	2.8	1.1	0.8	1.7	0.8	0.6	1.3
Japan	9.3	8.3	4.1	11.8	10.7	7.2	15.4	10.1	13.0
Korea	2.0	4.7	5.4	3.5	4.9	2.9	3.4	8.0	4.7
Taiwan	1.6	1.9	9.7	3.7	3.9	2.4	2.5	4.3	3.6
East and South East Asia	50.7	41.6	71.8	49.1	44.6	31.8	44.5	55.4	35.2
India	2.1	3.3	2.4	2.7	2.1	5.1	2.4	2.5	3.8
USA	16.3	5.9	5.5	10.5	10.0	12.2	6.9	5.9	11.2
EU28	16.1	9.5	7.8	13.5	7.7	19.4	11.6	10.4	16.3
Australia	1.7	3.4	1.2	3.2	2.6	3.0	4.6	3.9	4.0
Rest of the world	13.2	36.2	11.3	21.0	33.1	28.5	29.9	21.9	29.4

Source: Authors' elaboration on OECD-WTO TiVA database

Table A2 a). Foreign Value Added in Exports (geographical origin), Eastern Asia and India, 1995

Year 1995	CHN	HKG	JPN	KOR	TWN	EASIA (extra)	IND
DVA in Exports (% of gross exports)	66.7	78.4	94.4	77.7	69.4	89.9	90.7
FVA in Exports (% of exports)	33.3	21.6	5.6	22.3	30.6	10.1	9.3
<i>Geographical distribution</i>							
FVA in Exports (=100)	100	100	100	100	100	100	100
ASEAN	6.3	7.8	11.8	7.8	7.9	12.6	5.5
Brunei Darussalam	0.0	0.1	0.4	0.3	0.1	0.3	0.0
Indonesia	1.8	1.1	4.0	3.1	2.1	3.7	1.3
Cambodia	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Malaysia	1.3	1.2	2.2	1.6	1.8	2.6	1.3
Philippines	0.3	0.9	0.8	0.6	0.6	1.0	0.2
Singapore	1.4	2.6	1.9	1.3	1.8	2.7	1.5
Thailand	1.3	1.7	2.0	0.7	1.2	2.1	1.1
Viet Nam	0.1	0.1	0.4	0.1	0.1	0.3	0.0
Eastern Asia	46.7	50.1	14.4	31.7	41.3	-	13.1
China	-	17.1	3.8	3.3	2.2	-	1.4
Hong Kong	4.7	-	1.2	0.8	1.5	-	1.1
Japan	23.7	19.4	-	25.5	32.6	-	7.0
Korea	8.9	7.1	5.8	-	4.9	-	2.5
Taiwan	9.4	6.4	3.6	2.1	-	-	1.1
East and South East Asia	53.0	57.8	26.2	39.6	49.2	12.6	18.6
India	0.4	0.7	0.8	0.7	0.5	0.9	-
USA	11.9	12.2	22.8	17.7	16.6	26.3	11.0
EU28	17.1	15.7	20.8	15.3	15.4	27.4	25.0
Australia	2.2	2.7	5.1	4.5	2.8	5.2	3.3
Rest of the world	15.4	11.0	24.2	22.3	15.6	27.6	42.2

Source: Authors' elaboration on OECD-WTO TiVA database

Table A2 b). Foreign Value Added in Exports (geographical origin), Eastern Asia and India, 2011

	CHN	HKG	JPN	KOR	TWN	EASIA extra	IND
DVA in Exports (% of gross exports)	67.9	79.6	85.4	58.4	56.5	78.6	76.0
FVA in Exports (% of exports)	32.1	20.4	14.6	41.6	43.5	21.4	24.0
<i>Geographical distribution</i>							
FVA in Exports (=100)	100	100	100	100	100	100	100
ASEAN	9.6	9.1	11.8	8.8	9.7	13.6	7.6
Brunei Darussalam	0.1	0.1	0.6	0.4	0.1	0.3	0.2
Indonesia	2.0	1.8	4.4	3.7	3.4	3.8	2.6
Cambodia	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Malaysia	2.5	0.9	2.4	1.5	2.2	3.1	1.5
Philippines	1.0	0.5	0.8	0.6	0.9	1.2	0.5
Singapore	1.9	4.5	1.2	1.3	1.9	2.4	1.6
Thailand	1.7	1.1	1.6	0.7	1.0	2.0	0.9
Viet Nam	0.5	0.2	0.7	0.6	0.3	0.7	0.2
Eastern Asia	30.6	41.8	21.7	26.0	33.5	-	14.5
China	-	26.2	14.7	11.4	11.3	-	8.5
Hong Kong	1.6	-	0.6	0.6	0.9	-	0.7
Japan	14.7	8.8	-	12.0	16.7	-	2.6
Korea	8.3	3.3	4.2	-	4.6	-	1.8
Taiwan	6.0	3.6	2.3	2.0	-	21.1	1.0
East and South East Asia	40.2	50.9	33.5	34.8	43.2	13.6	22.1
India	2.0	3.5	1.2	1.8	1.6	2.7	-
USA	9.4	11.4	10.8	8.5	8.9	13.0	9.2
EU28	17.0	15.7	12.8	11.0	9.7	21.2	14.2
Australia	3.9	2.5	6.5	5.4	4.6	6.4	3.9
Rest of the world	27.4	16.0	35.2	38.5	32.0	43.1	50.5

Source: Authors' elaboration on OECD-WTO TiVA database

Table A3 a). Domestic Value Added in Foreign Exports (geographical distribution), ASEAN, 1995

Year 1995	BRN	IDN	KHM	MYS	PHL	SGP	THA	VNM	ASEAN (extra)
DVA in Foreign Exports (% of gross exports)	21.1	16.3	18.0	15.6	12.8	12.3	12.1	13.1	12.5
<i>Geographical distribution</i>									
DVA in Foreign Exports	100	100	100	100	100	100	100	100	100
ASEAN (intra + extra)	35.5	20.7	68.5	30.9	17.6	22.0	22.9	35.0	-
Brunei Darussalam	-	0.0	0.0	0.2	0.0	0.2	0.1	0.0	-
Indonesia	0.9	-	0.4	1.6	0.9	2.6	1.3	1.6	-
Cambodia	0.0	0.1	-	0.0	0.0	0.0	0.2	0.4	-
Malaysia	3.3	5.0	12.3	-	3.5	10.5	6.8	5.4	-
Philippines	0.4	1.6	0.2	1.3	-	2.2	1.7	4.3	-
Singapore	16.2	11.1	2.8	22.2	9.2	-	12.1	15.4	-
Thailand	14.3	2.5	51.3	5.2	3.7	5.5	-	7.9	-
Viet Nam	0.3	0.4	1.5	0.4	0.3	0.8	0.8	-	-
Eastern Asia	52.4	41.1	12.4	25.2	28.5	24.4	25.3	30.7	38.5
China	3.0	8.9	4.6	6.1	4.5	6.3	7.6	7.4	9.1
Hong Kong	2.2	1.3	1.5	1.3	3.2	2.7	2.4	1.3	2.6
Japan	20.3	11.4	1.5	5.8	7.0	4.9	6.5	11.0	9.7
Korea	21.6	11.0	0.9	5.2	6.4	4.1	3.0	5.3	8.0
Taiwan	5.4	8.6	3.9	6.7	7.4	6.3	5.8	5.8	9.0
East and South East Asia	87.9	61.8	81.0	56.1	46.1	46.3	48.3	65.8	38.5
India	0.1	0.5	0.1	0.5	0.2	0.5	0.5	0.1	0.6
USA	2.5	7.8	2.1	12.9	20.7	17.1	12.6	3.0	17.1
EU28 (intra + extra)	4.6	18.8	7.9	20.9	23.9	25.4	26.3	17.6	29.7
Australia	1.3	3.1	0.4	1.9	0.8	1.9	1.6	7.1	2.8
Rest of the world	3.7	7.9	8.6	7.7	8.2	8.8	10.7	6.4	11.3

Source: Authors' elaboration on OECD-WTO TiVA database

Table A3 b). Domestic Value Added in Foreign Exports (geographical distribution), ASEAN, 2011

Year 2011	BRN	IDN	KHM	MYS	PHL	SGP	THA	VNM	ASEAN (extra)
DVA in Foreign Exports (% of gross exports)	42.7	31.5	11.9	19.8	27.4	19.9	15.4	16.0	12.5
<i>Geographical distribution</i>									
DVA in Foreign Exports	100	100	100	100	100	100	100	100	100
ASEAN (intra + extra)	19.8	23.3	34.0	19.3	17.9	22.0	21.5	21.1	-
Brunei Darussalam	-	0.0	0.0	0.1	0.0	0.1	0.0	0.0	-
Indonesia	8.8	-	0.8	2.6	0.9	2.0	2.2	1.4	-
Cambodia	0.1	0.1	-	0.1	0.1	0.1	0.3	0.9	-
Malaysia	2.1	9.0	4.8	-	5.0	12.1	9.4	10.1	-
Philippines	0.2	1.1	0.2	0.9	-	1.1	1.0	0.7	-
Singapore	1.5	6.7	6.0	6.8	5.2	-	4.8	2.9	-
Thailand	2.7	4.9	10.3	6.5	5.2	5.1	-	5.2	-
Viet Nam	4.5	1.6	11.8	2.2	1.6	1.5	3.7	-	-
Eastern Asia	47.9	47.9	24.6	49.7	53.0	37.6	42.0	41.3	57.3
China	9.7	18.3	16.5	29.8	32.4	21.4	27.3	21.5	30.2
Hong Kong	0.3	0.7	0.3	0.4	0.6	2.1	0.7	0.4	1.2
Japan	15.4	8.2	2.7	5.9	5.6	2.9	5.4	6.0	7.6
Korea	20.4	13.7	3.4	7.3	7.8	6.2	4.9	10.2	11.3
Taiwan	2.1	7.0	1.7	6.1	6.6	5.0	3.7	3.2	7.0
East and South East Asia	67.8	71.2	58.6	68.9	70.9	59.6	63.5	62.4	57.3
India	4.3	4.1	1.8	3.1	3.0	3.3	2.6	1.4	4.2
USA	1.3	3.3	6.9	3.6	4.1	4.5	4.5	5.1	5.0
EU28 (intra + extra)	4.1	10.5	20.3	11.5	12.9	21.0	14.6	15.5	17.7
Australia	15.6	3.7	0.5	4.3	0.6	2.1	2.1	6.8	4.4
Rest of the world	6.9	7.2	12.0	8.5	8.5	9.5	12.7	8.9	11.4

Source: Authors' elaboration on OECD-WTO TiVA database

Table A4 a). Domestic Value Added in Foreign Exports (geogr. distribution), Eastern Asia and India, 1995

	CHN	HKG	JPN	KOR	TWN	EASIA (extra)	IND
DVA in Exports (% of gross exports)	9.5	15.8	23.8	17.1	15.8	17.9	13.6
<i>Geographical distribution</i>							
DVA in Foreign Exports (=100)	100	100	100	100	100	100	100
ASEAN	11.7	18.9	18.8	16.9	17.6	26.2	15.4
Brunei Darussalam	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indonesia	1.1	0.8	1.3	1.9	1.5	2.0	1.3
Cambodia	0.0	0.1	0.0	0.0	0.1	0.0	0.0
Malaysia	2.8	5.2	4.4	3.5	4.4	6.1	3.6
Philippines	0.7	1.7	2.0	1.9	1.9	2.7	0.6
Singapore	4.0	8.3	7.2	6.3	5.4	9.8	6.5
Thailand	2.5	2.5	3.7	2.6	3.5	5.0	3.2
Viet Nam	0.4	0.2	0.3	0.8	0.8	0.6	0.2
Eastern Asia	36.1	41.9	29.9	33.0	35.3	-	16.8
China	-	27.6	9.8	16.6	23.1	-	3.7
Hong Kong	14.0	-	1.9	3.1	3.7	-	1.5
Japan	7.6	4.1	-	6.1	5.0	-	4.3
Korea	8.2	3.2	7.5	-	3.6	-	4.1
Taiwan	6.2	7.1	10.7	7.2	-	-	3.3
East and South East Asia	47.8	60.8	48.7	49.9	52.9	26.2	32.2
India	0.4	0.5	0.2	0.4	0.2	0.4	-
USA	13.5	6.9	18.4	15.2	16.5	24.8	8.5
EU28	23.9	18.7	20.6	18.8	17.9	29.7	36.0
Australia	1.1	1.4	1.1	0.9	1.0	1.6	1.1
Rest of the world	13.3	11.7	11.1	14.8	11.5	17.4	22.2

Source: Authors' elaboration on OECD-WTO TiVA database

Table A4 b). Domestic Value Added in Foreign Exports (geogr. distribution), Eastern Asia and India, 2011

	CHN	HKG	JPN	KOR	TWN	EASIA (extra)	IND
DVA in Exports (% of gross exports)	15.6	23.2	32.8	20.5	24.1	18.2	19.1
<i>Geographical distribution</i>							
DVA in Foreign Exports	100	100	100	100	100	100	100
ASEAN	13.7	15.7	14.9	12.1	14.9	24.1	15.3
Brunei Darussalam	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indonesia	0.9	0.6	0.8	1.0	0.6	1.4	1.0
Cambodia	0.3	0.2	0.0	0.1	0.3	0.3	0.1
Malaysia	3.9	3.9	4.3	3.0	4.8	6.9	3.3
Philippines	0.6	0.4	0.6	0.6	0.8	1.1	0.4
Singapore	2.8	6.9	2.8	2.6	3.4	5.1	6.8
Thailand	3.3	2.8	5.1	2.6	3.1	6.5	2.7
Viet Nam	2.0	0.8	1.2	2.2	1.8	2.8	1.0
Eastern Asia	23.4	46.7	51.5	51.2	58.0	-	25.6
China	-	34.2	31.8	41.1	46.7	-	14.7
Hong Kong	2.2	-	0.8	0.7	1.1	-	1.0
Japan	6.3	2.6	-	4.3	3.7	-	1.8
Korea	9.6	5.3	10.6	-	6.4	-	5.4
Taiwan	5.4	4.6	8.3	5.2	-	-	2.7
East and South East Asia	37.1	62.4	66.4	63.4	72.9	24.1	40.9
India	3.0	2.5	1.0	1.6	1.3	3.2	-
USA	10.1	4.2	6.8	5.9	5.2	13.1	5.8
EU28	27.9	19.3	13.3	14.6	11.9	32.4	33.3
Australia	1.2	1.6	0.8	0.5	0.5	1.6	0.6
Rest of the world	20.8	10.0	11.7	14.0	8.2	25.7	19.3

Source: Authors' elaboration on OECD-WTO TIVA database

Part II:

EU external trade strategy vis-à-vis Asia

ABSTRACT

As countries participating in 'Factory Asia' grow more integrated with one another, regional trade agreements have flourished in recent years with the ultimate aim of making production networks in the region work as smoothly as possible. It is more and more important for the EU to secure good trade relations with Asia, the most dynamic area in world trade. To this end it must adopt a coherent trade strategy *vis-à-vis* the different Asian economies participating in regional value chains in which EU companies are significantly and increasingly involved. The Transpacific Partnership (TPP) opens a potentially new phase for EU external trade strategy towards Asia. China's *de facto* marginalisation in the current mega-deals (TPP and the Transatlantic Trade and Investment Partnership (TTIP)) has weakened its bargaining power *vis-à-vis* the leading world economies of the United States and Japan. The latter are China's most important trading partners, but are trying to counter the on-going trend towards a more central role of China in APEC (Asia Pacific Economic Cooperation) trade. In this context, the EU is in a delicate position. Although it is marginalised by the TPP, its bargaining power towards the other marginalised actor, China, has been strengthened. As a consequence, the EU might exploit this position through initiatives and overcome the current inertia in its policy towards Asia. This would entail ending the internal deadlock on the EU-Singapore FTA, ensuring the FTA with Korea functions well and moving ahead in the postponed negotiations for an FTA and bilateral investment treaty (BIT) with China. Overcoming the institutional stalemate in the EU-Singapore FTA would not only improve the EU's reputation as a trade partner *vis-à-vis* the whole of Asia, but would also favour improved trade relations with the major hub in South East Asia that is also a TPP member country.

Executive summary

Asia is the world's fastest growing region and is currently by far the EU's largest partner region in trade, and is therefore crucial for the EU's economic growth and prosperity. Intra-regional trade in Asia has also contributed to economic growth in the region and to making Asia a hub for international world trade. Since the 2000s, there has been a rapid proliferation of bilateral and regional FTAs in Asia as well as major plurilateral FTAs across the region including the Trans Pacific Partnership (TPP) signed in 2015, and the Regional Comprehensive Economic Partnership (RCEP) and the China-Japan-South Korea trilateral FTA that are currently both still being negotiated.

The EU is China's largest trading partner while China is the EU's second largest partner with nearly EUR466.8 billion in bilateral trade in goods in 2014. Japan, South Korea and India are the EU's 7th, 8th and 9th largest trading partners with total bilateral trade in goods in 2014 of EUR108.48 billion, EUR81.99 billion and EUR72.59 billion respectively. ASEAN as a region is the EU's third largest trading partner outside Europe, after the U.S. and China, with more than EUR179.72 billion (US\$195.7 billion) trade in goods in 2014. The EU is ASEAN's second largest trading partner (2014) and is the largest foreign investor in the region with 22 % of foreign direct investment (FDI) inflow into ASEAN. More than 10,000 European companies currently operate in Southeast Asia.

The EU has entered into a series of FTAs with Asian countries. The EU-Korea FTA is one of the most comprehensive free trade agreements ever negotiated by the EU and was the first of the new generation of FTAs launched in 2007 as part of the 'Global Europe' initiative. These agreements, based on solid economic criteria, represent stepping-stones for future liberalisation as they tackle issues, which are not ready for multilateral discussion, and that go beyond the market opening that can be achieved in the WTO context.

The EU has several on-going FTA negotiations with other Asian countries: India (since 2007), Malaysia (since 2010), Vietnam (since 2012, now concluded but not yet ratified), Thailand (since 2013), Japan (since 2013), and New Zealand (since 2015) as well as investment agreement talks with China. Scoping exercises are underway for FTAs with the Philippines, Brunei, and Indonesia. In September 2013, the EU and Singapore initialled a comprehensive bilateral free trade agreement (FTA) that had been under negotiation since March 2010. The EU-Singapore FTA is a highly ambitious and comprehensive agreement that seeks to unlock serious untapped potential between the two Parties. According to a report by the European Commission's Directorate General for Trade, within a decade, the FTA could boost EU's exports to Singapore by around EUR 1.4 billion and Singapore's exports to the EU by almost EUR 3.5 billion. The report also estimates an increase in the EU's real GDP resulting from the FTA with Singapore of around EUR 550 million and an increase of EUR 2.7 billion for Singapore. Negotiations on investment rules continued until 17 October 2014 and were intended to pave the way for ratification and the eventual entry into force of the agreement. However, the EU-Singapore FTA has still not entered into force, as it currently remains mired in an institutional deadlock between the European Commission and the Council over a dispute concerning the implementation of the Treaty of Lisbon. The Commission sought a ruling from the European Court of Justice on the competence issue, essentially concerning investment. This opinion of the Court will have to clarify the EU competence to sign and ratify the FTA with Singapore.

The EU-Singapore FTA is the EU's first comprehensive FTA completed with a country in the South East Asian region, and is only the EU's third in Asia following the EU-South Korea FTA and the agreement with Viet Nam signed in 2015. As such, the EU-Singapore FTA has been widely hailed in Europe as a strategic accomplishment for the EU's partnership with the Asian trading giant and as a gateway for the EU into the dynamic South East Asian market. It has also been perceived as a mini-victory in the EU's overall approach to Asia as the EU-Singapore FTA is crucial also for the EU-ASEAN relations. In 2007, the EU and

ASEAN had initiated negotiations on a region-to-region FTA but this was shelved seven rounds later in 2009, primarily over human rights concerns regarding Myanmar. However, the EU Joint Communication entitled 'The EU and ASEAN: a partnership with a strategic purpose' issued on 19 May 2015, called for the EU to scale up its trade relations with ASEAN towards an ambitious region-to-region FTA 'building on bilateral agreements between the EU and ASEAN Member States'. The EU-Singapore FTA is the first agreement that needs to be in place in order to build a block-to-block FTA between the EU and ASEAN and would set the tone for agreements with the other ASEAN members and ultimately with ASEAN as a whole.

ASEAN, which is progressively gaining prominence, would then provide a steppingstone for the EU to enter Asia. Not only does ASEAN find itself at the heart of Asia's emerging regional economic and security architecture, but also as a regional organisation, ASEAN's integration process is advancing at a pace. By the end of 2015, ASEAN has pledged to implement its ASEAN Economic Community (AEC) that seeks to 'transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy'. Already, ASEAN represents a 600 million strong market and a combined GDP of about USD 2.5 trillion.

ASEAN's nominal GDP has grown from US\$ 1.3 trillion in 2007 to US\$ 2.4 trillion in 2013, while GDP per capita has risen from US\$ 2249 to US\$ 3832 over the same period. The economic convergence among ASEAN countries has increased rapidly – GDP per capita of the richest ASEAN economy was 105 times larger than the poorest ASEAN economy in 2007; in 2013 it was just 62 times. This gap is set to reduce further to 47 times by 2018. The least developed economies, such as Cambodia, Laos, Myanmar and Vietnam are also driving growth in ASEAN - their economies today constitute around 10 per cent of ASEAN's GDP (2013), up from only 7 % in 2007.

Beyond its own dynamic economy, ASEAN lies at the core of two mega-FTAs in Asia: the high profile TPP (Transpacific Partnership) and RCEP (Regional Comprehensive Economic Partnership). The TPP in particular is not exclusive or restrictive as such and could eventually expand to embrace all ASEAN countries. In this regard, ASEAN member countries hope to ultimately transform the mega-FTAs into a Free Trade Area of the Asia Pacific (FTAAP). Already today however, both the TPP and RCEP will spur intra-regional trade and Asian trade with the Pacific Rim countries, and could also result in important trade diversion from transatlantic trade towards the Asia Pacific region. The TPP is also consolidating US interests in the region alongside those of China and is projecting US approaches to the regulation of trade and commerce to the detriment of the EU. This has an impact on the EU because the EU and the US are the two main sources of trade rules and they are in some respects competitors. This phenomenon, coupled with the fact that the EU remains largely absent from the region's free trade architecture, will inevitably make EU trade with the region more difficult.

While the EU-Singapore FTA is likely to be implemented eventually, the current institutional impasse has a number of important consequences. First of all, the deadlock has led to a temporary setback in EU-Singapore ties. Second, it has raised serious questions about the EU's common commercial policy in the sense that it has undermined the trust in the EU as a negotiating partner among the other countries presently negotiating or seeking an FTA with the EU. On a related point, the dispute, which has emerged post agreement between the EU and Singapore, has brought into question the EU's ability to perform as a reliable trading partner. The stalemate could therefore seriously jeopardise EU's external trade policy in general and its strategy vis-à-vis Asia in particular.

The dispute over ratification of the EU-Singapore FTA results from the diverging views of the Commission and Council on whether the whole of the agreement is covered by exclusive EU competence or whether the text is a mixed agreement requiring separate ratification by every EU member state parliament. On 30 October 2014 the Commission declared its intention to request an opinion from the European Court of Justice (ECJ) clarifying the interpretation of the Lisbon Treaty. According to EU officials, the difference of

opinions arose during a Commission meeting with the Council at which the FTA with Singapore was only a minor item on the agenda. Once it emerged that the Council did not agree on the use of exclusive competence, neither of the parties sought to elaborate or further discuss the issue. So it seems clear that the Commission was intent on seeking the opinion of the ECJ. Areas of contention include the investment chapter as well as, those on transport, services, transparency, and intellectual property.

The Commission-Council dispute over the scope of exclusive competence of the EU raises the question whether the EU has a viable, watertight common post-Lisbon Treaty commercial policy and whether it can compete in negotiating trade agreements at a time when bilateral and mega-regional free trade agreements are proliferating at an all-time high. The internal power struggle between the Council and the Commission spills over into external relations and does not bode well for the EU for obvious reasons. The impasse has critically stalled the progress of the EU's trade strategy with both ASEAN and broader Asia at a time of intense FTA activity by the EU's top competitors in the region – China and the US. Compared to the pace of growth of Asian FTAs, the speed with which the EU has been negotiating FTAs with Asian countries is considerably slower. Nor does the EU have anything equivalent to the TPP that spans the region. The proposed plan to re-launch the EU-ASEAN region-to-region FTA also depends largely on the EU-Singapore FTA.

While the Commission has decided to address the question of its competence head on, its request for clarification by the ECJ only relates to the agreement with Singapore. The official request mentions that 'in case of the EU-US trade talks, for instance there will most likely be a number of elements that will require ratification by national parliaments' (European Commission, 2014). It is therefore uncertain that a clarification from the ECJ on Singapore would also to all future FTAs. This means a degree of uncertainty for other countries negotiating or seeking to enter into investment agreements or FTAs with the EU. It is therefore essential for resolution of the dispute to be found and for the EU to reboot its external trade strategy with Asia.

Current trade negotiations among the Asian economies have important geo-political rationales and implications. The Indian Ocean, South China Sea and East China Sea are vital transit routes for the world economy (eight out of ten of the world's busiest container ports are in the region; two-thirds of the world's oil shipments travel across the Indian Ocean on their way to the Pacific; almost 30 % of global maritime trade goes across the South China Sea, including goods worth US\$1.2 trillion annually bound for the U.S. Around 75 % of global crude and natural gas also transits the South China Sea each year, where there are currently serious territorial disputes. A large part of the territorial waters in the South China Sea is contested and China is the biggest and the most assertive claimant country. Through its so-called 'Nine-Dash Line' (a line marking the borders of Chinese territorial waters as viewed from China) Beijing claims sovereignty over more than 90 % of the South China Sea. These geo-political tensions have been at the centre of both the new Pentagon 'Asia-Pacific Maritime Security Strategy' announced in August 2015, and the acceleration of TPP negotiations, which is also part of US-driven China containment. The TPP excludes China, which has long claimed that the US never had the intention to invite China to join. There is little doubt that the TPP is also understood as a political initiative by Japan in particular as a trade pact that strengthens commercial ties between the U.S. and like-minded countries that share concerns about China's economic and military rise.

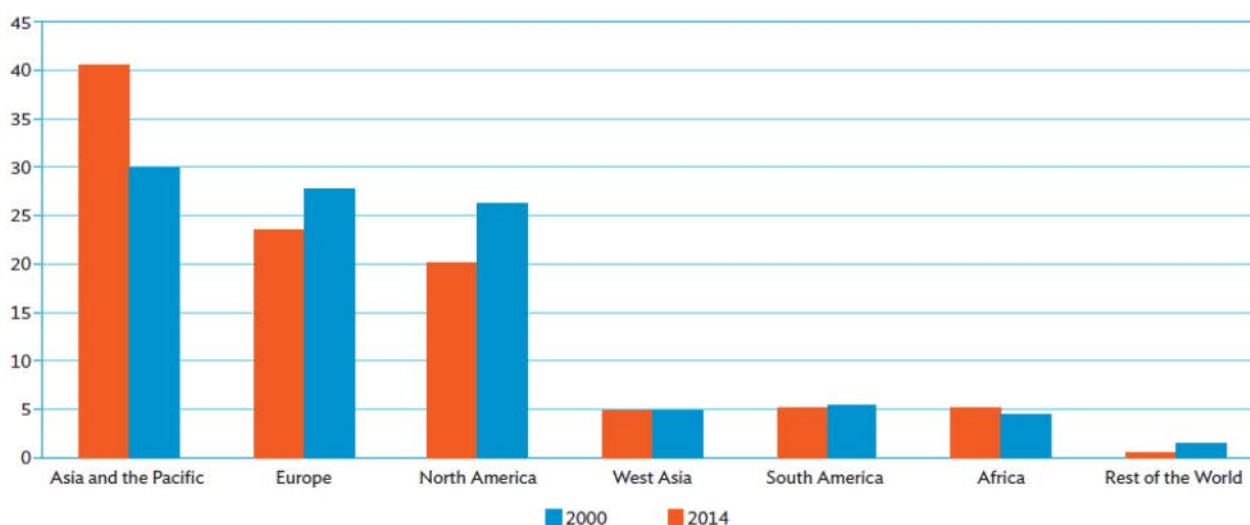
The TPP opens a potentially new phase for EU external trade strategy towards Asia. China's de facto marginalisation in current mega-deals (TPP and TTIP) has weakened its position in terms of bargaining power *vis-à-vis* the leading world economies of the United States and Japan. The latter are China's most important trading partners but are also trying to counter the trend towards China gaining a more central role in APEC trade. In this context, the EU is in a delicate position. Although it is marginalised by the TPP, its bargaining power towards the other marginalized actor, China, could be said to have been strengthened. As a consequence, the EU might exploit this position by taking initiatives in its trade policy

towards Asia. This would entail ending the internal deadlock on the EU-Singapore FTA in South East Asia, ensuring a well-functioning FTA with Korea and moving ahead with the postponed negotiations for an FTA and BIT with China. So overcoming the institutional stalemate on the competence question in the EU-Singapore FTA would improve the EU's reputation as a trading in the eyes of its potential Asian partners, and thus improve the prospects of trade relations with the major hub that is Southeast Asia.

1 The Asian century and its economic and trade implications for the EU

Since the turn of the XXI century, Asia has become a new major engine of global growth. Whereas the United States' economy grew by an average of 1.6 % a year over the past decade, the European Union's by 1.7 % and Latin America's by 4.6 %, East Asia expanded by 5.4 % and South-East Asia by 5.9 % (data from the Economist). Above all, developing Asia is maintaining its growth momentum with an acceleration from 6.1 % in 2013 to 6.2 % in 2014 and 6.4 % in 2015. Consequently, Asia has considerably increased its regional share of world GDP over the past decade compared to other regions of the world (Figure 1). As such economic dynamism of Asian economies is expected to continue (OECD, 2015), the Asian share on world GDP is projected to reach 29.4 % in 2030 (up from 22.6 % in 2004, according to ADB, 2014). At the same time, the shares of Western Europe and the United States are both projected to decrease to around 25 % in 2030 (from 33 % and 28.5 % respectively in 2004). Within Asia, all countries, except Japan, are expected to increase their share of world GDP, and among them the faster-growing Asian developing economies will account for considerably larger shares of the projected global economy over the next two decades (from 11 % to 22 %).

Figure 1 Percentage distribution of GDP in the world economy, 2000 and 2014



GDP = gross domestic product, PPP = purchasing power parity.

Sources: Derived from Table 2.1 and World Development Indicators Online (World Bank 2015).

Source: ADB 2015 p

Sustained economic vitality in Asia compared with modest growth in other world regions has caused a major demand shift from Europe and the United States to Asia, currently the more vibrant market worldwide, and expected to remain such in the years to come. Combined with fast income and spending growth by Asian consumers, population growth is also contributing to market expansion, more so in the largest Asian emerging economies of China and India, the two most populous countries in the world (1.38 and 1.31 billion respectively), the latter projected to bypass the former with 1.5 billion in 2030. Therefore, domestic demand for goods and services will increase rapidly, including that for imported goods and services from the rest of the world, most notably for consumption and high-tech capital goods from advanced economies. Hence, securing good trade relations with Asia will be vital for the rest of the world, even more so for Europe, where growth has recovered much more slowly than in the United States after the 2009 recession. As a growing share of total employment in Europe is generated by demand outside the EU – around 14 % of EU jobs depend on extra-EU exports –, increasing EU trade flows to Asia will be crucial to implement the 'Europe 2020' strategy in the Asian century.

Sustained income growth in Asia has been primarily due to the increasing trade openness of Asian economies, which nearly tripled from 11 % in 1990 to 31 % in 2011 (according to ESCAP) and growing participation to world trade, which has boosted job creation and productivity. Trade plays a pivotal role in many developing economies in Asia. In 20 out of the 32 developing Asian economies, the total value of exports of goods and services in 2014, or the latest year for which data are available, exceeded 30 % of GDP. In 24 out of the same 32 economies, total imports exceeded 30 % of GDP. In the region's developed economies – Australia, Japan, and New Zealand – the ratios of exports to GDP and imports to GDP were less than 30 %.

Asia has become the most dynamic region in world trade. Compared to the 1950s, when most economic activity took place across the Atlantic, it has since gradually moved from the Atlantic to the Pacific, and today the 21 economies of the largest trans-Pacific grouping, Asia-Pacific Economic Cooperation (APEC), account for nearly half of global trade (*The Economist*). Most of the trade activity of APEC economies is with other APEC members: according to a CEPII study (Lemoine, 2014), for all APEC countries but Russia, intra-APEC trade is higher than 60 %. The three largest APEC countries – United States, Japan and China – account for half of intra-APEC trade and trade among those three countries represent 2/3 of total trade by all 21 APEC countries.

The most relevant trend from the EU perspective, and for the design of a comprehensive EU external trade strategy *vis-à-vis* Asia, is the changing role and increasing weight of Asia within APEC. The centre of gravity of intra-APEC trade has substantially changed over the last 15 years in favour of the Asian side of the Pacific to the detriment of the American side. While intra-APEC trade was fairly balanced (1/3 intra-America, 1/3 intra-Asia and 1/3 America-Asia) in 2000, today trade flows between the two sides of the Pacific have lost ground. The share of America-Asia trade declined from 31 % to 26 % of intra-APEC trade, while intra-Asia trade increased to 41 % and intra-America trade declined to 21 %. The dramatic increase in intra-Asia trade flows to the detriment of trade between Asia and Pacific economies has been mainly due to booming Chinese trade with other economies in Asia. China has become the largest trading country in the continent: the first exporter in the region (with 22 % of intra-regional exports) and the first importer (with 17 % of intra-regional imports). Therefore, China has become a central actor within APEC (replacing the United States) but also worldwide, given the importance of APEC trade over world trade.

These economic growth trends have coincided with structural change and industrialisation in developing Asia and the rest of the world; according to the ADB (2015), between 2000 and 2014, the share of agriculture in GDP fell in almost all the regions of the world. At the same time, the share of industry in GDP rose in around half of regional economies between 2000 and 2014 and the importance of services increased in most (ADB, 2015). These changes are likely to have profound implications for trade patterns over the next two decades, in particular for the importance of Asia's intraregional trade and its trade with the rest of the world. Specifically, according to some estimates based on the GTAP² model (ADB, 2011), the developing country share of global exports of all products will almost double, rising from 33 % in 2004 to 55 % by 2030, and the share of developing Asia will increase from 21 % to 40 % over the same period. China's share alone is forecast to grow from 7 % to 20 %, entirely at the expense of high-income countries. Not only exports, but also imports will grow, as the developing Asia's import share is forecast to rise from 18 % to 29 %.

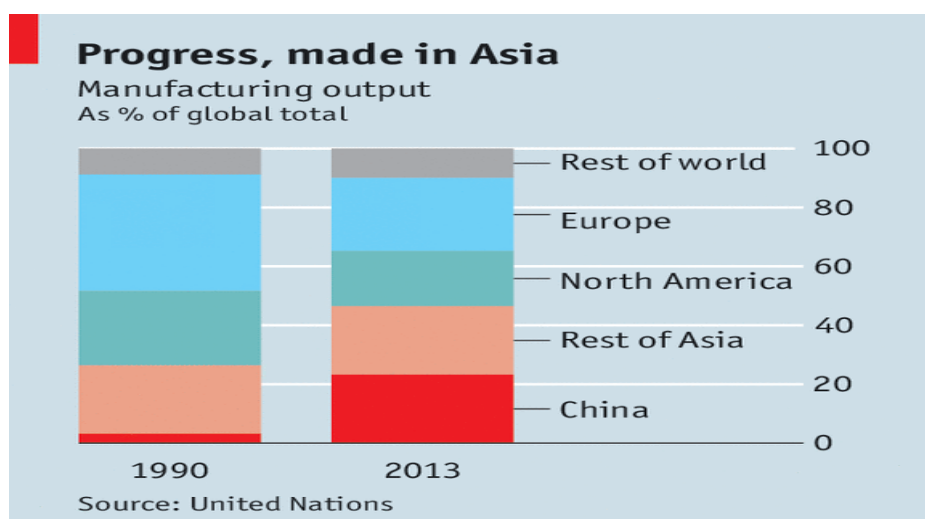
² The GTAP (Global Trade Analysis Project, is a global network of researchers and policy makers conducting quantitative analysis of international policy issues) model is a multi-region, multi-sector, computable general equilibrium (CGE) model, allowing economists to explore numerically a huge range of issues on which econometric estimation would be impossible; in particular to forecast the effects of future trade policy changes. Since its inception in 1993, GTAP has rapidly become a common 'language' for many of those conducting global economic analysis.

According to the Asian Development Bank, the product composition of Asian trade will change quite substantially due to rapid industrialisation in developing Asian economies and the projected increase in per capita income. Developing Asia's share of primary products in world exports will rise slightly and its share of manufactures in world exports will double by 2030 (ADB, 2011). Developing Asia's share of primary products in world imports will also rise substantially, due to expected continued rapid industrialisation. Given the political sensitivity of farm trade, it is worth noting that the regional shares of world trade in agricultural and food products are also projected to undergo substantial change. Developing countries' share of exports of these goods is projected to remain virtually unchanged, but their share of global imports of farm products rises dramatically, mainly due to the rise China and India. This will bolster export expansion of agricultural and food products from the rest of the world, especially from the world's largest producers, namely the United States, Australia and the EU. The changing role of Asia in world trade is therefore another reason why the EU should develop a more forward-looking trade strategy *vis-à-vis* Asia.

An effective EU trade strategy *vis-à-vis* Asia, as recently stated in the European Commission's communication 'Trade for all' (EC, 2015), should update trade policy to take account of the new economic realities, such as cross-border supply or value chains, that is, the splitting of the production of goods and services into linked stages of production scattered across international borders (either within or across regions)³. The rise of Global Value Chains (GVCs) has shaped world trade patterns over the past decade or so, and this is particularly evident in the case of Asia, where the growth of intra-Asian trade has been largely due to such value chains within the region (hence the term 'factory Asia'). Asia first emerged as a manufacturing power in the 1960s, when Japan began exporting electronics and consumer goods. Taiwan and Korea followed its lead. By the 1980s, Japanese firms were building plants across South-East Asia, and by 1990, Asia as a whole accounted for 26.5 % of global manufacturing output. China's opening was the game changer. The country attracted an increasing number of foreign firms (from other more advanced Asian economies, such as South Korea, Taiwan, Japan and from the rest of the world) to produce locally, initially only for export and then gradually also for the domestic Chinese market. By 2013, the Asian share of global manufacturing output had reached 46.5 %, of which China accounted for half, while the European share has dramatically shrunk (Figure 2).

³ When production is split into different stages across countries within a given region, these value chains are regional (and the related intermediate trade is also intra-regional). When countries from a variety of world's regions contribute to this production sharing, even if with just a small contribution in terms of value added, supply or value chains become global – the so called Global Value Chains (GVCs) (and intermediate trade spans across different world regions).

Figure 2. Manufacturing output in the world, 1990 and 2013 (% of global total)



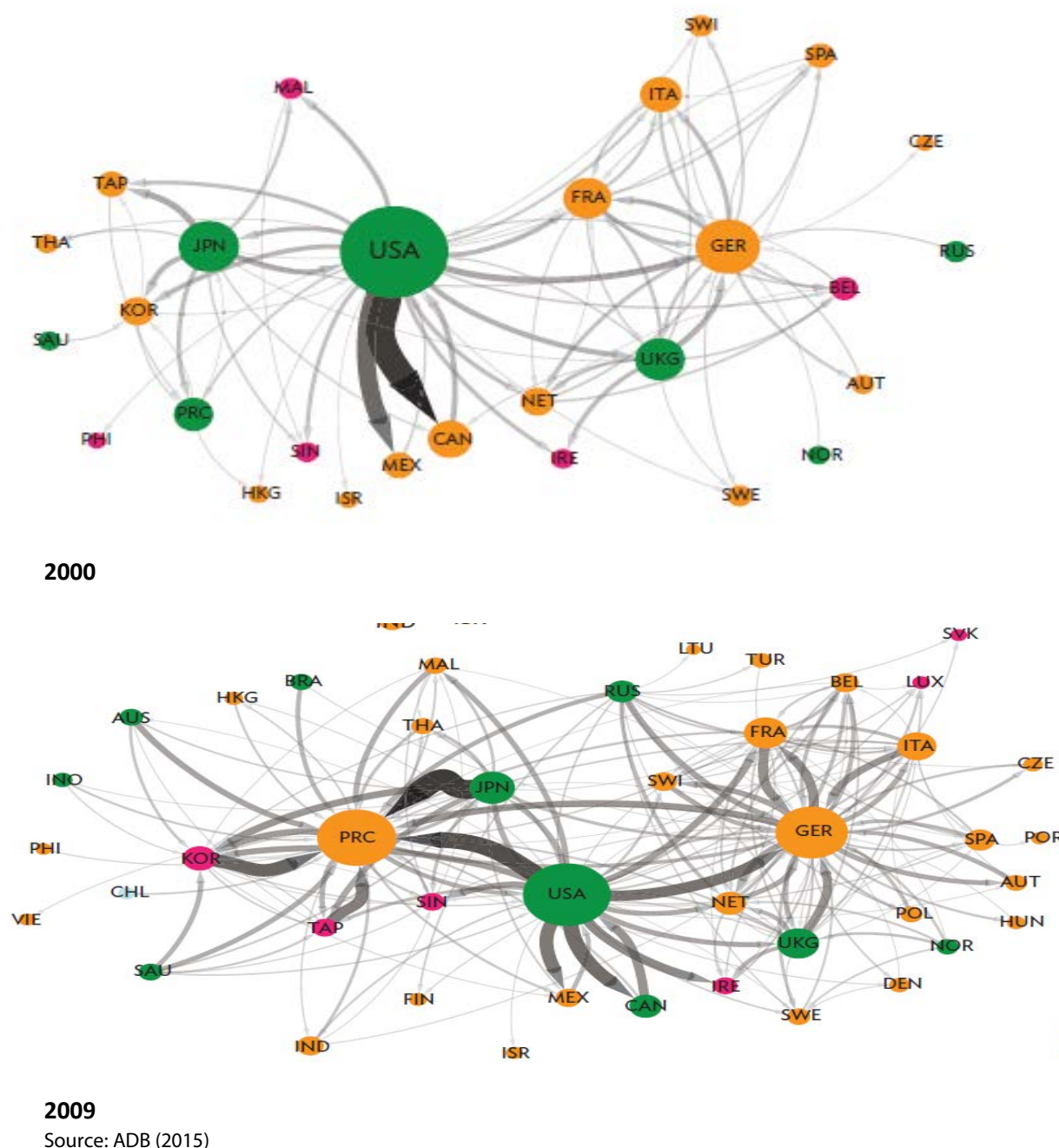
Economist.com

Source: The Economist

As cross-border supply or value chains split the production of goods and services into linked stages of production scattered across international borders (either within or between regions), they generate cross-border trade flows of intermediate goods, i.e. parts and components that are eventually pieced together into final products. Hence, a country or region's share of the global trade in intermediate inputs is an overall indicator of that country or region engagement in Global Value Chains (GVCs). Asia has increased dramatically its engagement in GVCs as measured by the region's share of the global trade in intermediate inputs. This rose from 14 % in 2000 to 50 % in 2012. Originally, the role of China in 'factory Asia' was simply as an assembler of imported inputs of parts, with limited (if any) local content and value added. The more profitable parts of the operation, such as design and marketing, remained in the West and Japan. Chinese workers contributed just 3.6 % to the cost of an Apple iPhone. Over time, Chinese local content progressively increased, and today 65 % of the content of goods China sells to the world are made at home, up from 40 % in the mid-1990s (*The Economist*).

The emergence of GVCs has brought about a progressive change in the global trade map. The rise of GVCs increased trade flows in intermediate goods within and between the NAFTA, the EU, and the Asian regional supply chain, with the People's Republic of China (PRC) at its core. The regional trading blocks are increasingly interconnected (Figure 3). Three main hubs – the US, Germany (GER), and the China – occupy the centre of a tightly knit web of trade flows. In the European regional network, horizontal integration prevails, with value added in goods flowing in both directions between pairs of countries. Asian production networks are more hierarchical. At the top, Japan and the US inject value by providing key components and services directly to China, which is the downstream hub. Malaysia, Thailand, and some other Southeast Asian economies, as well as India, also supply components to China that often embody value-added by the US and other industrial economies. Other key players at the centre of the regional networks are the Republic of Korea, Singapore, and Taiwan. GVCs have expanded rapidly and grown more complex since 1995. By 2005, the China had overtaken Japan as the centre of the Asian regional production network.

Figure 3. Evolution of GVCs since 2000



Relatively low Chinese wages have been crucial to the rise of China's role in 'factory Asia', so the current trend towards growing labour costs in China – where hourly manufacturing wages have risen by an average of 12 % a year since 2001 – has spurred the relocation of production out of China to the neighbouring countries in Southeast Asia, starting from low-tech sectors such as textiles and clothing and progressing to advanced manufacturing such as electronics. Much of this relocation has been in ASEAN. ASEAN economies will therefore grow more and more important in Asian manufacturing value chains. This will only work effectively if the region becomes more integrated. ASEAN countries have made progress in removing tariffs, especially on goods, but non-tariff barriers on consumer goods, electronics and the automobiles remain high, as do restrictions on services, investment and labour mobility. Custom regulations also constitute a trade cost. According to the McKinsey Global Institute, import/export costs (clearing customs, port fees, inland transportation, and so on) are 24 % higher in ASEAN than in China,

and the region's customs procedures take 66 % longer than the OECD average. Moreover, the average standard of education is lower than in China, as is that productivity and infrastructure.

As countries participating in 'Factory Asia' grow more integrated with one another, regional trade agreements have flourished over the last few years, with the ultimate aim being to make production networks in the region work as smoothly as possible. ASEAN nations have now a free-trade agreement with China and are negotiating a deepening regional integration within an ASEAN Economic Community. China and Korea have just signed a Free Trade Agreement. It is therefore becoming more and more important for the EU to secure good trade relations with these countries because European industry and services enterprises are significantly and increasingly involved in global value chains including the Asian economies, as detailed in the next Section.

2 The status of EU engagement in the Asia-Pacific region compared with Asian emerging powers and the US

One of the more widespread beliefs about economic globalisation is that the global economy has grown increasingly interconnected through trade and investment across continents. In fact, world trade has grown increasingly regional, that is it has mainly expanded within three regional trading blocs – the EU, NAFTA and APEC – and to a minor extent across regional blocks (Table 1). More specifically, intra-regional exports are the highest share of total exports in the EU (62.6 % in 2014), and the share is even higher in APEC (68.1 % in 2014), and to a lesser extent in North America (50.2 % in 2014) (Table 1). Similar trends hold on the import side (Table 2).

Table 1. Share of intra-regional exports in major world trading blocs, 1995 and 2014

	1995				2014			
	Intra-group	Rest of the region	Rest of the world	Total trade of group	Intra-group	Rest of the region	Rest of the world	Total trade of group
APEC	71.7		28.3	100	68.1		31.9	100
EU28	66.2	8.7	33.8	100	62.6	11.0	37.4	100
NAFTA	46.0	12.8	54.0	100	50.2	14.7	49.8	100
TPP	53.0		47.0	100	47.6		52.4	100

Source: author's elaboration on UNCTADstat

Notwithstanding the high share of intra-EU trade, the interconnection among regional trading blocs has grown over the past decade. The share of EU intra-regional exports decreased by almost 4 percentage points in favour of extra-regional exports over this period. Asia and the Asia-Pacific region have become important partners for the EU for both trade and investment, and today accounts for 19.8 % of EU exports. The EU is already China's largest trading partner while China is the EU's second largest partner with nearly EUR 466.8 billion in bilateral trade in goods in 2014 and 3.6 % of EU exports. Japan, Korea and India are the EU's 7th, 8th and 9th largest trading partners with total bilateral trade in goods in 2014 of EUR 108.48 billion, EUR 81.99 billion and EUR 72.59 billion trade in goods respectively, in the same year. As a region, ASEAN is the EU's third largest trading partner outside Europe, after the U.S. and China, with more than EUR 179.72 billion (US\$ 195.7 billion) trade in goods in 2014. The EU was ASEAN's second largest trading partner in 2014.

Table 2. Share of intra-regional imports in major world trading blocs, 1995 and 2014

	1995				2014			
	Intra-group	Rest of the region	Rest of the world	Total trade of group	Intra-group	Rest of the region	Rest of the world	Total trade of group
APEC	71.7		28.3	100	67.4		32.6	100
EU28	64.0	9.5	36.0	100	58.8	13.3	41.2	100
NAFTA	37.7	11.6	62.3	100	35.1	13.8	64.9	100
TPP	52.4		47.6	100	38.6		61.4	100

Source: author's elaboration on UNCTADstat

In comparison the US and major Asian emerging powers are much more engaged in the Asia-Pacific region as far as trade is concerned. The share of US exports destined to other APEC economies is 61.8 % and China within APEC accounts for 7.6 % of US exports, i.e. more than double the share for the EU (Table 3). In other words Asia-Pacific region, and China in particular, is much more important for the US than for the EU, as a final market for goods. Similarly, the share of APEC in total exports from Korea and China is as high as 72.5 % and 63.8 % respectively, and within APEC China accounts for more than 25 % of Korean exports. India's engagement in the Asia-Pacific is comparatively much lower, as only 39 % of Indian exports are destined for APEC markets, with only 4.2 % for Chinese. This confirms that India's level of regional integration is still very low and that there is still a long way to go in terms of China-India regionalism.

Table 3. Geographic composition of EU exports, compared to APEC, the US and selected Asian economies (2014)

Exports from:	EU28	US	South Korea	China	India
to:					
World	6139463908	1619742864	573074773	2342343011	317544642
EU28 (% on world)	62.6	17.1	9.1	15.8	16.2
APEC (% on world)	19.8	61.8	72.5	63.8	39.1
of which:					
China	3.6	7.6	25.4	-	4.2
US	6.7	-	12.3	17.0	13.4
other TPP	4.5	44.8	20.5	18.6	11.3

Source: author's elaboration on UNCTADstat

On the import side, intra-regional flows within APEC have declined from 72 % in 1995 to 67 % in 2014. The Asia-Pacific now imports more from outside the region, and the EU is a major trade partner for China in a number of sectors with shares above 50 % (in 27 of 255 sectors), although the share of China's imports from the EU declined from 16.5 % of the total in 1995 to 12.4 % in 2014 (Table 4). In many sectors, the share of the EU on total imports by APEC and ASEAN declined over the same period, which suggests massive trade diversion towards China to the detriment of other Asian economies.

Comparing the EU and US engagement in the APEC region the general trade trends is broadly similar. The US is slightly more important as an export market than the EU for Korea (as the EU and the US account for 12.3 % and 9.1 % of exports from Korea, respectively). The same holds for China, for which 17 % of its exports go to the US compared to 15.8 % to the EU (Table 3). On the other hand, the EU is a

greater export market for India than the US, as 16.2 % of Indian exports go to the EU compared to 13.4 % to the US.

Table 4. EU share on China's imports, 1995 and 2014 (%)

Imports from:	EU						US					
	China		APEC		ASEAN		China		APEC		ASEAN	
	1995	2014	1995	2014	1995	2014	1995	2014	1995	2014	1995	2014
[TOTAL] Total all products	16,5	12,4	16,1	14,0	15,1	9,1	12,2	8,2	16,3	10,1	13,9	7,1
[016] Meat, edible meat offal, salted, dried; flours, meals	5,3	97,5	23,2	41,7	27,8	31,4	9,9		20,2	32,2	29,2	12,2
[633] Cork manufactures	39,5	89,1	88,5	85,2	65,4	22,6	0,9	0,8	5,4	2,0	3,7	21,2
[212] Furskins, raw, other than hides & skins of group 211	53,3	79,6	63,9	69,0	0,4	76,9	7,6	3,8	17,7	12,2	37,1	6,2
[891] Arms & ammunition	80,9	79,3	37,4	42,7	60,8	20,1	0,8	8,0	36,4	18,4	13,8	17,1
[783] Road motor vehicles, n.e.s.	23,7	78,5	12,8	13,0	31,9	21,9	8,5	13,3	24,0	18,2	10,4	2,5
[677] Rails & railway track construction mat., iron, steel	50,2	78,0	33,2	29,3	32,2	13,6	0,0	1,8	6,7	15,8	4,7	0,5
[112] Alcoholic beverages	84,6	72,6	71,8	63,9	81,9	72,2	5,8	3,6	6,5	5,0	1,9	2,5
[073] Chocolate, food preparations with cocoa, n.e.s.	15,2	72,1	50,3	35,2	27,9	32,8	29,8	5,0	14,4	16,7	14,4	8,2
[791] Railway vehicles & associated equipment	73,2	70,7	36,1	33,3	67,2	18,0	12,6	7,6	20,2	24,9	5,0	14,4
[831] Travel goods, handbags & similar containers	3,2	70,0	21,4	29,0	44,8	39,7	1,1	0,4	2,3	0,9	4,4	1,4
[711] Vapour generating boilers, auxiliary plant; parts	39,5	68,6	40,4	14,4	51,2	6,2	29,6	2,0	18,9	5,9	11,7	1,8
[542] Medicaments (incl. veterinary medicaments)	52,7	67,7	60,7	59,1	46,9	41,1	4,8	9,6	10,8	8,5	7,4	8,9
[662] Clay construction, refract. construction materials	51,0	65,0	54,8	32,0	50,1	8,6	13,5	5,7	9,0	5,2	4,4	1,2
[725] Paper mill, pulp mill machinery; paper articles man.	56,1	62,4	53,7	49,9	55,1	24,0	5,3	5,9	12,1	7,2	6,4	4,0
[762] Radio-broadcast receivers, whether or not combined	0,1	61,8	0,8	4,7	1,3	4,3	0,2	1,7	4,9	4,8	1,1	0,9
[812] Sanitary, plumbing, heating fixtures, fittings, n.e.s.	10,0	61,5	23,1	26,9	34,4	7,1	34,2	5,0	21,3	10,3	7,8	1,4
[265] Vegetable textile fibres, not spun; waste of them	73,2	59,7	38,0	53,5	8,6	2,4	0,2	0,0	0,4	0,1	5,2	0,4
[726] Printing & bookbinding machinery, & parts thereof	41,9	58,2	51,8	45,9	47,5	18,5	10,2	4,0	10,9	5,8	9,0	4,0
[781] Motor vehicles for the transport of persons	65,5	57,7	23,7	35,4	33,1	27,2	8,8	20,5	12,0	11,5	1,3	4,0
[712] Steam turbines & other vapour turbin., parts, n.e.s.	36,4	55,6	28,9	29,8	37,3	17,0	22,6	7,6	27,9	7,2	11,9	5,3
[722] Tractors (excluding those of 71414 & 74415)	47,4	55,0	44,8	37,0	36,4	8,0	34,4	28,2	15,4	17,9	15,0	4,6
[541] Medicinal and pharmaceutical products, excluding 542	56,7	54,8	47,7	55,6	32,4	41,9	9,9	22,5	18,9	14,9	9,4	14,1
[742] Pumps for liquids	45,0	53,6	33,7	31,8	29,5	20,4	17,0	14,6	26,0	17,3	19,3	15,9
[745] Other non-electr. machinery, tools & mechan. appar.	48,7	53,1	44,8	41,4	41,9	36,0	9,2	9,6	18,1	11,7	11,3	6,5
[821] Furniture & parts	15,7	52,8	19,4	13,7	24,3	10,5	9,8	7,7	12,8	6,0	10,4	3,4
[724] Textile & leather machinery, & parts thereof, n.e.s.	30,3	51,2	37,8	30,2	27,3	17,5	2,1	1,5	4,4	4,3	3,6	1,2
[846] Clothing accessories, of textile fabrics	0,8	50,4	19,9	12,3	13,2	15,2	0,9	1,1	7,9	1,7	2,0	1,9

Source: author's elaboration on UNCTADstat

Although the Asia-Pacific accounts for a relatively small share of total EU exports (including intra-EU trade), the EU is much more engaged in the region than one might imagine by just looking at total trade flows between the two regions. Some EU industrial sectors are heavily dependent exports originating in Asia (and to a major extent from China), including industrial supplies and high-tech parts and components of strategic industries (such as electronics), as well as raw minerals (most notably, rare earths elements, which are critical resources for high-tech sectors). Therefore, a comprehensive description of the EU and US engagement in Asia-Pacific also requires analysing some specific sectoral trends. Table 5 shows that intra-regional trade in high-skill parts and components of electrical and electronic goods is much lower in the EU than the share of intra-EU total trade (39 % vs. 59 %), and this is even more true for the US, whose share of imports of such goods from outside North America is 88 %. This high dependence of major world powers on imports from Asia – and mostly from China – implies a strong dependence of industrial production in the EU and US upon a constant flow of imports of industrial supplies from Asia, and therefore from good trade relations with Asia.

Table 5. Share of intra-regional imports of high-skill parts and components of electronics goods in major world trading blocs, 1995 and 2014

	1995				2014			
	Intra-group	Rest of the region	Rest of the world	Total trade of group	Intra-group	Rest of the region	Rest of the world	Total trade of group
APEC	89	..	11	100	94	..	6	100
EU28	44	3	56	100	39	2	61	100
NAFTA	22	1	78	100	12	22	88	100
TPP	61	..	39	100	26	..	74	100

Source: author's elaboration on UNCTADstat

China today is a leading exporter of rare earths elements. High technology and environmental applications of the rare earth elements (REE) have grown dramatically in diversity and importance over the past four decades. As many of these applications are highly specific, in that substitutes for the REE are inferior or unknown, the REE have acquired a level of technological significance much greater than expected from their relative obscurity. Most of the world's supply comes from only a few sources. The United States was once largely self-sufficient in REE, but in the past decade it has become dependent upon imports from China. As a consequence, the United States is in danger of losing its longstanding leadership in many areas of REE technology. Transfer of expertise in REE processing technology and REE applications from the United States and Europe to Asia has allowed China to develop a major REE industry, eclipsing all other countries in production of both ore and refined products. Moreover, dependence on imports from China comes at a time when REE have become increasingly important in defence applications, including jet fighter engines and other aircraft components, missile guidance systems, electronic countermeasures, underwater mine detection, antimissile defence, range finding, and space-based satellite power and communication systems. Finally, availability of Chinese REE to foreign markets depends on continued stability in China's internal politics and economy, and its relations to other countries (see section 5).

A comprehensive assessment of the engagement of the EU in the Asia-Pacific cannot ignore the blossoming of GVCs in Asia in the past decade. While Asia as a whole grew in its relevance for GVC, the choice of Asian partners in production sharing from advanced countries (Europe, North America, Japan) has changed over time, moving in part away from China toward smaller and less advanced countries in the region, this is especially marked in traditional sectors. European Union Member States are among the most important participants of Asian GVCs. At the world level, the Euro Area involvement in GVC (considering only flows outside of Euro area) measured in terms of foreign value added in exports is approximately 20 %, higher than the similar measure for other advanced economies, and growing over time.

In 2011, for the Euro Area taken as a whole, GVCs were as important as in China and more important than in the US and Japan. As for many other areas, GVCs tend to be geographically concentrated, and for the Euro Area the largest contributions to production value added come from the rest of Europe. The Eastern EU countries (Bulgaria, Czech Republic, Hungary, Lithuania, Latvia, Poland and Romania) have increased their relevance as origins of value added in Euro Area exports. But, in spite of distance, Asia plays an important and growing role. In 2011 Asian value added embodied in Euro Area exports was approximately equivalent to the value added coming from other European Member States. Asia (excluding China) shows a stable share (average of 1.8 % in the period), while China recorded a very significant increase (from 0.6 % in 2000 to 2.1 % in 2011), surpassing Eastern EU Member States. Still with a level below 2 % of the value added for many European countries, the role of China should not be

overestimated. In terms of sectors, Asian involvement in European GVC is particularly relevant in electronics and electrical equipment, textiles, apparel, leather goods and transport equipment.

The EU is the largest foreign investor in Asia being the source of 22 % of foreign direct investment (FDI) inflow in 2012. More than 10,000 European companies currently operate in Southeast Asia. EU FDI in China has grown by nearly 46 % over the period 2010-2012 and even Chinese FDI in the EU has growth by an impressive 338 % over the same years (Table 7). As an increasing number of EU firms invest in China and vice-versa, the interest has been growing for a bilateral investment treaty that could regulate investment flows.

Table 6. Foreign direct investment, EU, 2010-13

	Outward FDI flows					Inward FDI flows				
	2010	2011	2012	2013	Share in 2012 (%)	2010	2011	2012	2013	Share in 2012 (%)
Extra EU	302,6	474,8	255,6	341,4	100,0	222,6	424,0	291,8	326,6	100,0
Asia, of which	45,9	89,8	57,0	:	22,3	42,8	47,7	38,0	:	13,0
Arabian Gulf countries	7,3	11,5	13,8	:	5,4	4,9	14,1	-0,1	:	0,0
China (excl. Hong Kong)	10,5	20,1	15,5	8,2	6,1	0,4	4,3	7,7	1,1	2,6
Hong Kong	7,8	7,0	15,0	10,4	5,9	13,8	7,2	-1,1	8,2	-0,4
Japan	-1,7	3,7	1,4	2,8	0,6	-0,7	10,0	3,9	9,6	1,3
India	7,5	13,8	5,5	3,2	2,1	0,5	2,3	-0,7	0,4	-0,2
Singapore	7,4	7,9	-8,9	:	-3,5	10,7	4,4	5,8	:	2,0
South Korea	2,4	2,5	0,0	:	0,0	4,0	1,7	4,3	:	1,5
Oceania and southern polar regions, of which	17,4	-3,2	11,0	:	4,3	-0,3	3,7	0,5	:	0,2
Australia	17,1	-4,0	11,6	:	4,5	-0,4	3,7	0,2	:	0,1
Offshore financial centres	13,7	69,9	23,0	39,9	9,0	37,5	46,4	74,2	-41,4	25,4

Source: Eurostat

Table 7. Top 10 recipients of extra EU-27 FDI end 2010–12

	Outward				Inward			
	2010	2011	2012	Growth rate 2010–12 (%)	2010	2011	2012	Growth rate 2010–12 (%)
Extra EU-27	4.237,0	4.940,9	5.206,8	22,9	3.144,7	3.768,1	3.947,4	25,5
United States	1.266,9	1.598,9	1.655,0	30,6	1.247,7	1.526,8	1.536,4	23,1
Switzerland	555,5	683,5	679,0	22,2	394,8	482,6	505,2	28,0
Canada	197,7	228,6	258,0	30,5	146,1	139,0	142,6	-2,4
Brazil	198,9	248,2	246,8	24,1	90,4	96,9	98,1	8,6
Russia	130,6	169,4	189,5	45,1	50,3	57,2	76,6	52,4
Australia	120,2	128,0	141,6	17,8	30,4	35,9	34,3	12,8
Hong Kong	112,3	119,8	132,9	18,4	41,5	64,7	50,2	21,0
Singapore	109,5	124,8	118,7	8,3	56,5	60,3	68,6	21,4
China	81,0	103,0	118,1	45,8	6,1	18,5	26,8	338,0
Japan	98,1	100,5	98,8	0,8	133,4	147,0	161,5	21,1

Source: Eurostat

3 The flourishing of regional and plurilateral FTA initiatives in Asia and its implications for EU-Asia trade

Unlike in Europe and North America, regional economic integration in East and Southeast Asia has traditionally been more market than institution-driven, in the sense that formal integration initiatives were prompted by countries seeking economic gains from further deepening the on-going regional economic interdependence through trade and investment liberalisation. In Europe and North America, it was only after the establishment of formal regional institutions in the form of RTAs that economic integration accelerated within each region.

Until 2000, the largest trading economies in the region – China, Japan, and Korea – were not a party to any RTA/FTA. Therefore, some important bilateral trade flows within APEC were not covered by RTA/FTAs at that time, for instance trade between China and Hong Kong, China; Korea and the United States;

Singapore and China; and Japan and Thailand. Deepening regional interdependence through trade and investment, and the necessity for stability and revitalisation of the regional economy after the East Asian financial crisis in the late 1990s led the East Asian countries to adopt preferential RTAs. Since then, East Asian countries have been active in free trade initiatives with countries in and outside the region. After 2000, China put adopted seven intra-APEC RTA/FTAs with 13 APEC members. Japan did the same with 12 intra-APEC RTA/FTAs covering 11 APEC members. Similarly, Korea enforced six intra-APEC RTA/FTAs with 11 APEC economies. Other APEC economies also started to actively engage in RTA/FTAs. For example, after 2000, Chile and Peru implemented nine intra-APEC RTA/FTAs; Australia and Singapore implemented eight new intra-APEC RTA/FTAs; and New Zealand participated in seven new intra-APEC RTA/FTAs. By 2014, 54 intra-APEC RTA/FTAs had already been agreed and had entered into force covering trade flows between signatory parties of US\$ 3.7 billion or 59 % of intra-APEC trade. However, despite the proliferation of RTA/FTAs within APEC, there still are important bilateral trade relationships that are not covered by any agreement. The two notable ones are trade between China and the United States; and China and Japan, which are the fourth and fifth most important bilateral intra-APEC relationships after Canada and the United States; China and Hong Kong, China; and Mexico and the United States.

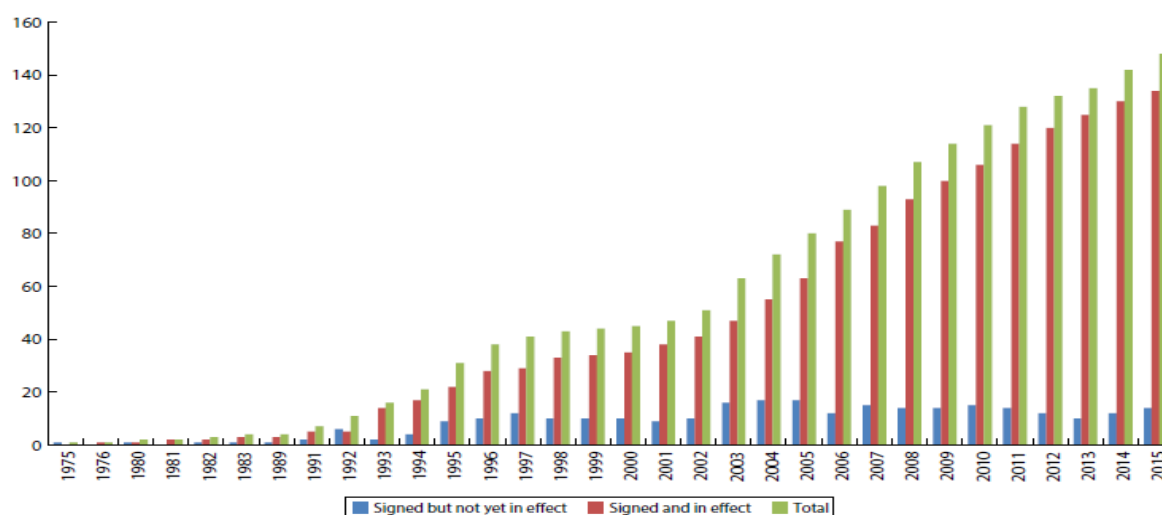
It is important to highlight that some important bilateral flows that were not under RTA/FTAs in 2014 will be covered by RTA/FTAs in the near future. For example, an FTA between Australia and Japan entered into force on 15 January 2015. Also, China signed new free trade agreements with Korea and Australia on 1 June 2015 and 17 June 2015, respectively, which have been recently ratified and are expected to be implemented shortly.

The structure of RTA/FTAs implemented in 2014 includes all the traditional chapters in trade agreements, such as trade in goods, rules of origin, customs provisions/administration and dispute settlement appears in all of these RTA/FTAs. Other traditional chapters, such as those on sanitary and phytosanitary measures (SPS) and technical barriers to trade (TBT), appear in all RTA/FTAs, except in the China-Iceland agreement, which includes specific provisions on these matters in the trade in goods chapter. There is a positive trend in recent years regarding the inclusion of chapters on cross-border trade in services. The six RTA/FTAs entering into force in 2014 include commitments on a list of specific services, or comprehensive commitments on national treatment, market access and local presence with a list of exceptions (i.e. non-conforming measures). Some agreements such as the Australia-Korea FTA and the Canada-Honduras FTA, also include chapters on specific services sectors, such as financial services, telecommunications and e-commerce. Similarly, these agreements have a dedicated chapter on mode 4 of services provision (i.e. movement of natural/business persons).

This new round of FTAs follows the increasing interest in including investment chapters in RTA/FTAs. Five of the RTA/FTAs entering into force in 2014 (except Chile-Hong Kong) include a specific chapter on investment. As for the other topics, all these six recent RTA/FTAs include a chapter on competition (or competition policy). Most of them include provisions related to cooperation between competition authorities and consultations. Others go further and deal with issues concerning the interpretation and application of competition laws, monopolies and state enterprises, among other things. Chapters on government procurement, environment, transparency and intellectual property also appear in four out of these six RTA/FTAs. However, the depth of these provisions differs. Topics such as cooperation and labour appear as individual chapters in only three and two agreements, respectively. In all agreements, clauses promoting cooperation among relevant authorities can be found in the other individual chapters. For example, chapters on customs procedures include provisions to strengthen cooperation among border agencies in mutually determined areas.

Such a proliferation of regional trade agreements within the continent has produced a 'noodle bowl' of FTAs including major plurilateral initiatives (Figure 4).

Figure 4. Free Trade Agreements signed by Asian countries (cumulative number)



FTA – free trade agreement.
 Note: Includes bilateral and plurilateral FTAs with at least one of ADB’s 48 regional members as signatory. 2015 covers January to August. Signed but not yet in effect refers to FTAs where the parties sign the agreement after negotiations have been completed, but the agreement has yet to become effective. Signed and in effect refers to FTAs where provisions become effective, after legislative or executive ratification.

Source: ADB (2015)

Although FTAs are fostering a deeper economic and trade integration within the Asia-Pacific region, there is also likely to be a negative impact on efficient regional trade integration arising from the overlapping of these FTAs in what has been called a ‘noodle bowl’ of bilateral agreements. Apart from bilateral agreements, there has also been an increase in plurilateral FTAs in and between East and Southeast Asia, including the five ASEAN+1 RTAs: the ASEAN-China FTA, the ASEAN-Japan CEPA (Comprehensive Economic Partnership Agreement), the ASEAN-Korea FTA, the ASEAN-Australia and New Zealand FTA, and the ASEAN-India FTA. This ‘noodle bowl’ effect is one of the main reasons explaining the recent attempts at rationalising the vast number of bilateral FTAs in East and Southeast Asia into regional frameworks, such as:

- the EAFTA (East Asian Free Trade Area) preferred by China and encompassing the ASEAN+3 countries (10 ASEAN countries, China, Japan, and Korea);
- the CEPEA (Comprehensive Economic Partnership for East Asia) preferred by Japan that includes the ASEAN+6 countries (10 ASEAN countries, China, Japan, Korea, Australia, New Zealand, and India);
- the ASEAN-driven RCEP (Regional Comprehensive Economic Partnership) including the ASEAN+6 countries;
- the US-led TPP (Trans-Pacific Partnership) including Brunei Darussalam, Singapore, Malaysia, Vietnam, Australia, New Zealand, Chile, Peru, the USA, Canada, Mexico, and Japan; and a FTAAP (Free Trade Area of the Asia Pacific) including 21 Asia Pacific Economic Cooperation (APEC) member countries.

The ASEAN Framework on Regional Comprehensive Economic Partnership (RCEP) aims at creating a large free trade area by combining ASEAN’s existing FTAs and including agreements covering services and investment (Figure 5). The RCEP was conceived in 2013 and is being negotiated between the 10 member states of the Association of Southeast Asian Nations (ASEAN), plus regional trading partners including

Australia, China, India, Japan, New Zealand and South Korea.⁴ The RCEP aims to establish deeper economic cooperation between ASEAN and its regional trading partners, with a focus on trade in goods, services and investment. The RCEP is therefore an exercise in harmonising and integrating existing FTAs between ASEAN and its individual partners. RCEP would create an economic bloc with a combined population of 3.4 billion and trade volume of US\$ 10.6 billion, accounting for nearly 30 % of the world's trade. China has been seen as the key driver of RCEP, which is viewed as an alternative to the U.S.-led TPP agreement, from which China has been excluded. Within the RCEP, seven countries - Australia, Japan, Malaysia, New Zealand, Singapore, Vietnam and Brunei - are part of the 12-nation TPP deal. RCEP's agenda includes discussions about intellectual property rights (IPRs), e-commerce, where RCEP members differ widely. China will be the largest beneficiary from the RCEP followed by other Southeast Asian countries that are not in the TPP.

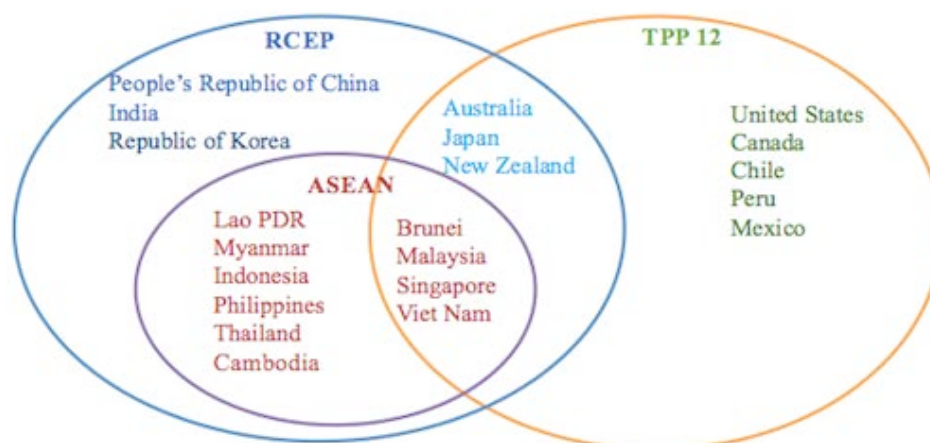
A competing track towards an alternative form of regional integration including the major APEC economies is the US-backed Trans-Pacific Partnership (TPP). After the United States' recent diplomatic disaster of trying to prevent general adherence to China's Asian Infrastructure Investment Bank (AIIB), US policy makers have been under pressure to strengthen their presence in Asia on the trade front. The TPP is a comprehensive, developing a new rulebook of sorts for trade and investment in goods and services, and much more exigent than the RCEP or other existing FTAs among TPP partners.

APEC economies are increasingly connected with one another. A growing percentage of APEC economies' trade is with RTA/FTA partners. Compared to 23 % of APEC's total exports and 10 % of APEC's total imports covered by RTA/FTAs in 1996, in 2014, APEC's trade with RTA/FTA partners accounted for a much larger 44 per cent share of APEC's total exports and 39 % of APEC total imports. Most important, the US is increasingly dependent on Asia – especially on China – for its imports of a large variety of consumer products and capital goods, but also industrial supplies and raw materials that are vital for the survival of many high technology industries (see Section 5). Therefore, the TPP is an attempt by the United States and others to create a new, more ambitious 21st century trade agreement with high standards. Unlike the RCEP, whose aim is to streamline the current FTAs among member countries into a common framework, the TPP sets a more ambitious aim, that is, to create an alternative focus of regional integration in APEC. Its overall aim is to reduce APEC's and the US's dependence on trade with China and to re-centre US trade relationships around the Pacific and with selected East and Southeast Asian economies that share a concern about the growing influence of China in regional trade (Figure 12). The EU needs thoroughly to assess the emergence and rapid development of these various plurilateral FTA initiatives in Asia. Seen from a European perspective, these mega-regional agreements might turn out to be massive trade and investment diverters to the detriment of EU-Asia trade and investment relations.

For China the Trans-Pacific Partnership (TPP), an historic trade agreement linking the US, Japan and ten other countries, would be seen as thwarting its goal of reducing Washington's presence in its neighbourhood. Furthermore, the TPP would connect the United States to the economic centre of the 21st century, one of the fastest-growing regions of the world, and cement its relationship to Japan, its key ally. It would be the first real manifestation of Obama's pivot to Asia, which has so far consisted of mere rhetoric. However, for TPP to really make a mark it has to be bigger. China plays a central role in supply chains in APEC. Any Asian trade zone without it faces one of two sorry fates. Either the deal would be so riddled with exemptions because of China's centrality in Asian supply chains that it becomes worthless. Or, if TPP gains traction, the effect would be to divert trade away from the most efficient Chinese companies and hurt the global economy.

⁴ ASEAN was established in 1967 among Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Myanmar and Cambodia)

Figure 5. Competing tracks in regional integration initiatives



Source: The Asia Foundation

4 The EU's current external trade approach to Asia

Although the EU remains Asia's largest trading partner, its position is quickly being eroded relative to competing countries both within and outside the continent. Over the past few years, the EU has slowly lost its position as the largest trading partner of several Asian countries, mainly in favour of China. As documented in the previous section, Asian intra-regional trade has been growing much more rapidly than Asian trade with the EU or the rest of the world (and is now approaching the weight of intra-EU trade, at a high of 65 %). Moreover, South-South trade within Asia is getting stronger to the detriment of Asian trade with advanced economies outside of Asia, most notably the EU and the US.

When exports to the EU declined during the financial crisis, resulting in falling GDP growth rates, Asia actively sought opportunities in new markets and regions. India for one came up with its Focus Market Scheme, which looks at expanding trade with new markets in Latin America, Africa and East Asia. China has been keen on expanding trade with Africa. In 2011, China-Africa trade stood at US\$166.3 billion, a rise of 83 % from 2009. Moreover, as discussed above there has been an impressive proliferation of FTAs in Asia, from 53 in 2000 to more than 250 agreements in various stages of development, of which 150 are exclusively intra-regional.

Given the export orientation of the EU and its Member States, it has no other choice but to seek parallel negotiations with current and future members of TPP, in order to prevent the potential of trade and investment diversion. In fact, the EU seems already firmly engaged in the race for access to the largest and more dynamic Asian markets. It is negotiating a free trade agreement with Japan (since 2013), the world's fourth largest economy. It concluded talks with Vietnam, a dynamic emerging market of 90 million people, in August 2015, and it sealed an FTA with Singapore in 2013, which is however still to be ratified (see below). All these three partners are part of TPP. Moreover, an FTA with Korea has been implemented as a new generation of FTAs with a comprehensive number of chapters on WTO+ issues. The EU also has several other on-going FTA negotiations with a number of other Asian countries: India (since 2007), Malaysia (since 2010), Thailand (since 2013) and New Zealand (started in 2015) as well as talks for a standalone investment agreement with China. It is considering or is about to open negotiations with Australia, Brunei, Indonesia, and the Philippines.

However, effective and concrete progress on EU Free Trade Agreement (FTA) projects in the region has been very slow. Except for the EU-Korea FTA, progress on other FTAs with Asia has lagged in the last few

years for a number of reasons. First, the EU has historically been rather slower than some other parties in latching on to the global shift from the blocked multilateral trade negotiations at the WTO to bilateral FTAs. Negotiations with India, Korea and ASEAN began only in 2007 after the launching of the Global Europe Strategy in 2006.

The EU approach to Asia needs a coherent trade strategy instead of the various, and often-inconsistent lines of action vis-à-vis individual countries or regions. Moreover, a China strategy is almost completely absent despite China being the EU's most important first trading partner and a major trading power.

This section will discuss the current EU trade policy vis-à-vis Asia by partner country and region. After summarising the EU's existing trade policy towards each country, it will present the partners' general trade policy vis-à-vis Europe, the United States and other regional partners, with the aim of drawing some implications for the future of the EU trade strategy towards Asia.

4.1 South Korea

The EU-Korea FTA, now at its fourth year of implementation, is the most comprehensive free trade agreement negotiated by the EU at that time, and the first of the new generation of FTAs launched in 2007 as part of the 'Global Europe' initiative. These agreements, based on a solid economic rationale, represent a stepping-stone for future liberalisation as they are tackling issues, which are not ready for multilateral agreement and which go beyond the market opening that can be achieved in the WTO context.

The EU-Korea FTA has set the level of EU ambition in preferential trade negotiations. Such high ambition is welcome as it allows for the inclusion of WTO-plus issues such as labour, environment, standards, etc., which are now among the objectives of the overall EU external trade policy (i.e. contributing to development). However, the EU-Korea FTA was signed with an advanced economy and many countries currently involved in negotiations with the EU (most notably India) are among the poorest economies in the region or the world, so ambition needs to be reconciled with feasibility. More precisely, it seems unlikely that developing countries would ever be in a position to negotiate similarly ambitious FTAs, as their business and regulatory environments are much less developed than that of the EU. On the other hand, lowering ambitions to accommodate the developmental concerns of an FTA would also run counter to the broad objectives of EU external trade policy in terms of job creation and welfare enhancement at home, recently confirmed in the Trade for All communication.

In the case of the EU-Korea FTA the general impact of the trade liberalisation in the FTA has been beneficial to both parties, relatively more so for the EU. The EU trade deficit with South Korea in the years before the entry into force of the FTA was turned into a trade surplus of EUR 4.4 billion in 2014. Bilateral trade increased substantially in both directions with a stronger performance of EU exports to (compared to imports from) Korea. EU goods exports to Korea increased by 55 % from EUR 30.6 billion in 2010 to EUR 47.3 billion in 2014 (EU exports of fully liberalised goods increased by 57 %). EU imports from Korea in the third and fourth year of FTA implementation increased annually by 5-6 % (imports of fully liberalised goods from South Korea increased by 35 %). As a result, Korea increased its importance as an importer from the EU, but decreased its weight as a supplier to the EU. Korea is currently the 8th largest trading partner for the EU, both on the export and import sides, accounting respectively for 2.5 % of extra-EU exports and 2.3 % of extra-EU imports.

Korea has also been targeted as a strategic FTA partner in East Asia by the US. The KORUS FTA was implemented in 2012, just one year after the EU-Korea FTA. For Korea it is part its global trade strategy of becoming the economic hub of Northeast Asia. So far both parties to KORUS have experienced positive effects. Korea's exports to the US rose by 31.54 % in the first three years of the FTA, while Korea's imports

from the US rose by 10.77 %. The FTA also improved Korea's investment environment for US companies. Preliminary bilateral talks between the US and Korea to explore Korea's joining the TPP have raised the possibility of the TPP superseding the KORUS. The US is unlikely to put up barriers to Korea's joining the TPP given the success of KORUS for the US. In that case, the TPP will assume more importance for Korea than the EU-Korea FTA, because the trade relations between Korea and the TPP countries are much more widespread and sizeable as are the economic linkages arising from participating into the same production networks centred on the Asia-Pacific.

Korea joining the TPP is likely to pose severe challenges to further progress in the bilateral trade and investment between Korea and the EU, because the complementarity of production structures is lower than that between Korea and a number of developing economies among TPP members. Moreover, some of the advanced TPP economies are direct competitors with the EU in some of the sectors that have fared better in EU exports to Korea with the implementation of the EU-Korea FTA. This is the case for example, agricultural and food products (especially meat and dairy) where competition from Australia and the US represent formidable competition for EU exports to Korea. But this will depend on TPP being ratified and implemented so it is too early to be able to make any predictions in terms of the scale of trade diversion.

4.2 India

The EU started negotiating an FTA with India in 2007 and 12 full rounds of negotiations as well as other smaller, expert level inter-sessional meetings, chief negotiator meetings and high level meetings were held between 2007 and 2013. Thereafter, negotiations were brought to a de facto standstill in the summer 2013 due to a mismatch between the EU and Indian levels of ambition. This concerned differing expectations on the offers on market access for goods, the overall ambition of the services package and a meaningful chapter on government procurement and sustainable development. Moreover, a change of government in Delhi, and the EU's negotiations with the US on Transatlantic Trade and Investment Partnership (TTIP) agreement delayed the negotiating process. The negotiations stalled in August 2015 when the EU imposed a ban on the sale of 700 drugs clinically tested by GVK Biosciences, an Indian drug company. Notwithstanding the legality of the EU action, India's latest attempt to delay the talks is broadly consistent with the country's stance in multilateral trade negotiations, which is dominated by nationalistic arguments used as the alibi for postponing opening to foreign trade and investment.

India now enjoys trade preferences with the EU under the Generalised Scheme of Preferences (GSP). The proposed FTA with the EU is a genuinely ambitious bilateral pact as it covers higher levels of commitments in trade in industrial goods and agricultural products, services and investment liberalisation, intellectual property rights and government procurement. In comparison, India's existing FTAs are far narrower in scope. The India-EU FTA would cover 1.7 billion people, almost 20 % of the world population, and therefore the potential impact (both positive and negative) would be more far reaching than other agreements signed by India. That is why it has provoked a lot of public scrutiny. In India, civil society groups as well as business associations (such as Society of Indian Automobile Manufacturers – representing car and vehicle industry) have expressed concerns over the agreement being negotiated in secret and without adequate public consultation.

In terms of the detail, the proposed agreement has been facing hurdles on several contentious issues. To begin with, India is resisting demands from the EU to drastically cut tariffs on automobiles, wines and spirits, and dairy products. There is also resistance to the EU seeking greater market access in the services sector such as banking, retail trade, telecommunications, and legal and accounting services. In the banking sector, for instance, EU is seeking removal of barriers to market access (commercial presence, cross-border supply and consumption) and granting of national treatment commitments.

The European firms and service providers are interested in the opening up of government procurement markets, but India has only committed to transparency in the conduct of government procurement processes. A stringent intellectual property rights regime is another contentious issue, as New Delhi has apparently not accepted any TRIPS-plus provisions. In addition, India is reluctant to include labour and environment standards under the proposed agreement.

India is largely looking for gains in the services, especially IT and ITeS and seeking a significant relaxation of restrictions on the movement of its skilled professionals (for short-term assignments) within the EU. This would enable Indian IT and ITeS industry to move professionals freely from one country to another in Europe. Currently the EU does not offer a work permit with validity for the entire EU. India is also seeking 50 000 extra working visas a year for its citizens. New Delhi wants the EU to recognise India as a 'data secure' nation, which would immensely help the country's IT industry to gain greater access to the European markets.

Apart from these long-pending issues, some new ones have cropped up recently which could further delay the negotiating process. Take the case of investment protection measures, which represent almost the other half of this agreement. India has substantially revised its model investment protection treaty text early this year after several foreign investors served arbitration notices on the Indian government for alleged breaches of its bilateral investment treaties. From now on India will base its approach to bilateral investment treaties and FTAs on this new model text. The draft new model text adopts a narrower definition of investment (limiting it to only foreign direct investment (FDI)), removes the MFN clause from investment, and restricts the scope of national treatment and fair and equitable treatment clauses. It only allows investors to initiate international arbitration once they have exhausted domestic legal remedies to resolve the investment dispute.

India has a lot to gain from an FTA with the EU, particularly concerning preferential and duty-free access to the European market. A Sustainability Impact Assessment, commissioned by the EU, indicated that an extended (broad) FTA (including further non-tariff barriers to trade harmonisation) would result in significant benefits for both parties in terms of welfare gains, production, international trade, wage increases and productivity increases. The welfare effects amount to an additional 0.3 % growth for the Indian economy in the short run and 1.6 per cent growth in the long run. However, domestically, the Indian government might find it difficult to sell this agreement as a win-win deal that is in the best interest of farmers, workers and producers, because the EU has already much lower tariffs on agricultural and industrial goods than India. This is because India has maintained higher bound tariffs under the World Trade Organization (WTO) on goods covered by the Non Agricultural Market Access (NAMA) negotiations, while the EU progressively liberalised its tariffs, meaning that India would be asked to make greater reductions that would benefit the EU more. This is also true in other sectors within manufacturing, as in the case of cars, for instance, where India's import duty range from 60 to 100 % while the EU charges a flat rate of 10 % on imported cars. Unlike Europe, 93 % of India's workforce is employed in the informal, non-organised sector with very low wages and no social security. In many important ways, the proposed FTA could be seen to run counter to 'Make in India' initiative launched with much fanfare by the present government, because the latter has been inspired by a fairly protectionist approach inconsistent with the need for a willingness to liberalise necessary for the negotiations with the EU on greater openness.

The EU-India FTA is particularly important and should be given special attention by the EU when designing a coherent external trade and investment strategy in South Asia. According to the US National Intelligence Council's Global Trends 2030 report, in two decades India will have the world's largest middle class and resemble the booming market that China is today, while the Chinese economy will have begun to decelerate. Furthermore, while the US and China are important partners for the EU, they must also be seen as competitors in the region. Given that the US has no free trade agenda with India at the

moment, and the vast potential for increased EU-India trade, the EU-India FTA could provide a considerable leg-up for the EU in Asia.

4.3 Japan

Japan is the EU's second biggest trading partner in Asia after China. Together the EU and Japan account for more than a third of the world's GDP. Japan remains a major trade partner for the EU and Europe is a very important market for Japan. Japan is also a major investor in the EU. Imports from Japan to the EU are dominated by machinery, electrical machinery, motor vehicles, optical and medical instruments, and chemicals. EU exports to Japan are similarly dominated by motor vehicles, machinery, pharmaceuticals, optical and medical instruments, and electrical machinery.

In July 2012, an impact assessment of the future Free Trade Agreement was released. The Council gave the Commission the green light to start trade negotiations with Japan in November 2012 and the EU-Japan Free Trade Agreement negotiations were officially launched on 25 March 2013. There have been thirteen negotiating rounds so far (in April, June, and October 2013, in January, March/April and July, October and December 2014, and in February, April, July, September and October 2015). The negotiations aim at concluding an ambitious and mutually beneficial trade agreement that will contribute to economic growth in the EU and Japan. During the negotiations, a number of EU concerns will need to be addressed, including the non-tariff barriers (NTBs) which European companies encounter in Japan and the further opening of the Japanese public procurement market.

Together with the negotiating agenda the EU and Japan established specific 'roadmaps' for the removal of non - tariff barriers and for the opening up of public procurement markets in the Japan's railways and urban transport. As set out in the negotiating directives a review of Japan's implementation of its commitments on the elimination of NTBs within the first year of negotiations took place. At the end of May 2014 the EU concluded that sufficient progress had been achieved during the first year for the negotiations to continue. Besides advancing on the implementation of the various roadmaps, the EU and Japan have also exchanged market access offers on trade in goods as well as on services and investment. In addition, progress has been made on the consolidation of the negotiating texts for various chapters. In December 2014, the EU transmitted to Japan a second list of non-tariff measures, which reflected the continuing concerns of EU Member States and European businesses about doing business in Japan.

After the first year of negotiations the Commission provided to the Council a report assessing the progress achieved. This review had been foreseen in the original negotiating mandate for the EU. Since this review the negotiations have been continuing with added momentum. Japanese Prime Minister Shinzo Abe has expressed several times the objective of concluding the negotiations by the end of 2015, a deadline that was clearly missed due to the various and serious stumbling blocks on market access in Japan. In fact, in the fourteenth round of negotiations on the Japan-EU Economic Partnership Agreement (EPA), held in Tokyo from November 30 to December 4, 2015 there seems to have been a tightening of negotiating positions on the part of Japan. No chapter has been concluded yet. Key outstanding issues include notably market access for goods, non-tariff measures, services, investment, public procurement, geographical indications, SPS, Trade and sustainable development.

Although the conclusion of TPP should not necessarily be bad news for the EU, as it could signal that Japan is capable of real trade liberalisation, Japan expects a deal that offers similar terms to what Japan offered to the United States and others in TPP. This would mean some fundamental EU interests would have to be abandoned, such as some non-trade barriers of particular interest to the EU, public procurement, geographic indications, mobility for professionals, and some import tariffs on pork meat or cereal products. The Japanese now like the idea of regulatory cooperation on standardisation issues, while the Europeans are not keen on including that in the FTA negotiations. But the Japanese are

pressing the EU to get started as soon as possible on a parallel process, and they are clearly using the TPP this as a lever in the FTA talks. Moreover, the EU now wants a public international investment court (the Investment Court System) to replace existing private investment arbitration, while in Japan's view, the TPP's investment chapter contains sufficient guarantees for a state's right to regulate and is therefore in favour of retaining the existing investor-state dispute settlement (ISDS) model. Overall, the current prospects for reaching an agreement with Japan appear to be fading.

4.4 ASEAN

Negotiations with a regional grouping of 7 ASEAN Member States started in July 2007. In March 2009, the 7th Joint Committee agreed to take a pause in the regional negotiations. Although a region-to-region agreement is potentially still on the horizon, this would be in the form of a framework agreement. The ambition for an EU-ASEAN agreement should be reconsidered, first of all because differences among ASEAN economies are too large to expect them to ever agree on a common negotiating agenda, and second, because ASEAN is an FTA itself and therefore did not have a common trade policy. Therefore, for the EU to insist on an ASEAN-wide approach would backfire due to the complexities in reconciling existing bilateral FTAs by individual member countries.

So, in December 2009, EU Member States agreed that the Commission would pursue FTA negotiations in a bilateral format with countries of ASEAN. Negotiations with Singapore and Malaysia were launched in 2010, with Vietnam in June 2012 and with Thailand in March 2013. The Commission continues exploratory informal talks with other individual ASEAN member states with a view to assess the level of ambition at bilateral level. But by July 2012, ASEAN for instance has signed FTAs with almost every important regional actor, both with emerging economies and with very advanced economies, such as the ASEAN free trade area, AFTA, ASEAN-Australia and New Zealand, ASEAN-China, ASEAN-India, ASEAN-Japan and ASEAN-Korea FTAs. The bloc has also launched the US-ASEAN Expanded Economic Engagement initiative, intended to boost bilateral trade and investment ties.

Asian economies in recent years have been driven by China's impressive growth, especially since its ascension to the World Trade Organization in December 2001, and by Japan's focus on Asia. Still this time, a number of countries with relatively low level of trade integration have questioned their positions in the 'Asian factory' and the benefits of FTAs for their economies. And it is true that the use of existing ASEAN FTAs has been limited, and predominately by large firms.

Indonesia - Although Indonesia has been quite active in concluding free trade agreements (FTAs), like India it has been very reluctant to liberalise. Indonesia has effectively eight FTAs, six regional through ASEAN and two bilateral, the Indonesia-Japan EPA and an Indonesia-Pakistan FTA. These agreements mean that Indonesia has FTAs with trading partners that account for 67 % of its total trade. As a comparison, Chile, Peru, and Mexico have FTA coverage ratios of more than 80 %, while Canada, Singapore and New Zealand are at more than 50 %.

Singapore - The negotiations on an EU-Singapore comprehensive Free Trade Agreement were completed on 17 October 2014. The draft agreement now needs to be formally approved by the European Commission and then agreed by the Council of Ministers, and ratified by the European Parliament. On 10 July 2015 the Commission lodged an application initiating proceedings with the European Court of Justice (ECJ) for a Court opinion on the EU competence to sign and ratify the FTA.

Vietnam - After region-to-region negotiations on a free trade agreement between the EU and ASEAN countries proved difficult, talks for an EU-Vietnam FTA were launched in June 2012, and the agreement signed after two and a half years of negotiations on 4 August 2015. The two partners trade goods worth EUR 28 billion, which has increased by 200 % over the last 10 years. Vietnam is the fourth largest trading

partner of the EU with ASEAN. The EU is also one of the largest foreign investors in Vietnam. In 2013, EU investors placed more than EUR 500 million in foreign direct investment and remains Vietnam's sixth largest foreign investment partner. The EU-Vietnam agreement will remove tariffs on goods traded between the two economies, and covers goods and services, investment and other issues such as government procurement.

The EU-Vietnam agreement is seen as a milestone in trade relations between the EU and ASEAN countries, many of which are also parties to the Trans-Pacific Partnership, including Vietnam, Singapore and Malaysia. EU exports to Vietnam are dominated by high technology products, including electrical machinery and equipment, aircraft, vehicles, and pharmaceutical products. Vietnam's key export items to the EU include telephone equipment, electronic products, footwear, textiles and clothing, coffee, rice, seafood, and furniture. With this agreement, EU companies will be able to bid for public contracts with Vietnamese ministries, including for infrastructure projects such as roads and ports as well as for contracts with important state-owned enterprises such as the power utilities, railway operators and public hospitals. The deal will need approval from EU trade ministers and the consent of the European Parliament. In reality, only a general agreement was reached with Vietnam, there remain still a number of issues to be resolved. After that and the legal scrubbing there will be a decision on provisional application and the agreement will be submitted to the EP for consent.

Malaysia - Malaysia is the second most important trading partner for the EU in ASEAN after Singapore. EU-Malaysian trade is focused on machinery and transport equipment, but opportunities are growing for the service sector. Malaysia also has bilateral FTAs with Japan, Pakistan, New Zealand, India, Chile and Australia, and is currently negotiating FTAs with Turkey. It is one of the 12 members of the TPP. The key sectors for Malaysia's exports to the EU are machinery, transport equipment, chemicals and related products, and other manufactured goods. The EU's most important exports to Malaysia are equally machinery and transport equipment, followed by chemical products and manufactured goods. Within the still modest trade in services between Malaysia and the EU, one subsector — trade of commercial services — has been growing steadily, at an average annual increase of 8 % since 2004, and opportunities are increasing due to Malaysia's liberalisation policies. The major EU imports of services from Malaysia are transportation, business services and travel. On the EU export side the important sectors are business, financial services, communication and transportation. Generally, areas that are new to Malaysia in the context of FTA negotiations — such as government procurement, competition and intellectual property rights — have been harder to negotiate than others. A specific issue for Malaysia in FTA negotiations is the country's halal requirements (for foods to meet Islamic requirements), which require that each food establishment in the EU be inspected. Some issues have elicited particular public attention in Malaysia. During the second round of negotiations in Kuala Lumpur, civil society groups demonstrated against the FTA on the grounds that the chapter on intellectual property rights would cause a significant rise in the prices of medicines — a claim that seems to have been based on information about other trade agreements, and in particular, US trade agreements with Latin American countries. The protestors also voiced concerns about the future of government procurement and farming in Malaysia, and the loss of jobs in small and medium sized enterprises at the expense of international corporations.

Thailand - The Council endorsed the launch of negotiations on an FTA with Thailand in February 2013. Both sides are seeking to negotiate a comprehensive agreement covering, inter alia, tariffs, non-tariffs, services, investment, procurement, intellectual property, competition, regulatory issues and sustainable development. The talks were officially launched in March. Four rounds have taken place so far. The last meeting took place on 8-10 April 2014 in Brussels, but no further rounds were scheduled.

4.5 China

The EU trade approach to China deserves special attention, as it has not yet resulted in anything that could be considered as a coherent strategy. This is particularly worrying because, as discussed above, China's weight as a trading partner in Asia has rapidly expanded its weight as trade partner within Asia. China is also currently the EU's second largest trading partner and is indeed China's largest partner. Therefore, in view of China's activism in establishing RTAs with an increasing number of both advanced and developing countries, both in and outside of Asia, it is urgent for the EU to articulate an external trade and investment strategy with China in order to maintain good bilateral trade relations.

Negotiations of a comprehensive EU-China investment agreement were formally launched at the Beijing EU-China Summit in November 2013. As for similar agreements the aim of this is to remove market access barriers to investment and provide a high level of protection to investors and investments in EU and China markets. It will replace the 26 existing Bilateral Investment Treaties between 27 individual EU Member States and China with one single comprehensive investment agreement. So far, 7 rounds of negotiations have taken place. The 7th round took place in Beijing in the week of 14 September 2015.

Negotiations with China for an upgrade of the 1985 Trade and Economic Cooperation Agreement were launched in 2007 but have been stalled since 2011 due to divergences between the mandates and expectations of the parties.

Besides becoming a member of the multilateral trading system with its accession to the WTO in 2001, China has been pursuing regional trade agreements by promoting a number of FTAs with neighbouring countries and key trading partners. As discussed above these numbered 14 as of December 2015. The motivations of China's activism in regional trade integration are based on both domestic and external factors. First, China's role in global value chains makes it vital for the country to reduce trade costs within these chains, most of which link China to countries in the Asia-Pacific region. Over the past decade these FTAs have bolstered China's role in regional and global value chains, by means of tariff reductions, provisions clarifying rules of origin and simplifying custom procedures. These have been coupled with China's tax exemption on imported raw materials and other inputs to be processed or just assembled into goods for export, and have jointly played an important role in facilitating trade between China and its trade partners. Second, China's promotion of FTAs can be considered a strategy in the face of the challenges posed by mega-regional trade agreements such as the TPP, which is seen as a competing track to trade integration in the Asia-Pacific.

China has one of the busiest FTA programs in Asia. Agreements in place include FTAs with countries such as Chile, Costa Rica, New Zealand, and Switzerland. Meanwhile, FTAs now in the pipeline will boost China's economic integration with Australia, Japan, the Republic of Korea, Norway, and the Gulf Cooperation Council countries of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. Further initiatives are underway to liberalise trade and facilitate investment at the regional level. For instance, RCEP incorporates a range of Asia-Pacific countries, such as ASEAN, Australia, China, India, Japan, and New Zealand. The fourth round of negotiations on RCEP was held in Nanning, China, from March 31 to April 4, 2014. The expectation that it would be concluded by 2015 has been clearly misplaced.

In the early 2000s China's main emphasis in negotiations was on conventional issues in FTAs such as goods, services, and investment, particularly tariff reductions on goods, while the so-called Singapore issues, such as government procurement, competition, and trade facilitation, have received little attention. Since China's FTAs with New Zealand and Singapore in 2008, Chinese negotiators have begun to consider trade in services and the Singapore issues, although competition and government procurement were deemed too sensitive. More recently, for example in the agreements with Iceland and Switzerland, signed in 2013, China has started engaging in a higher level of trade liberalisation, with a

wider coverage in goods, services, and investment as well as the Singapore issues. However, the level of liberalisation of China's FTAs is not as comprehensive in terms of coverage or depth as what might be considered to be FTA practice in Asia, such as the U.S.-Korea and EU-Korea FTAs.

China's trade with its FTA partners only accounted for 22 per cent of its total trade in 2012. That suggests great potential for China to liberalise trade with other partners via FTAs. RCEP could be an important platform to update existing FTAs with economies in the Asia-Pacific and provide a more sophisticated and comprehensive trade regime. At the same time, China aims to further integrate with other economies, such as in Latin America and Europe.

Now that the momentum appears to have gone from the U.S. and China bilateral investment agreement, Europe could become a frontrunner in the negotiations with China. And China has already expressed interest in initiating negotiations on a bilateral FTA with the EU. Indeed, both players stand to benefit considerably from such an FTA. Total bilateral trade in goods reached EUR 467 billion in 2014, making China the EU's most important trade partner after the US. An additional area of cooperation lies in China's ambitious infrastructure 'One Belt, One Road' project, in which Beijing will be looking for financing from Europe. At the end of September, China announced it will become the first non-EU nation to contribute to the European Commission's EUR 315 billion investment plan. Meanwhile, the EU said it would examine the possibility for China becoming a member in the European Bank for Reconstruction and Development (EBRD), a developmental investment bank.

With China, therefore there are a number of areas of possible cooperation for the EU from such financing arrangements to a potential free trade agreement (FTA) and a bilateral investment agreement. China is the EU's biggest source of imports and has also become one of the EU's fastest growing export markets with the EU now China's biggest source of imports. China and Europe now trade well over €1 billion a day. EU imports from China are dominated by industrial and consumer goods with bilateral trade in services amount to just one tenth of total trade in goods. Of the EU's exports to China, only 20 % are of services. Investment flows show significant untapped potential, especially considering the size of the two respective economies. China accounts for just 2-3 % of overall European investment abroad, whereas Chinese investment in Europe is rising, but from an even lower base. A comprehensive EU-China investment agreement could tap into this potential to the benefit of both parties.

The first round of negotiations for an EU-China investment agreement took place in Beijing on 21-23 January 2014. A comprehensive EU-China investment agreement would provide a simpler, more secure and predictable legal framework for investors in the long term. The EU sees an investment agreement with China as an important element in forging closer trade and investment ties between the two economies. One of the EU's priorities in the negotiations will be to remove barriers to EU investors on the Chinese market. The negotiations start in the context of ambitious economic reforms recently announced in China. These include the decision to further open up China's economy to foreign investors in order to boost innovation and competitiveness by having more advanced industries and services on the mainland.

4.6 Australia and New Zealand

The EU has agreed to launch FTA negotiations with New Zealand and Australia. Total trade in goods between the EU and New Zealand was EUR 7.9 billion in 2014. The EU is New Zealand's third largest trading partner, after Australia and China. New Zealand, the chief architect of the TPP, could be the ideal candidate as an FTA partner. New Zealand ranks consistently number one in terms of market openness, and rule of law. Over the past 10 years, however, EU-New Zealand trade has been stagnating, and the country ranks only 55th as a source of EU imports, and 50th as an export destination. Trade in goods amounted to EUR 7.2 billion or 0.2 % of total EU external trade, but the European market is second to

Australia in importance as a market for New Zealand, closely followed by China, the US, Japan and Korea. With roughly EUR 200 billion GDP New Zealand is bigger than Peru and Vietnam, countries with which the EU has FTAs. With US\$ 77 billion (roughly EUR 70 billion), consumption in New Zealand is bigger than Singapore (US\$ 48 billion), Vietnam (US\$ 69bn) or Peru (US\$ 73) with whom the EU has signed FTAs. The country's agricultural land is limited, and shrinking, due to tourism and urban development. In terms of arable land, New Zealand is smaller than Belgium or Estonia. Production is also counter-seasonal, and already exported in large part to Pacific countries and China, New Zealand has an FTA. For the EU, a negotiation with a liberal economy like New Zealand will allow the bloc to refresh its FTA model and develop a third generation FTA that goes beyond the current one in the form of EU-Korea.

Total trade in goods between EU and Australia amounted to EUR 38.8 billion in 2014. Traditionally, Australia's exports to the EU are dominated by mineral commodities (fuels and mining products) and agricultural products, most notably dairy and lamb, while EU's exports to Australia are predominantly manufactured goods. Total trade in commercial services between EU and Australia in 2013 amounted to EUR 27bn and represented more than 1/3 of the total trade. Australia and New Zealand because of their historical British heritage have a mixture of US and European regulatory structures that should facilitate agreement in negotiations. New Zealand favours a system of mutual recognition, which already exists to some extent in the agri-business, but they would like it to be extended across a number of sectors. Europe is the world's largest agricultural exporter, and it is making great inroads into the Australia and New Zealand market for agricultural products, thanks to the sophistication and high quality of the products concerned.

As a bloc, the EU is Australia's largest source of foreign investment and second largest trading partner. In 2014, the EU's foreign direct investment in Australia was valued at \$169.6 billion and Australian foreign direct investment in the EU at \$83.5 billion. Total two-way merchandise and services trade between Australia and the EU was worth \$83.9 billion. The EU is Australia's largest services export market, valued at nearly \$10 billion in 2014. Services account for 19.7 per cent of Australia's total trade in goods and services and will be an important component of any future free trade agreement. On both sides, there are strong interests for an FTA. Australian beef exporters are concerned they are hitting the ceiling of the quota for their access to the European market, exposing them to new tariffs. Europe's car manufacturers want to get their vehicles into Australian dealerships at more competitive prices. But the deal will be resisted by, for example, Irish farmers, wary of competition from high-quality Australian beef and lamb, and by Italian and French producers who want to protect regional products from similar Australian ones. If the European Council approves the start of negotiations, these would begin with a joint scoping exercise as Europe and Australia decide how broad or narrow they want the deal to be.

5 Geostrategic and security issues linked to trade and economics in Asia

Territorial disputes in the East and South China Seas have the potential to disrupt peace and stability in East and Southeast Asia, and China is clearly the (main) elephant in the room, challenging and unilaterally changing the territorial status quo. Chinese territorial policies and actions in the area have increased U.S. preparedness to protect – and insist on – 'freedom of navigation' in the South China. The US is increasingly showing physical presence in territorial waters (and airspace), which Beijing claims as part of its national territory. In fact, through China's by now infamous 'Nine-Dash Line' (for details see below) Beijing has unilaterally decided that more than 90 % of the South China Sea belongs to China, de facto

rendering other countries' territorial claims obsolete. In the East China Sea Beijing is challenging Japanese control over the Senkaku Islands, which since 1895 and the Japanese victory over China in the Japanese-Sino War, have belonged to Japan.⁵ Although this challenge is unlikely to lead to armed conflict with Tokyo, the frequent intrusions into Japanese-controlled territorial around the Senkaku Islands continues to be a factor of instability. It is also the main motivation for Japan to continue to prepare and equip its navy and coast guard to react and respond to what is in Japan – and pretty much everywhere else in East and Southeast Asia – considered as Chinese territorial expansionism. The fact that the South China Sea is a vital sea route shipping goods and crude oil for all the countries involved in the territorial disputes (for details see below) will most probably continue to help contain any military conflict. The US involvement and military presence will continue to deter China from (even) more provocative action and policies. Washington has for example, made it very clear more than once that a Chinese attempt to reclaim the Senkaku Islands by force would lead to U.S. military intervention legitimised by the U.S.-Japan Security Treaty (adopted in 1960).

5.1 Flow of Energy and Goods in the Indian Ocean East and South China Seas

The Indian Ocean, South China Sea and East China Sea are vital transit routes for the world economy. Eight out of ten of the world's busiest container ports are in the region. Two-thirds of the world's oil shipments travel across the Indian Ocean on their way to the Pacific, with 15 million barrels of oil passing through the Straights of Malacca Strait daily. Almost 30 % of global maritime trade goes across the South China Sea, including goods worth US\$ 1.2 trillion bound for the U.S. each year. The South China Sea accounts for over 10 % of world fisheries production and is thought to have oil and natural gas deposits beneath the seabed. Almost a third of global crude oil and over half of global liquefied natural gas (LNG) passes through the South China Sea each year and more than 50 000 vessels transit the Straits of Malacca per year. A large amount of crude oil arriving in the Strait of Malacca (roughly 1.4 million barrels per day) is shipped to terminals in Singapore and Malaysia. After processing, this crude oil is then shipped out to Asian markets through the South China Sea as refined petroleum products, such as motor gasoline and jet fuel. The rest of the crude oil passes through the South China Sea mainly to China and Japan, by far the region's two largest energy consumers (while 15 % of crude oil shipped through the South China Sea goes on to the East China Sea and to South Korea). Roughly 80 % of China's crude oil imports (from the Middle East and Africa) travel through the Straits of Malacca¹. Three times more of crude oil travels through the South China Sea than through the Suez Canal and 15 times more than through the Panama Canal. By 2020, it is estimated that the amount of oil and gas shipped through the South China Sea will double.

Five of the world's most important deep-water ports (able to accommodate the largest container ships) are located in the East and South China Seas: Hong Kong, Singapore, Shanghai, Kiaohsiung, Yokohama and Guangzhou. The South China Sea is also a major destination for LNG exports. With growing demand for natural gas in East Asia, the South China Sea's share of global LNG trade is likely to further increase, not least as Japanese LNG imports have – due to the energy shortage after the Fukushima nuclear crisis in 2011 – increased significantly over recent years. Large quantities of coal from Australia and Indonesia, the world's two largest coal exporters, also pass through the South China Sea to markets around the world, above all to China, Japan, and India. These coal shipments include both steam coal used for generating

⁵ From a Japanese perspective not even subject to a territorial dispute with China. The Senkaku Islands are in Tokyo's view not disputed as they are an integral part of Japanese territory.

electricity and process heat as well as metallurgical coal for primary steel production.

5.2 Other Strategic Issues

In terms of other strategic issues the US expansion of trade ties in the shape of the TPP is seen from a Chinese perspective as nothing less than an attempt to strategically 'encircle' China as part of a US-led containment strategy. The inter-regional free trade pact excludes China, which has long claimed that the US (despite maintaining otherwise) never had the intention to invite China to join the TPP. In fact, the argument in Beijing usually goes, Washington has sought – through membership rules and regulations such as the treatment of state owned enterprises, that China would not be able to meet – to intentionally exclude Beijing from the TPP from the very beginning. Whether or not this is true is secondary. And China has been excluded from the TPP to which Vietnam, whose state-owned enterprises (SOEs) are in terms of structure and overall positioning in the Vietnamese economy similar to its Chinese counterparts, has been admitted⁶. There is little doubt that the TPP is – from a Japanese perspective in particular⁷ – also to be understood as a political initiative to strengthen ties among the U.S. and like-minded countries, which share concerns about China's economic and military rise.

China's dominance of the rare earth sector and its ability to control the price of such raw materials could be the source of geopolitical tensions (in which Europe and the EU are involved).⁸ Western dependence could encourage Beijing to use its market power in the sector as a means of exerting political and geopolitical pressure. In 2010, Beijing used – albeit only temporarily – its quasi-monopoly of rare earths to exert political pressure on Japan following a diplomatic feud when Japan detained a Chinese boat captain who had intentionally rammed a Japanese coast guard in the East China Sea. Like Japan, the EU is dependent on China for more than 90 % of its rare earths, above antimony, a material of crucial importance for Europe's aerospace industry. Both Japan and Europe are dependent on rare earths for high-technology motors, solar power panels, fuel cells, X-ray equipment and lasers. The vast majority of these elements are concentrated in China. Regardless of China's political objective of imposing export restrictions on rare earths, restrictions inevitably result in a rapid shortfall in the market.

China issued 57 different export-restrictions (quotas, licenses) on the rare earth metal antimony between 2009 and 2012. While there may be an economic motivation for such measures, which are still arguably in compliance with WTO rules, temporary interruptions could become permanent in the case of geopolitical tensions.⁹ This might happen if China felt obliged to respond if it were put under 'sufficient pressure'. Europe's direct involvement in any of China's regional and territorial conflicts is limited so the interruption of rare earth exports to Europe is very unlikely, but cannot be completely excluded either. Roughly 60 per cent of China's antimony is produced in Lengshuijiang province, where Beijing closed several mines in May 2015 that led to a delay of antimony shipments.

⁶ Chinese SOEs and the kind of financial support and subsidies they receive from the Chinese state, are inconsistent with TPP provisions.

⁷ Japanese Prime Minister Shinzo Abe has more than once in the recent past argued that the TPP is also a political project and not only an agreement to facilitate trade.

⁸ Rare earths are found in very small concentrations in larger geographic deposits and include 17 elements (lanthanum, cerium, praseodymium, neodymium, promethium, samarium, europium, gadolinium, terbium, dysprosium, holmium, erbium, thulium, ytterbium, lutetium, scandium and yttrium).

⁹ Over recent years China has brought itself into compliance with WTO rules on quantitative restrictions of exports. However, the transition away from the use of export quotas towards export licenses shows that China still reserves the right for itself to interpret WTO rules and regulations as it sees fit.

6 EU-Singapore FTA: Institutional deadlock and future of the EU Common Commercial Policy

On 20 September 2013, the European Union (EU) and Singapore initialled a comprehensive bilateral free trade agreement (FTA), under negotiation since March 2010. Negotiations on investment rules though continued until 17 October 2014 finally paving the way for the ratification process and eventual entry into force of the agreement. However, the EU-Singapore FTA has still not entered into force as it currently remains mired in an institutional deadlock between the European Commission (EC) and the Council over a dispute concerning the implementation of the Treaty of Lisbon. The implementation of the agreement must therefore await a ruling on the dispute from the European Court of Justice (ECJ) in the indefinite future and if EC and the Council consider the matter resolved.

EU-Singapore FTA has been widely hailed in Europe as a strategic accomplishment for the EU's partnership with the Asian trading giant and as a gateway for the EU into dynamic South East Asia. It has also been perceived as a mini-victory in the EU's overall approach to Asia. The current institutional impasse has five important consequences. First, the deadlock has led to a temporary setback in EU-Singapore ties. Second, it has raised serious questions about the EU's common commercial policy. Third, it raises questions of trust in the minds of negotiators from other countries presently negotiating or seeking an FTA with the EU. Fourth, the dispute has brought into question the EU's position as a reliable trading partner. And finally, the stalemate stands to seriously jeopardise EU external trade policy and strategy.

6.1 The Dispute – exclusive competence or mixed agreement?

The EU's Common Commercial Policy has, since its inception in 1957, evolved significantly in subsequent EU treaties. The treaties of Amsterdam and Nice in particular expanded the scope of the Common Commercial Policy setting in place a complex and ambiguous system of rules¹⁰. The Treaty of Lisbon, which came into force on 1 December 2009, was the most far reaching in the sense that it brought further policy areas under the Common Commercial Policy making FDI in particular exclusive EU competence (Articles 206 and 207, TFEU).

However, the Singapore case throws some into doubt the extent of EU exclusive competence with respect to FDI under the Lisbon Treaty. The Commission seeks to interpret the treaty provisions broadly as permitting the EU to exclusively negotiate and conclude international agreements – both FTAs and international investment agreements covering FDI. The Council on the other hand is of the opinion that EU trade agreements covering FDI and some other topics are 'mixed agreements', hence requiring ratification by 28 national parliaments and not just the European Parliament. On 30 October 2014, an EC press release declared the EC's intention to request an opinion from the ECJ clarifying the interpretation of the Lisbon Treaty on whether the investment provisions in the EU – Singapore FTA fall under EU exclusive competence. Areas of contention under the EC-Council disagreement also include transport, aspects of services, transparency, and intellectual property.

¹⁰ The treaty of Nice treaty extended the common commercial policy to the negotiation and conclusion of agreements in trade and services and the commercial aspects of intellectual property. LawTeacher, UK. (November 2013). The Common Commercial Policy. Retrieved from <http://www.lawteacher.net/free-law-essays/commercial-law/the-common-commercial-policy.php?cref=1>

On intellectual property rights (IPR), article 207 of the Treaty of Lisbon does not distinguish between commercial aspects and trade-related aspects. Article 207 indeed gives exclusive competence to the EU on the commercial aspects of IPR, but omits any mention of trade related aspects leaving the debate open as to which aspects of IPR are covered by exclusive competence by the Treaty. The above-mentioned Article 207.1 also empowers the EU to take actions related to direct investment under the common foreign policy mentioning 'foreign direct investment' (FDI) but, once again, without providing a clear definition of FDI. Article 207 remains unclear whether aspects of regulation relating to the activity of third country nationals in the EU (and EU nationals in third countries), the post-establishment treatment of foreign investors and the protection of foreign investment against expropriation should or not be excluded.

Also unclear is whether aspects of services are included under exclusive competence. The Lisbon Treaty incorporates social, health, educational and cultural services into the general scope of EU competence under Article 207.1 (TFEU) Treaty on the Functioning of the EU, but article 207.6 links competence to EU harmonisation. More explicit is transport, as the Lisbon Treaty excludes transport services from the Common Commercial Policy. However the EU – Singapore FTA contains a chapter related to transport.

But why is there a dispute now with the EU-Singapore FTA when there was none with the EU-Korea one? The answer to this is that the EU–Korea FTA was created as a 'mixed agreement' before the application of the Lisbon Treaty, whereas EU – Singapore FTA was deliberately created as an 'EU-only agreement' to be concluded by the EU alone by a Council decision and the consent of the EU Parliament. As the Commission states, 'the nature of every agreement is linked to its content', the EU–Singapore was submitted to the Council as an EU agreement. The EU–Korea agreement was submitted by the Commission to the Council as a 'mixed agreement'. When the Singapore agreement was presented as an 'EU-only agreement' the COREPER asked the Commission to make the necessary modifications in order for it to be concluded as a 'mixed agreement'. The EU-Singapore FTA contains provisions covering all types of investments that are, implicitly included under the EU exclusive competence, but the issue remains sensitive because certain member states would like to retain more control over aspects of commercial policy.

6.2 The impact: for EU-Singapore relations and EU trade policy?

While the EC and Council have maintained that the dispute is simply an internal, institutional matter that will be resolved in due course, it has not been without consequences for EU-Singapore relations, for EU-ASEAN trade as regards the broader picture of EU-Asia relations, and for EU trade policy in general or rather how it is perceived in Asia.

The dispute has proved to be a political faux pas for the bilateral EU – Singapore relationship. According to officials, Singapore was neither consulted on the EC's decision to bring the matter to the Court of Justice. Even though Singapore has respected EU internal procedures, these circumstances have left the country in the uncomfortable position of having no alternative but wait. Moreover, Singaporean officials now estimate that given the current situation, the FTA might realistically not enter into force for at least the next two years, which would imply significant losses for both sides.

It is in the interest of both parties (the EC and the Council on the one hand and the EU and Singapore on the other) to have the issue resolved as soon as possible. As mentioned earlier, the FTA holds the potential to boost EU exports to Singapore by around EUR 1.4 billion and Singapore's exports to the EU by almost EUR 3.5 billion within the next decade. Singapore is an important market for the EU and vice versa. In 2013, Singapore was the EU's 15th largest trading partner globally and the second largest Asian investor into the EU. In turn, the EU makes up around 10 per cent of Singapore's total external trade

volumes and is the largest contributor of FDI into the island nation.¹¹ Singapore represents around third of EU trade in goods and services with ASEAN and around 95 per cent of FDI from ASEAN trade into the EU¹². Moreover, the EU runs a trade surplus with Singapore. The microstate is also one of the world's top trading nations (14th largest exporter and 15th largest importer globally)¹³.

The dispute furthermore has an important bearing on the EU's success as an international trader. It invites the question as to whether the EU has a viable common commercial policy and is capable of satisfactorily concluding and ratifying agreements. The EU is currently negotiating a number of FTAs across Asia and the complications that have arisen within the EU-Singapore FTA post signature only serve to deter the EU's other external negotiating partners. The attractiveness of a deal with the EU is severely dampened by the fact that after years of negotiations, unexpected internal challenges within a sui generis organisation like the EU could scuttle the deal and indefinitely delay the anticipated benefits. Such complications prove difficult for the EU's partners (and for EU member states) to justifying to national stakeholders. As for the EU, the FTA with Singapore raises questions about the scope of the extension of exclusive competence under the Treaty of Lisbon and it is not certain that such disputes will not arise in the future with other FTAs.

6.3 An EU-ASEAN/Asia trade shipwreck?

The EU-Singapore FTA is crucial for EU-ASEAN relations. A Joint Communication of the EU adopted on May 19 2015, entitled 'The EU and ASEAN: a partnership with a strategic purpose', called for the EU to revive the project of an ambitious region-to-region FTA 'building on bilateral agreements between the EU and ASEAN Member States'¹⁴. The EU-Singapore FTA is the first bilateral agreement that needs to be in place, especially as it is the most advanced FTA between the EU and ASEAN member countries. The EU-Singapore FTA should provide a precedent for the level of ambition of further agreements and ultimately for a region-to-region agreement between the EU and ASEAN¹⁵.

ASEAN, which is progressively gaining prominence, would then be a stepping-stone for the EU in Asia. Not only does ASEAN find itself at the heart of Asia's emerging regional economic and security architecture, but also as a regional organisation, ASEAN's integration process is advancing at a momentous pace. By the end of 2015 ASEAN pledges to implement its ASEAN Economic Community (AEC) that seeks to 'transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy'¹⁶. Already, ASEAN represents a 600 million strong market and a combined GDP of about US\$ 2.5 trillion¹⁷.

¹¹ EU Commission Press Release, 'EU and Singapore Conclude Investment Talks', 17 October, 2014, Available at: http://europa.eu/rapid/press-release_IP-14-1172_en.htm

¹²Gauri Khandekar, 'Mapping EU-ASEAN Relations', FRIDE, 05 March, 2014, Available at: <http://fride.org/publication/1183/mapping-eu-asean-relations>

¹³ Roberto Azevedo, 'For global cities, the global system works best', The Straits Times, 25 May 2015, Available at: <http://www.straitstimes.com/opinion/for-global-cities-the-global-trading-system-works-best>

¹⁴ European Commission, 'The EU and ASEAN: a partnership with a strategic purpose', JOINT COMMUNICATION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL, 18 May 2015, Available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=JOIN:2015:22:FIN&from=EN>

¹⁵ Op. Cit., Note 17

¹⁶ ASEAN Economic Community Blueprint, ASEAN, January 2008, Available at: <http://www.asean.org/archive/5187-10.pdf>

¹⁷ 'ASEAN Financial Integration: Where Are We, Where Next?' - Keynote Address by Mr Ravi Menon, Managing Director, Monetary Authority of Singapore, at ASEAN Banking Council Meeting on 12 June 2015, Available at: <http://www.mas.gov.sg/news-and-publications/speeches-and-monetary-policy-statements/speeches/2015/asean-financial-integration-where-are-we-where-next.aspx>

ASEAN nominal GDP too has grown from US\$ 1.3 trillion in 2007 to US\$ 2.4 trillion in 2013, while GDP per capita has risen from US\$ 2249 to US\$ 3832 over the same period¹⁸. The economic convergence among ASEAN countries is also impressive. In 2007 GDP per capita in the richest ASEAN economy was 105 times that of the poorest, in 2013 it was just 62 times¹⁹ and this gap is set to fall to 47 times by 2018. The least developing economies Cambodia, Laos, Myanmar and Vietnam are also driving growth in ASEAN. Today their economies constitute around 10 % of ASEAN GDP (2013), up from only 7 % in 2007²⁰.

Beyond its own dynamic economy, ASEAN lies at the core of two high-profile mega-regional FTAs: the TPP and RCEP. The TPP in particular is not restricted and could eventually expand to embrace all ASEAN countries. Countries in the region also aim to ultimately transform these mega plurilateral FTAs into a single Free Trade Area of the Asia Pacific (FTAAP). For the moment, however, TPP and RCEP will spur intra-regional trade and Asian trade with the Pacific Rim countries (which include the US, Canada and Mexico in addition to certain Latin American countries), and could create important trade divergence from transatlantic trade towards the Asia Pacific. In addition, the TPP – an initiative of the US, which is a major EU competitor in the region aside from China – is spreading US standards and regulatory approaches throughout the region, not EU. This phenomenon, coupled with the fact that the EU remains largely absent from the region's free trade architecture, will inevitably make EU trade with the region more difficult.

It is essential for the EU to urgently hone down its common commercial policy and reboot its external trade strategy. The impasse of the EC-Council dispute over the EU-Singapore FTA has generated much mistrust amongst the EU's other Asian trade and negotiating partners in addition to inconveniencing EU member states who have no opposition to the FTA. Ensuring that this impasse finds a sustainable solution both in terms of greater clarity towards honing down the EU's common commercial policy and developing a geo-economic approach in the EU's external trade policy, would be best case outcome that the EU must aim for.

7 How the EU should streamline and improve its strategy *vis-à-vis* Asia

The new EU trade strategy, 'Trade For All', seeks to please everybody, but fails to confront the most difficult issues facing EU trade and investment policy. The document proposes 'a trade and investment policy based on values'. Its subtitle announces 'a more responsible trade and investment policy'. What the Commission is in fact doing is officially taking on board an NGO and radical left agenda that has dominated the debate on TTIP. At the same time, on substance, the concrete proposals it makes, including and monitoring sustainable development, human rights and worker rights in trade deals are not really new. The real novelty on this front is the official promotion of the new EU dream of an international investment court.

The Communication announces greater transparency in EU trade negotiations and policy. More transparency in EU policy, including in trade and investment policy, is a valuable goal and should contribute to reducing the risk that specific interest groups unduly shaping negotiations such as TTIP in their own favour. But the document does not address the more fundamental problems with transparency in trade policy making in the EU, such as the point trade policy objectives are formulated at

¹⁸ Ji Xianbai, 'Time to revisit an ASEAN-EU FTA?', *The Diplomat*, 03 June 2015, Available at: <http://thediplomat.com/2015/06/time-to-revisit-an-asean-eu-fta/>

¹⁹ *Ibid.*,

²⁰ *Ibid.*,

the stage when the 28 member states set a mandate. Having said this a lot in this strategy makes sense from an economic perspective, such as the strong focus on services trade liberalisation and on the promotion of professional mobility and digital trade, all of which are consistent with the needs of the EU economy.

The new strategy prioritises concluding major on-going projects such as the EU-Japan FTA and the EU-China investment agreement, while opening the door to new negotiations in the 'vital Asia-Pacific region' including with the Philippines and Indonesia.

The strategy makes specific references to requesting a mandate from EU Member States for free trade negotiations with Australia and New Zealand. For the EU, a negotiation with a liberal economy like New Zealand will allow the bloc to refresh its FTA model and to create a third generation FTA that is at least on the par with TPP, and that goes beyond the current one, which is modelled on EU-Korea, at a time of Europe's difficulties with TTIP. The pre-existence of EU-New Zealand regulatory cooperation - much inherited by the British Commonwealth - on technical barriers to trade, sanitary and phytosanitary measures (SPS) and data privacy provides a starting point for negotiations that does not exist with other jurisdiction. FTAs with New Zealand could set the new FTA model for the future EU trade agreements.

The conclusion of the TPP by the United States has refocused the Commission's attention on its strategy towards Asia. Contrary to what commentators have said, the EU is not now 'pivoting' towards Asia. It already did so years ago. What the Commission is doing in its new document is reviving an old idea initiated under then-Commissioner Peter Mandelson in 2006: a region-to-region free trade agreement with the South East Asian grouping ASEAN, build by a series of bilateral. Trade talks with Japan – a crucial TPP member – are on-going. In fact, the real response to TPP could be the EU – Japan and TTIP.

Another novelty is the inclusion of Taiwan and Hong Kong as potential partners for a bilateral investment treaties, though the prospect has been pushed back to after the (unlikely) conclusion of a BIT with China. For the first time, the Commission also mentions the idea of a bilateral free trade agreement with China.

But the EU trade strategy is still absent with regards to China and Russia. Nowhere in the strategy is there an articulation of a coherent approach to China, the EU's second largest trading partner and arguably one of the most divisive topics in EU trade policy. One big issue to be resolved is whether the EU should agree to recognising China as a market economy by next year – which would reduce the Asian giant's exposure to the EU's activist trade defence policy. But market economy status – MES – is not mentioned once in the document. Russia is the EU's third largest trading partner. A looming threat is Russia's trade policy response in January 2016 when Ukraine starts implementing its DCFTA with the EU. Negotiations on a settlement with Russia on this matter are not going well.

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Part III:

Implementation of the EU-Republic of Korea FTA

ABSTRACT

The EU-Republic of Korea FTA (EU-Korea FTA) has so far been beneficial to both parties, although relatively more so for the EU, because the EU market was already a more open market than that of Korea. The benefits have been partly due to the trade liberalisation in the FTA and partly due to macroeconomic factors, such as the slow GDP growth and thus sluggish demand in the EU, and the Euro depreciation *vis-à-vis* the Korean Won over the last 5 years. Sectorial developments have also been at work, such as the reduction in Korean output and thus exports in key sectors, due to global overcapacity and reorganisation of production in sectors that are important in EU–Korea competition. The most important increase in exports from the EU to Korea has been in transport equipment, more specifically cars and trucks, but the size of the increase is substantially lower than that forecast. There was also a significant increase in EU agricultural and food product exports (food and beverages), with the greatest increases in meat and dairy products. Concerning the auto industry, EU imports from Korea increased by 16 % from 2010 to 2014. On the export side, the EU exported 6 million motor vehicles in 2014, worth EUR 124 billion, which is 27 % up on 2010 and the largest increase was indeed to Korea. The EU-Korea FTA is the first comprehensive FTA completed with a fully industrialised and developed economy. As such, it serves as a test for the EU's ability to implement beneficial FTAs with economies characterised by important non-tariff barriers to trade (technical barriers to trade, regulatory provisions in the services sector, a lack of access to government procurement markets) and other less evident trade barriers (such as anti-competitive practices that restrict access to markets by companies from the other party).

Executive summary

1 July 2015 marked the fourth anniversary of the EU-South Korea FTA (Free Trade Agreement), with the majority of custom duties already removed by both parties. Overall, the impact of trade liberalisation has been beneficial to both parties, relatively more so for the EU, whose trade deficit with South Korea in the years before the entry into force of the FTA turned into a trade surplus of EUR 4.4 billion in 2014. Comparing figures between the fourth year after the FTA was implemented, with the year before the entry into force, bilateral trade increased substantially in both directions with a stronger performance of EU exports to (compared to imports from) South Korea: EU goods exports to South Korea increased by 55 % from EUR 30.6 billion to EUR 47.3 billion (EU exports of fully liberalised goods increased by 57 %). EU imports from South Korea in the third and fourth year of FTA implementation increased annually by 5-6 % (imports of fully liberalised goods from South Korea increased by 35 %). As a result, South Korea increased its importance as an importer of the EU goods, but decreased its weight as a supplier to the EU. South Korea is currently the 8th largest trading partner for the EU, both on the export and import sides, accounting respectively for 2.5 % of extra-EU exports and 2.3 % of extra-EU imports. However, EU imports from South Korea have grown much stronger in 2014 (+8.3 %), which could signal an ongoing change in bilateral trade developments to be monitored in the future.

Bilateral trade developments between the EU and South Korea have been partly influenced by the entry into force of the FTA, and partly by macroeconomic factors, such as the slow GDP growth and sluggish demand in the EU, and the Euro depreciation vis-à-vis the Korean Won over the last 5 years. Sectoral developments have also been a factor, both at the domestic level such as the reduction in Korean output and exports in key sectors due to global overcapacity and oversupply, and the international level in the shape of reorganisation of production in sectors that are important in EU – Korea competition. Moreover, the improvement of EU trade balance with South Korea since 2011 is also due to the fact that the EU was already a more open market than South Korea so that liberalisation and the gains from trade could be expected to be larger for the EU than for South Korea. It is also worth noting that this relative improvement in EU trade performance has occurred even though the elimination of custom duties has been more front-loaded on the part of the EU than on the part of South Korea.

Overall, EU trade linkages with South Korea have intensified since 2011. In 2010 EU imports from South Korea were 2.1 % of all imports from extra EU sources and South Korea accounted for 2 % of extra - EU exports, South Korea now accounts for 2.5 %. EU imports from South Korea are very concentrated in a few sectors, with the top 10 sectors (classified according to the Harmonised System Revision 2, HS2) accounting for 87 % of total exports and top 5 sectors for 69 %. But sector concentration is decreasing, which means that the EU is now importing a larger variety of goods from South Korea. EU exports are also fairly concentrated (although less than imports), but concentration is increasing from 55 to 58 (top 5) and from 70 to 74 (top 10), which suggests that the EU is narrowing the variety of goods exported to South Korea.

Besides an overall assessment of broad aggregate trade trends, an industry-level analysis is essential in order to provide an in-depth assessment of the impact of the FTA, because important sectoral effects have been at work during the implementation period. These diverse sectoral effects confirm the ex-ante contrasting positions and explain why industries and interest groups continue to hold differing views on the impact of the FTA. In this context, there is a difference between the sectors in which the EU has a comparative advantage and those in which the EU has faced strong competition from South Korea. For the former, in the machinery and chemicals there has been an increase in the EU trade surplus. In the food and drink sector, which has historically been a less important exporter to Korea, there has also been the increase expected by the CEPII/ATLAS (2010) study. Conversely, in sectors in which the EU has faced fierce competition from Korea (automotive, electronics, textile and clothing) the EU trade deficit has declined or stabilised.

On the import side, it is worth noting that total EU imports from all extra-EU countries increased by over 10 % during the period, while EU imports from Korea were down by about 2 % between 2010 and 2014. However, this trend is due to strong sectoral effects in the machinery and transport equipment sector. EU imports of machinery and transport equipment from Korea declined by around 18 %. Some specific sub-sectors within machinery and transport were mainly responsible, such as the 'other transport equipment' sector (in this case mainly ships) in which imports from Korea virtually collapsed. This was due, on the supply side, to the persistent excess capacities in the global maritime shipping sector and, on the demand side, to a decline in orders from the EU. As Korea is one of the three biggest shipbuilding nations in the world, exports to the EU fell accordingly. EU imports from Korea also declined in IT equipment, electrical goods and optical products (mainly consumer electronics). This was probably mostly due to Korean firms in the sector shifting production to China or Southeast Asia (e.g. ASEAN countries) where wage costs are lower than in Korea. As a result, EU imports of these products increased from important ASEAN countries and China, but also in some cases from Eastern Europe. These imports then displaced imports from Korea. Without these sectors EU imports from South Korea in nominal terms increased by 42 %.

Regarding the trade performances of European and Korean automotive sectors, South Korea is the world's fifth-largest manufacturer of vehicles (90 % of which are passenger cars). The country produced 4.1 million passenger cars and 400,800 commercial vehicles in 2014 after three years of decline, largely due to production stoppages over wage disputes. Hyundai-Kia, Korea's leading car-maker (8 m units in 2014, a 8.6 % year-on-year increase), is very internationally oriented, exporting 68 % of domestic production in 2014. The group currently operates 34 plants worldwide, with only 50 % of total Hyundai production taking place in South Korea (16 plants), 30 % in China (8 plants), almost 10 % in the United States (2 plants) and the rest in Europe (4 plants). The companies plan to add six more overseas plants between 2016 and 2018 in order to locate more than 60 % of their global production outside Korea (EIU). The most important export markets for Korean cars are the United States, the EU and China. The current low oil prices are negatively affecting the competitiveness of Korean automakers in China and the US, because of their strength in small more fuel efficient cars and relative weakness in SUVs, large-size passenger cars and pick-up trucks. The carmaker is under pressure at home, where the FTAs (with the EU and with the US) have increased competition. According to the Korea Automobile Importers and Distributors Association (KAIDA), US carmakers reported a 43 % rise in sales in the Korean market between 2011 and 2013, while German and Japanese carmakers have seen a fivefold increase in exports during the period 2011-2013. German marques had the biggest share of South Korea's imported car market last year (67.5 %), followed by Japanese producers (14 %). Despite the increased sales volume US carmakers saw their share of South Korea's imported car market fall from 7.9 % in 2011 to 7.5 % in 2013.

Today, South Korea is the number one source of imports of cars into the EU in terms of units, accounting for a 21 % share of EU imports. In terms of value, it comes in third place (behind the US and Japan). Despite a shrinking EU market, the volume of Korean automobile imports into the EU is increasing year-on-year. South Korea is now the second largest exporter of cars to the EU, with 348,263 units, a 14 % share, up from 12 % in 2010, when it exported slightly less than 381,000 to the EU; over the same period, European passenger car exports to Korea increased by 166 %. EU exports to Korea are still limited to less than 8 % of the total market, and are made up almost exclusively of premium cars. The European automobile industry is however, encouraged by the increase in EU exports of motor vehicles to Korea. Several factors have contributed to this increase, such as European vehicles' environmental and safety standards (at least until September 2015), as well as a general increase in demand for European brands. These trends reflect shifts in consumer tastes that predate the implementation of the FTA. The Association of European Automobile Manufacturers car (ACEA) considers the increase to be a consequence of changing Korean consumer demand, rather than the effects of the FTA and therefore argues that the Korean car market will remain difficult to access. ACEA therefore shares the European

Commission's view that, in the automotive sector, tackling the remaining non-tariff barriers is still challenging.

Comparing the EU-ROK FTA with the other major preferential trade agreement signed by The Republic of Korea with an industrialised economy – the KORUS FTA – one can make the following observations. First, in the broader picture of US trade policy KORUS is not a high priority. It is in the US' interests to fold KORUS into the TPP to minimise any divergence in the rules and to reduce the costs of multiple agreements. Second, the FTA bodies implementing bodies and monitoring the KORUS are rather different to those in the EU-ROK. The EU-ROK structure and methods appear to be more robust than those in the KORUS FTA. Third, Korea's objectives with the FTAs can be likened to other small trade dependent countries in that it needs to maintain good relationships with all of its trading partners, but will necessarily prioritise its top trading and investment partners. This is important when considering the role of China and its relative importance to the South Korean economy. In conclusion, the first mover advantages for Korea stemming from the early implementation of the EU-ROK FTA compared to other FTAs (including KORUS) look quite likely to be overtaken as Korean companies with a strong EU presence continue to offshore production to China and Southeast Asia in order to maintain their global competitiveness.

In its negotiation of KORUS, which was implemented one year after the EU-ROK FTA as part of the Korean global trade strategy to become the economic hub of Northeast Asia, both Korea and the US have experienced positive gains. Korean exports to the US rose by 31.54 % in the first three years of the FTA, while Korean imports from the US rose by 10.77 %. The office of the USTR as well as the former US chief negotiator for KORUS, Wendy Cutler, expressed satisfaction that the FTA had improved Korea's investment environment for US companies. The issues that continue to be monitored and/or negotiated are: automotive regulation, certificate of origin verification, pharmaceutical patent linkage, pharmaceutical price reduction policy, the transfer of financial data, express delivery packages and processed organic food certification. Some of these (notably the certificate of origin verification, express delivery packages and financial data transfer) have revealed a divergence of views between Korea and the US that is likely to require detailed regulations or specific agreements. Several of the recently enforced measures (the systems for evaluating automobile emission figures, reducing pharmaceutical prices and verifying processed organic food) require further review and analysis to determine how consistent they are with the original objectives and purpose of the KORUS FTA. Preliminary bilateral talks between the US and South Korea to explore Korea joining the TPP have raised the possibility of the TPP superseding the KORUS FTA. The US is unlikely to stand in the way of Korea joining the TPP given the success of KORUS for the US. Furthermore, joining the TPP would offer benefits to the Korean economy, specifically by raising the standards of labour regulation in some TPP countries such as Brunei and Malaysia. Joining TPP could mean that TPP would replace KORUS when it is ratified and implemented. This would be beneficial for Korea because the trade relations between South Korea and the TPP countries are much more widespread and sizeable, as are the economic linkages arising from participating into production networks centred on the Asia-Pacific.

As the EU-ROK FTA is the first comprehensive FTA negotiated by the EU with a fully industrialised and developed economy, it serves as a test for the EU's ability to implement beneficial FTAs in line with the revised policy on FTAs adopted as part of the 'new Global Europe Strategy' in 2006. The EU-ROK FTA is the first with an economy characterised by important non-tariff barriers to trade (technical barriers to trade, regulatory provisions in the services sector and a lack of access to government procurement markets) and other less evident trade barriers, such as anti-competitive practices that restricted access for companies from the other party. At the same time, Korea's production structures are more similar to the EU's than those of non-industrialised and developing economies. In addition, the Asian partner shows potentially higher economic structural complementarity, and thus a higher share of intra-industry trade.

Introduction

As 1 July 2015 marked the 4th anniversary of the EU-South Korea FTA, with the majority of custom duties already removed by both parties²¹, it is time for a comprehensive review of the results achieved in terms of actual benefits compared with the projections suggested by the impact assessment study of the FTA conducted in 2010 (CEPII/ATLAS, 2010). The EU's merchandise trade balance with Korea improved quite substantially, as also evidenced by the annual assessment reports conducted by the EC (EC, 2014, 2015); it turned from a large deficit in the years before the entry into force of the FTA²² into a trade surplus in 2013 and further increased to EUR 4.4 billion in 2014. Overall, the impact of trade liberalisation has been beneficial to both parties, although relatively more so for the EU.

A comprehensive assessment of the results of the FTA must necessarily take account of the substantial changes and gyrations in a number of economic conditions during the implementation period, compared to the period prior to the entry into force of the FTA. Bilateral trade developments between the EU and Korea are likely to depend partly on the entry into force of the FTA, and partly on macroeconomic and sector specific developments. The latter concern both domestic developments as well as the international reorganisation of production in a number of sectors in which competition, including between EU and Korean producers, has intensified. The improvement in the EU trade balance with Korea after 2011, is also due to the fact that the EU was already the more open market of the two, so that the impact of liberalisation has tended to favour the EU more than Korea²³. It is also worth noting that the trade benefits for the EU were relatively greater despite the fact that the elimination of custom duties has been more front-loaded in the EU than Korea.

Besides an overall assessment of broad aggregate trade trends, an industry-level analysis is therefore essential in order to provide an in-depth study of the impact of the FTA, because important sector factors have been at work during the implementation period. These sector effects tend to confirm the various ex-ante positions of the parties and explain why the perceptions of the FTA differ between industries and interest groups. The present study will also provide a discussion of how well the institutional arrangements within the EU-ROK FTA have performed so far. There is also a comparison between the provisions of the EU Korea FTA and the KORUS, which was signed just one year after the EU-ROK FTA.

An assessment of the EU-ROK FTA constitutes an opportunity to draw lessons for the future of EU external trade and investment policy in the form of FTAs, because it was the first EU FTA negotiated with an industrialised and developed country (and therefore its manufacturing structure is much more similar to that of the EU than any developing economy). As such, deeper trade and investment integration between the EU and South Korea is expected to result in sizeable sectoral changes in both economies, especially in those sectors where the two are strong competitors in world markets and vis-à-vis each other.

²¹ The EU-ROK FTA is unprecedented both in its scope and in the speed at which trade barriers have been removed. The majority of custom duties on goods were removed at the entry into force of the FTA and by July 1 2016 practically all EU customs duties on industrial goods will be removed, which corresponds to almost 99 % of all duties paid by Korean exporters before the entry into force of the FTA. A limited number of agricultural and fisheries products have transitional periods longer than seven years and rice and a few agricultural products are excluded from the agreement.

²² The EU trade deficit with South Korea was consistently higher than EUR 10 million after at least 2004, reaching EUR 18 million in 2006, and in the year before the FTA entered into force was EUR 11 million.

²³ Average trade weighted tariff applied to EU exports in Korea was 6.2 %, compared to 2.5 % on Korean exports to the EU. Furthermore, about 68 % of the value of Korean exports already entered the EU duty free compared to 15 % of the value of EU exports to Korea.

1 Overall assessment

Overall, the impact of trade liberalisation so far has been relatively more beneficial for the EU, for which the trade deficit with Korea in the years before the entry into force of the FTA has been turned into a trade surplus after 2013. This was the first year in 15 that the EU recorded a trade surplus with Korea (EC, 2014; Kang and Kim, 2013) and there was a further increase to EUR 4.4 billion in 2014 (Figure 1). South Korea registered an opposite trend in its trade balance with the EU, with the surplus with the EU amounting to almost US\$ 9 billion in 2011 turning into a deficit of more than US\$ 10 billion in 2014 (Figure 3).

Comparing figures between the fourth year of implementation of the FTA and the year before its entry into force, one can see that bilateral trade increased substantially in both directions, with a stronger performance of EU exports to (compared to imports from) South Korea. EU merchandise exports to South Korea increased by 55 % from EUR 30.6 billion to EUR 47.3 billion (exports of fully liberalised goods increased by 57 %). EU imports from South Korea in the third and fourth year of FTA implementation increased annually by 5-6 % (imports of fully liberalised goods from South Korea increased by 35 %).

Figure 1. EU trade in goods with South Korea



Compared with forecasts provided by the impact assessment study conducted in 2010 (CEPII/ATLAS, 2010), the actual improvement the EU bilateral trade balance with South Korea is much lower than forecast: the actual EUR 4.4 billion surplus in 2014 being much lower than the forecast range of EUR 6.68-10.08 billion (Table 1).

Table 1. Comparing forecasts with current results in trade developments (billion EUR)

	Baseline 1 forecast	Baseline 2 forecast	2014 actual
EU exports to ROK	41.08	33.02	43.10
EU imports from ROK	34.41	22.95	38.80
EU Net exports to ROK	6.68	10.08	4.40

Sources: CEPII/ATLAS (2010) and Eurostat

The divergence between the forecast and the actual net impact of the FTA on bilateral trade development is due to a number of divergent trends in both EU exports to and imports from South

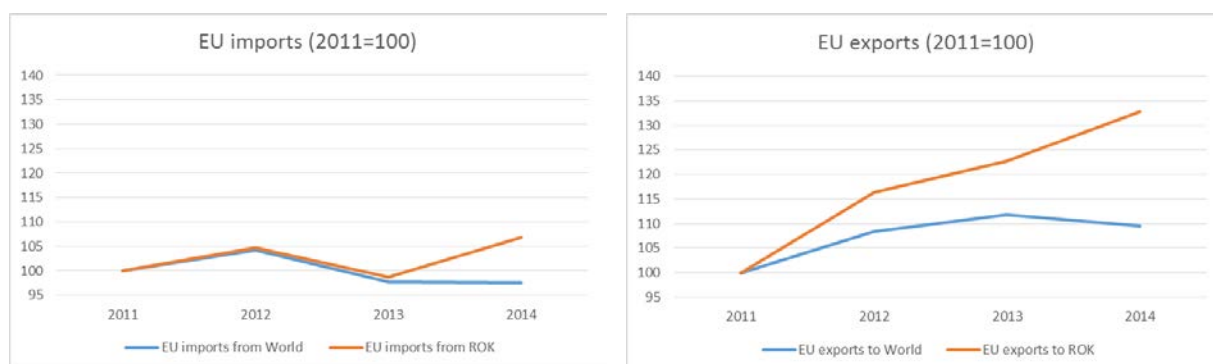
Korea. EU exports to South Korea grew less than forecast (55 % compared to 82 %) to more than EUR 43 billion in 2014, compared to the forecast range of EUR 33.02-41.08 billion. But EU imports from South Korea also grew more than expected, up to EUR 38.8 billion in 2014, compared to a forecast range of EUR 22.95-34.41 billion. Therefore, the most important factor explaining the positive, but lower than expected improvement for the EU, is a slower increase in EU exports to South Korea.

Compared to EU trade with the world, bilateral EU trade with South Korea performed quite well. EU imports from South Korea performed in line with EU imports from the rest of the world in the period 2011 to 2013, and started to increase faster from South Korea than from the rest of the world in 2014 (Figure 2). EU exports to South Korea increased consistently and much faster than EU exports to the world after 2011. Overall, EU trade performance with South Korea was much better than with the rest of the world suggesting that liberalisation due to the FTA expanded potential bilateral trade linkages.

Figure 2. EU merchandise trade since 2011

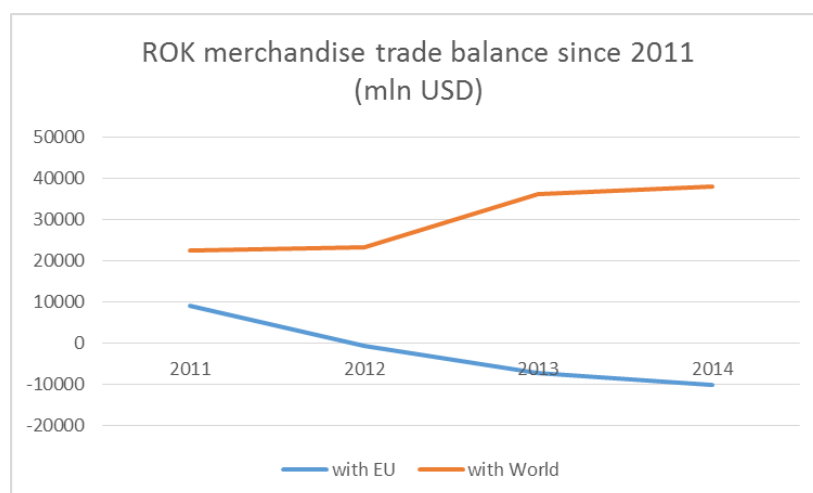
Source: Eurostat

In comparison, bilateral Korean trade performance with the EU was good but less positive than that with

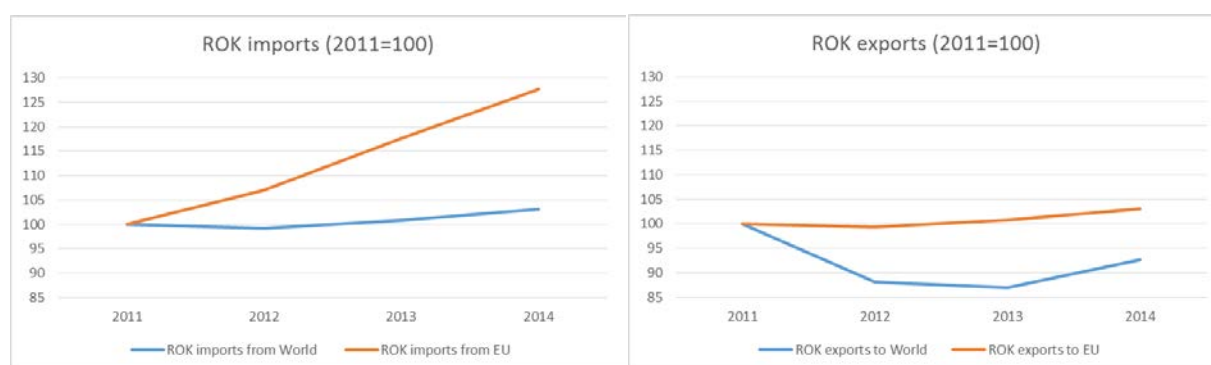


the rest of the world. In fact, South Korea’s net trade position vis-à-vis the EU went from a surplus of up to almost EUR 10 million in 2011 to a deficit of roughly the same amount in 2014, while Korea’s overall net trade surplus with the rest of the world almost doubled between 2011 and 2014 from more than EUR 20 to almost EUR 40 million (Figure 3).

This relatively worse performance for Korea with the EU does not necessarily mean the EU-ROK FTA has had a negative impact on South Korea. Despite the substantial worsening of the trade balance with the EU, Korean exports to the EU performed much better than overall ROK exports to the rest of the world, which declined by more than 7 % between 2011 and 2014 (Figure 4). It was the relatively closed nature of the Korean market compared to the EU that resulted in much a higher increase in Korean imports from the EU compared with Korean total imports from the rest of the world.

Figure 3. ROK merchandise trade balance since 2011 (mln USD)

Source: IMF

Figure 4. South Korea merchandise trade since 2011

Source: IMF

Overall, EU trade linkages with ROK have intensified since 2011. EU imports from ROK at that time were 2.1 % of all EU imports from extra EU countries and have slightly increased to 2.3 %. On the export side, ROK accounted for 2 % of EU exports to extra EU countries in 2010 and now accounts for 2.5 %. The EU has increased its weight on total ROK imports from the world, from 9 % in 2011 to more than 11 % in 2014, while EU weight on total ROK exports slightly declined from 10 % in 2011 to 9 % in 2014.

Trade intensity between the EU and South Korea increased also in services, which increased in both directions. In 2013 EU exports of services to Korea were equal to EUR 10.6 billion, having increased by 18 % compared to the previous year. At the same time, EU imports of services from Korea were EUR 5.6 billion, representing an 11 % increase compared to 2012.

Bilateral trade performance depends on a number of cyclical, micro and macroeconomic factors (including exchange rates and consumer preferences) unrelated to the FTA. These macroeconomic factors include slower GDP growth and more sluggish demand in the EU than the rather optimistic assumptions of the impact studies. There was also a Euro depreciation *vis-à-vis* the Korean Won over the past 5 years (15 % in nominal terms between July 2010 and October 2015). Moreover, some relevant sectoral developments have been at work both within the economies (such as the reduction in Korean exports in key sectors such as ships – due to global overcapacity and oversupply) and in the shape of the international reorganisation of production in some sectors. The latter includes the relocation of electronics from Korea to other Asian countries and of auto production to the EU, both of which resulted

in a diversion of trade. At the same time, non-tariff barriers (NTBs) in Korea are still widespread, especially in a number of industries and sectors (see below).

It is worth noting that some bilateral trade developments between the EU and Korea should not be considered as permanent effects of liberalisation between the two, and may be subject to change in the future. EU exports to Korea have invariably grown stronger than EU imports since 2010 (Table 2). EU imports from Korea increased by 6.8 % between 2011 and 2014, whereas EU exports to Korea more than doubled (+54 %). As a result, Korea increased in importance as a market for EU exports, but decreased as source of exports to the EU. Korea is currently the 8th largest trading partner for the EU, both on the export and import sides, accounting for 2.5 % of extra-EU exports and 2.3 % of extra-EU imports respectively. However, these trends are likely to depend on factors other than the FTA. EU imports from ROK have actually grown much stronger in 2014 (+8.3 %, which is also slightly stronger than EU exports to Korea, +8.2 %), which could signal an on-going shift in bilateral trade trends that should be monitored in the future

Table 2. EU trade with Korea, growth rates (%)

	2010	2011	2012	2013	2014
EU Imports from Korea	21.8	-8.22	4.7	-5.7	8.3
EU Exports to Korea	29.5	16.3	16.3	5.6	8.2

Source: European Commission

It is also worth noting that the overall bilateral trade developments between the EU and Korea are not reflected in the individual EU Member State positions. In order to provide a better assessment of the impact of the FTA, it is therefore necessary to look at the developments in trade between individual EU Member States and Korea. The increase in EU exports to Korea originates from a limited number of EU Member States. Just four EU Member States account for almost 77.5 % of the total increase in EU exports to Korea registered between 2011 and 2014. These are Germany with 29 %, the United Kingdom with 24.3 %, and Italy with 12.6 % and Spain with 11.5 %.

The development of German bilateral trade with South Korea since the entry into force of the FTA is particularly important in any detailed picture of the impact of the FTA. Germany registered the highest increase in exports to Korea among EU Member States. In the first half of 2015, despite modest GDP growth in Korea, German merchandise exports to Korea were up by more than 50 % on the level before the agreement came into force in July 2011. In contrast, total German exports to all markets increased by merely 13 % over the same period. Compared to Germany's other major trading partners, only exports to the US (+58 %) increased at a faster pace than those to Korea. This was partly a result of the Euro depreciation *vis-à-vis* the Korean Won over that period. However, the Euro also depreciated against the currencies of other important trading partners to a similar extent without a similar impact on exports to those countries. This suggests that the phasing out of trade barriers following the entry into force of the FTA played a major role in opening up German trade potential *vis-à-vis* Korea.

A detailed understanding the impact of the EU-ROK FTA on bilateral trade also requires exploring developments in trade in different sectors. As anticipated in the impact assessment (CEPII/ATLAS, 2010), the impact of trade liberalisation on individual EU Member States is likely depending on the sectoral composition of that trade and the comparative advantage of the sector concerned.

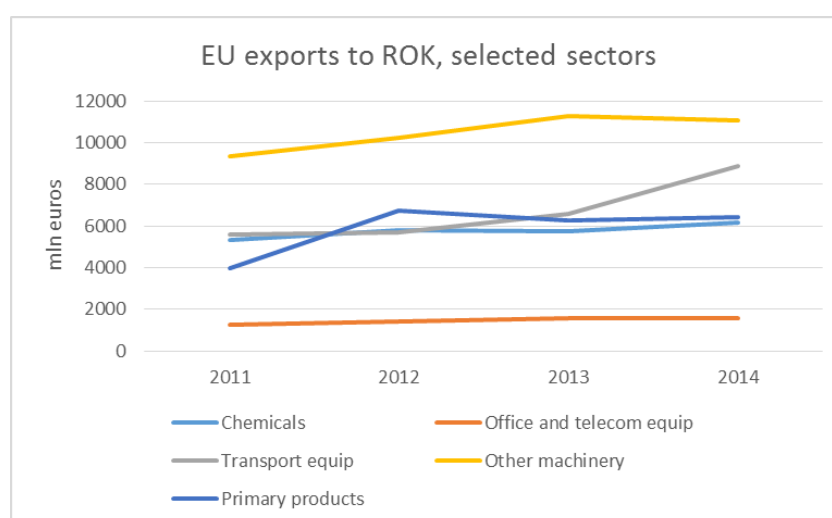
2 Sector-by-sector assessment

As anticipated by the impact assessment conducted by CEPII/ATLAS (2010), sectoral bilateral trade effects have been significant. The impact of the FTA has differed from sector to sector according to the initial comparative advantage of the EU in that sector vis-à-vis South Korea. Following the EU-Korea FTA, the EU's position was expected to improve in several industries where the EU has comparative advantage and protection was initially higher in South Korea. These sectors were pharmaceutical products, chemicals, machinery (specifically mechanical engineering), food and other agricultural products. In all these sectors the EU had 'offensive interests' in South Korea, in other words an opportunity to increase exports.

A comparison of actual trade balances in 2014 with forecasts from the impact assessment (CEPII/ATLAS, 2010) shows that in actual fact the most important increase in exports from the EU to South Korea has been in transport equipment (Figure 5), more specifically cars (+140%) and trucks (+64%), but the size of the increase is substantially lower than that forecast (+400%). There was also a significant increase in EU agricultural exports: food (+26%) in which the highest increases were in meat (+15%) and dairy products (+27%) and beverages (+24%).

As a result, agricultural and food products now account for a much larger share of total EU exports to Korea (up from 4.9% in 2008 to 15% in 2014). The EU was also expected to increase its industrial products exports to South Korea as a result of Korean reductions in non-tariff barriers (NTBs). In sectors affected by NTBs the actual outcome was an increase in consumer electronics exports of 34%, and machinery and electronic exports by 33%, which is lower than the most favourable scenario (+65%), probably due to the effects of both the EU and South Korea having concluded FTAs with other countries that have reduced the preference under the EU-Korea FTA.

Figure 5. EU exports to Korea, selected sectors



Source: Eurostat

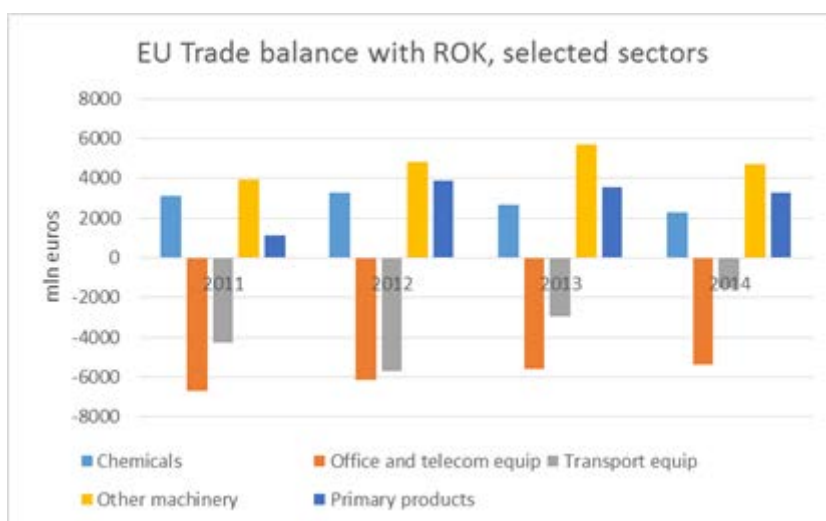
Similarly, Korea was expected to benefit relatively more in sectors such as textiles, leather/clothing, consumer electronics, motor vehicles and other transport equipment. As a matter of fact, the largest increase in EU imports from South Korea was in chemicals (+72%), contrary to the expectation that the EU competitive position vis-à-vis South Korea would result in increased exports. Compared to an average increase of EU imports from South Korea of 6.8%, EU imports of cars also increased (by +17%), industrial machinery (+17.5%), while imports of trucks declined by 34% and those of office equipment by 13%.

The actual outcome at a sectoral level is therefore quite different to that forecast based on expectations that sectors in which the EU has a comparative advantage would improve their trade balance with Korea

and the opposite would occur in sectors where the EU faces strong competition from Korea. According to the forecasts (CEPII/ATLAS, 2010), EU exports to Korea should have significantly exceed imports in chemicals, machinery and other manufactured products, leading to an improvement of the EU bilateral trade balance by about EUR 15 billion for these industries taken together. As a matter of fact, sectors such as machinery and chemicals, which had an initial EU trade surplus, behaved quite differently. The initial trade surplus in chemicals declined significantly (from EUR 3 billion in 2011 to EUR 2.2 billion in 2014), while trade balances in primary products and industrial machinery both improved (from EUR 1.1 billion in 2011 to EUR 3.3 billion in 2014, and from EUR 3.9 billion EUR in 2011 to EUR 4.7 billion EUR in 2014 respectively) (Figure 6).

In the food and drink sector, which has historically been a less important exporter to Korea than manufactures, there has been an increase as expected by the CEPII/ATLAS study, from EUR 1.3 billion in 2011 to EUR 1.7 billion in 2014 (the trade balances for meat and dairy products improved respectively from EUR 500 to 580 million, and from EUR 210 to EUR 266 million).

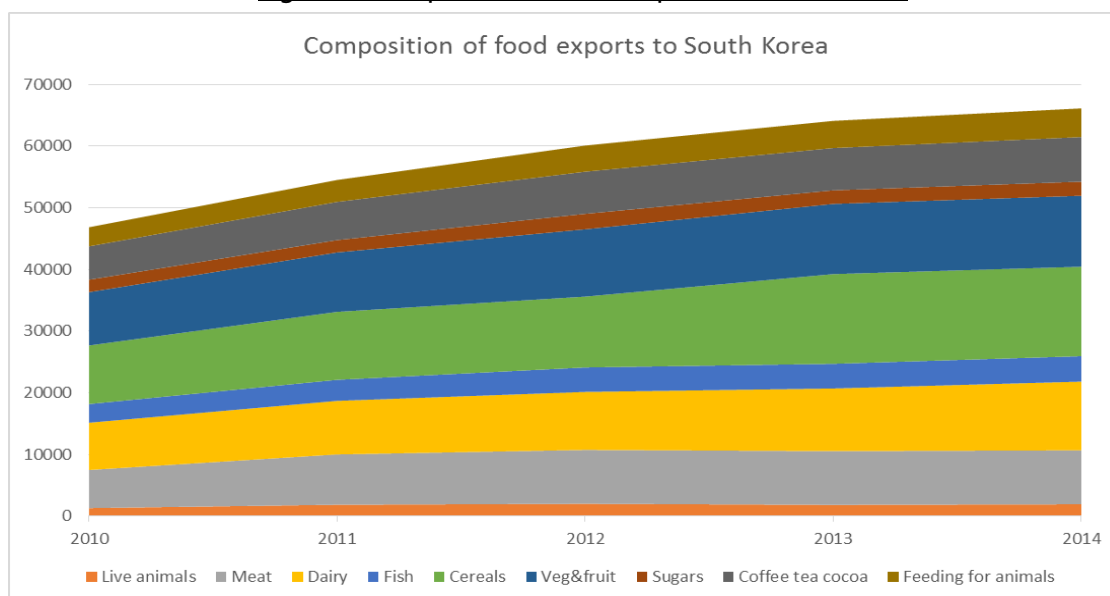
Figure 6. EU Trade balance with ROK, selected sectors



Source: Eurostat

These results also diverge quite sharply from some of the other forecasts, such as for example the IBM study (IBM, 2008), which suggested that there would be modest increases in EU exports of cereals, beef, pork, horticultural products, processed food and wines and spirits. Among food exports to Korea – which increased by 45 % from 2010 to 2014 – the largest increases were in fact registered by cereals products (+53 %); feeding for animals (+50 %), live animals (+47 %), followed by dairy products (+45 %) and meat (+42 %) (Figure 7). Cereals are now the EU largest exported food category to Korea (18 % of EU total food exports to Korea in 2014), followed by dairy (14.6 %), vegetables and fruit (14 %), and meat (11 %).

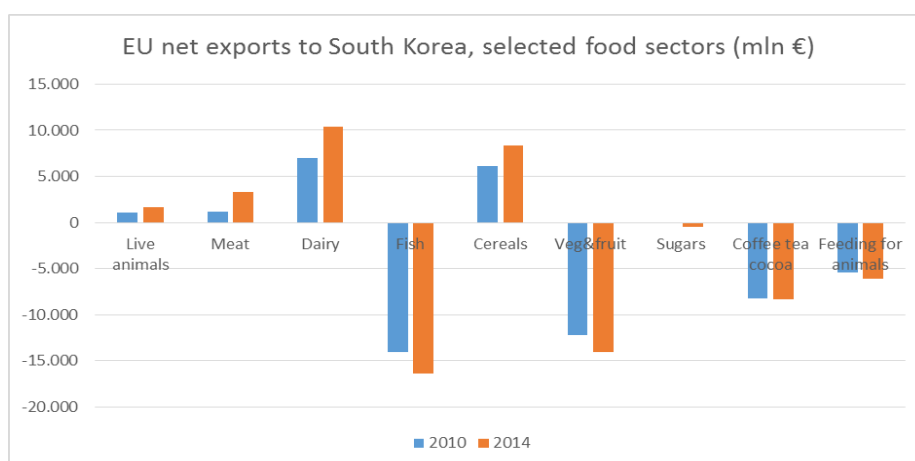
Figure 7. Composition of food exports to South Korea



Source: Eurostat

Within the food sector, the evolution of different segments has strongly differed; food categories where the EU already enjoyed a strong competitive position *vis-à-vis* South Korea (measured as positive net exports before the implementation of the FTA in 2010), such as live animals, meat, dairy products and cereals, improved their net exports, so that trade balances today are substantially higher than in 2010 (the largest improvement being registered in dairy products, in which the EU's trade balance improved by 48 %). The opposite occurred in sectors where the EU faced stronger competition from South Korea, such as fish, vegetables and fruit, coffee, tea and cocoa, and animal feeds (Figure 8).

Figure 8. EU net exports to South Korea, selected food sectors (mln €)



Source: Eurostat

In the textiles sector, which was expected to be one of those where Korea would register the largest trade gains, EU imports actually increased by more than 21 % (compared to a 9 % forecast from the CEPII/ATLAS study), but the EU's trade balance further deteriorated by 31 %, from EUR 371 million in 2011 to EUR 487 million in 2014 (Figure 9).

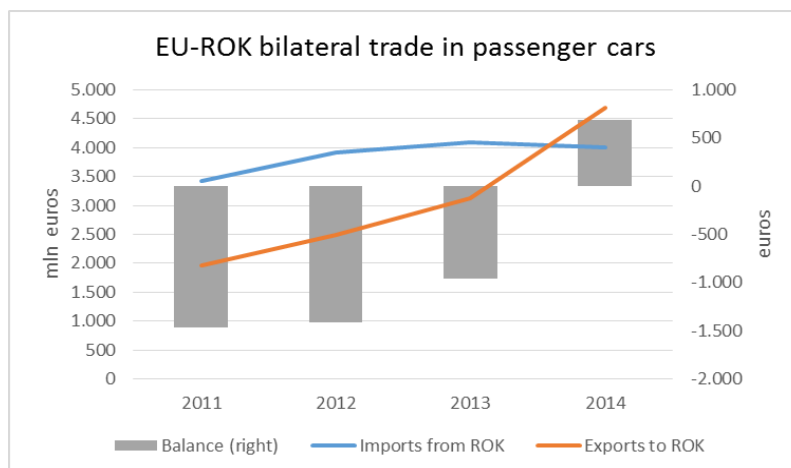
Figure 9. EU textiles trade with South Korea since 2011



Source: Eurostat

On the other hand, contrary to what was predicted by the CEPII/ATLAS study, not in all sectors in which the EU faces strong competition from South Korea has the EU trade deficit worsened. The bilateral EU net trade position with South Korea improved – although still negative – in transport equipment and office/telecoms equipment. The automotive sector deserves a special focus, as it was the single most defensive sector for the EU, for which all impact assessment studies agreed that the Korean motor vehicle industry would benefit more from the FTA than that of the EU. The forecasts of the car industry also expected a further deterioration in the EU bilateral deficit in cars with Korea of EUR 5 billion. In fact EU car imports from South Korea increased very little in value (+17 %), while the value of EU car exports to South Korea increased quite substantially (more than doubled), so that the EU trade balance in the sector improved from a deficit of around EUR 1.4 billion in 2011 to a surplus of more than EUR 680 million in 2014 (Figure 10). One of reasons why EU imports of passenger cars from Korea have not increased as much as expected is the relocation of part of Korean production to Europe. Korean production in automobile plants in the Czech Republic and Slovakia seem to have replaced EU imports from South Korea. As regards trade in volume (units), EU exports to South Korea increased by 166 % from 2010 to 2014, while EU imports from South Korea increased by only 16 %.

Figure 10. EU –ROK bilateral trade in passenger cars

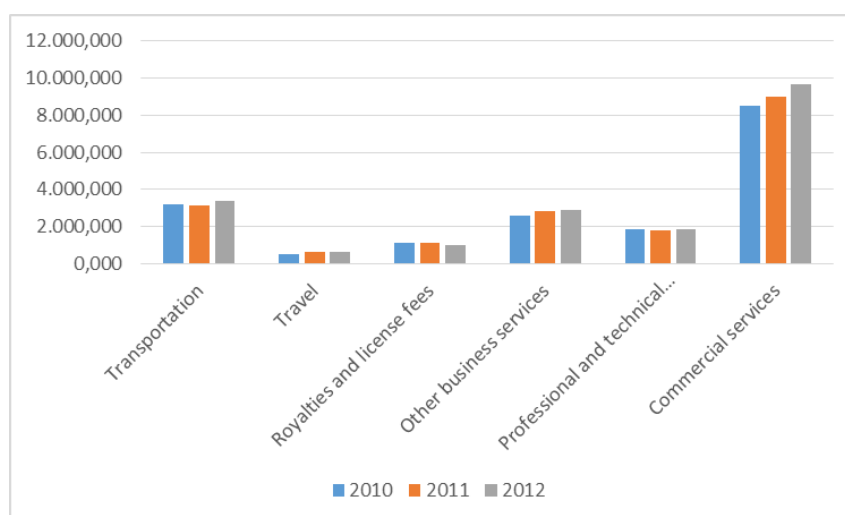


Source: Eurostat

As for services, it was estimated (Copenhagen, 2007) that some 70 % of EU gains would be attributable to the liberalisation of trade in services, and that EU exports would increase by 40-60 % especially in the areas of wholesale and retail trade, transport services, communications, financial services and other business services. In particular, forecasts predicted the largest trade gains for the EU would be in business services, with 22 % of the total gains. This forecast relative importance of service gains was explained by Korea's growing demand for service inputs to economic growth and the fact that the Korean service sector was highly protected by non-tariff barriers.

Although a complete assessment of the impact of the FTA on bilateral service trade is not possible due to limited data availability (service trade data are only available until 2012), the FTA seems to have initially provided the benefits forecast by the impact assessment. EU service trade exports increased by 12.5 %, from EUR 8.5 billion in 2010 to EUR 9.6 billion in 2012 (latest available data), while imports from Korea into the EU slightly declined, so that overall the EU net service trade position *vis-à-vis* South Korea improved from EUR 3.8 billion in 2010 to EUR 4.9 billion in 2012. As forecast, the largest trade gains seem to have occurred in business services, with an increase in the EU net trade position higher than expected at 30 % by 2012 (Figure 11).

Figure 11. EU service exports to South Korea, 2010-2012



Source: Eurostat

One of the major challenges faced by the EU when negotiating the EU-Korea FTA was the difficulty of assessing the potential costs and benefits for the EU. This difficulty is largely due to the fact that in Korea protection due to non-tariff barriers (NTBs) exceeded tariff protection to a large extent, and therefore required specific estimations of the *ad valorem* tariff equivalents (AVEs) of non-tariff protection. Moreover, the majority of manufactured industries showed higher NTB levels in Korea than in the EU, especially textiles, leather and clothing, metals, machinery and above all cars and trucks as well as other transport equipment. This was mainly due to Korean standards as well as long and costly certification processes. As the EU and South Korea have somehow similar manufacturing production structures (especially in some sectors such as electric, IT and transport equipment), the impact of further bilateral trade liberalisation could result in a severe trade disruption, both in Korea.

A further challenge during the negotiating process was the concern raised by some EU Member States (MS) about the potentially unequal geographic distribution of the costs and benefits of the FTA across different MS. This is because of the geographic distribution of industrial production in the EU, which is fairly concentrated on a limited number of MS, especially for some of the key advanced manufacturing

sectors. The actual outcome does in fact tend to confirm this fear, after four years of implementation; the EU-Korea FTA has produced benefits in terms of exports that are fairly concentrated on a few EU Member States. As one might expect, it is most notably Germany that has benefited, because it is the largest manufacturing producer in the EU by far, but also the United Kingdom, France and Italy, in which some of the more serious concerns about potential trade diversion were expressed during the negotiations (Table 2). However, the vast majority of EU MS registered very high export growth to South Korea between 2010 and 2014, much higher for the smallest than for the largest MS, although starting from a much lower base (Table 3).

Table 2. Exports to Korea from individual EU Member States, 2014
(percentage on EU exports to ROK)

Germany	34.1
United Kingdom	11.9
France	10.9
Italy	10.0
Netherlands	7.3
Spain	4.6
Belgium	2.9
Sweden	2.9
Rest of EU	15.4

Source: Eurostat

Table 3. Individual EU Member States' export growth rates to ROK, 2010-2014

Estonia	598.8	Bulgaria	62.4
Greece	403.8	France	59.1
Latvia	292.9	Belgium	58.9
Spain	202.7	Germany	48.8
Poland	182.5	Ireland	45.6
Romania	167.3	Finland	35.1
Malta	161.6	Austria	32.4
Lithuania	155.6	Slovenia	30.1
United Kingdom	127.9	Hungary	28.5
Portugal	127.0	Sweden	27.2
Slovakia	124.9	Netherlands	9.3
Denmark	73.1	Cyprus	2.0
Czech Rep.	69.7	Luxembourg	-4.5
Italy	68.1	Croatia	-20.8

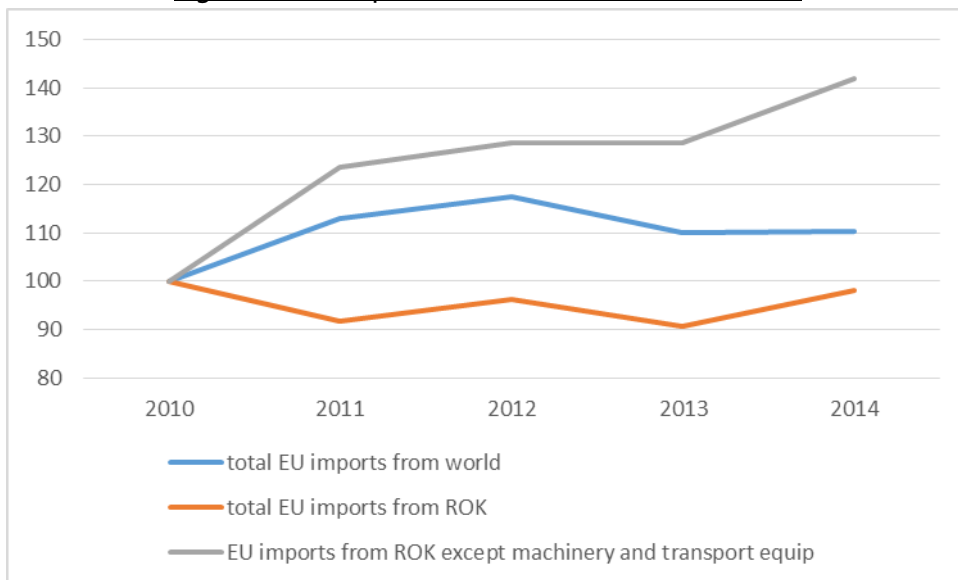
Source: Eurostat

A focus on specific industrial sectors shows that free trade agreements do not automatically insulate bilateral trade relations from broader cyclical or structural developments. Nearly all of EU's large industrial sectors were able to boost their exports to Korea after the FTA has been in force. Of the major export sectors, the automotive industry recorded the greatest growth. Traditionally, European carmakers (and parts suppliers) had always had difficulty penetrating the Korean market, mainly due to non-tariff trade barriers. After the FTA was implemented, almost all the largest EU MS recorded an increase in exports of transport equipment to Korea: compared to an EU average of +130 % after 2010, export of transport equipment from Spain increased by no less than 545 %, from the United Kingdom by 149 %, from Germany by 142 % and from Italy by 102 %. In 2015, the German automotive industry (the largest in the EU) generated roughly 34 % of total German exports to Korea. More specifically, in the first half of 2015 the major EU suppliers exports to Korea exceeded those of the first half of 2011 by 159 % in value. For German car brands, the market share in new registrations of passenger cars in Korea climbed steadily and reached almost 12 % in the first seven months of 2015 compared to just 4.1 % in 2010.

Other sectors with a heavy export bias such as electrical engineering, chemicals, pharmaceuticals and metals have also been able to boost their exports to Korea under the FTA. Only mechanical engineering reported lower exports in nominal terms in the first half of 2015 compared to the first half of 2011. One reason for this decline could have been competition from China, as exports of capital goods from China to South Korea increased during the period under consideration. General investment activity in Korea was also moderate from 2011 to 2014, which is generally a drag on demand for machinery and equipment.

On the import side, it is worth noting that overall EU imports from extra-EU countries increased by over 10 %, while EU imports from Korea were down by around 2 % over the corresponding period from 2010. This was due to strong sectoral effects in the machinery and transport equipment sector, which caused EU imports from Korea in these two sectors to decline by around 18 %. These figures were mainly due to some particular developments in sub-sectors, such as the 'other transport equipment sector' that is in this case of Korea exports to the EU mainly ships. EU imports of ships from Korea virtually collapsed due, on the supply side, to the persistently high excess capacities in the global maritime shipping sector and, on the demand side, to a decline in orders from the EU. As Korea is one of the three biggest shipbuilding nations in the world, exports to the EU fell accordingly. Moreover, EU imports of IT equipment, electrical goods and optical products (mainly consumer electronics) from Korea declined. The probable driving force behind this was that Korean firms in the sector shifted production to China or Southeast Asia (e.g. ASEAN countries) where wage costs are lower than in Korea. As a result, EU imports of these products shifted from Korea to important ASEAN countries and China as well as Eastern Europe in some cases. These imports then displaced imports from Korea. With these export categories taken out of the equation, EU imports from South Korea in nominal terms increased by 42 % (Figure 12).

Figure 12. EU imports from South Korea (2010=100)



Source: Eurostat

One further point on the structure of trade is worth noting. It has been suggested above that the better export performance of the EU compared to Korea may be partly due the initial higher protection of the Korean market together with the higher product concentration of Korean exports. There is in fact some evidence of higher concentration of EU imports from Korea (machinery and appliances account for 36 % of the total followed by transport equipment with 26 %).

Table 4. Sector concentration of EU imports from and exports to ROK, 2011-2014

Sector concentration, EU imports from ROK		% increase 2011-2014	% of EU imports from ROK 2014
85	Electrical machinery and equipment, and parts thereof	-11.6	22.52
87	Vehicles other than railway or tramway	6.2	15.91
84	Nuclear reactors, boilers, machinery and mechanical appliances	1.5	13.01
89	Ships, boats and floating structures	-8.6	9.14
90	Optical, photographic, cinematographic, medical instruments	0.4	6.28
39	Plastics and articles thereof	3.2	6.13
27	Mineral fuels, mineral oils	2.2	5.09
72	Iron and Steel	0.8	3.77
29	Organic Chemicals	1.4	2.57
40	Rubber and articles thereof	0.5	2.55
Sector concentration, EU exports to ROK		% increase 2011-2014	% of EU exports to ROK 2014
84	Nuclear reactors, boilers, machinery and mechanical appliances	-5.4	23.23
87	Vehicles other than railway or tramway	4.6	14.01
85	Electrical machinery and equipment, and parts thereof	-1.6	8.31
27	Mineral fuels, mineral oils	5.7	6.47
90	Optical, photographic, cinematographic, medical instruments	-0.5	5.80
88	Aircraft. Spacecraft, and parts thereof	2.1	3.81
30	Pharmaceutical products	-0.8	3.64
29	Organic Chemicals	-0.6	3.28
39	Plastics and articles thereof	-0.2	2.51
73	Articles of iron and steel	0.3	2.19

Source: Eurostat

There is also a high concentration of EU imports from ROK in a few sectors, with the top 10 sectors (HS2) accounting for 87 % of total and top 5 sectors for 67 %, but sector concentration has been decreasing. EU exports are also fairly concentrated (although less than imports), but concentration has been increasing from 55 to 58 (top 5) and from 70 to 74 (top 10) (Table 4).

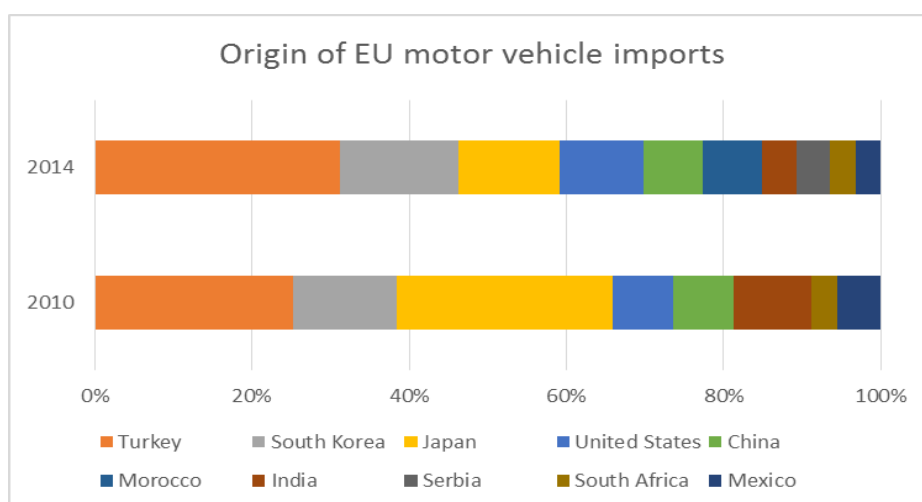
3 Trade performance of European and Korean auto firms

South Korea is the world’s fifth-largest manufacturer of vehicles (90 % of which are passenger cars). The country produced 4.1 m passenger cars and 400,816 commercial vehicles in 2014, after three years of decline largely due to production stoppages over wage disputes. Hyundai-Kia, Korea’s leading car-maker producing 8 m units in 2014 (a 8.6 % year-on-year increase), is heavily export oriented, with 68 % of domestic production for export in 2014. The group currently operates 34 plants worldwide, and only about 50 % of total Hyundai production takes place in South Korea (16 plants), around 30 % in China (8 plants), almost 10 % in the United States (2 plants) and the rest in Europe (4 plants). The companies plan to add six more overseas plants between 2016 and 2018 to locate more than 60 % of their global production outside Korea (EIU). The most important export markets for Korean cars are the United States, the EU and China. The current low oil prices are damaging the competitiveness of Korean automakers in China and the US because of their comparative advantage in smaller, fuel-efficient cars and relative weakness in SUVs, large-size passenger cars and pick-up trucks. Korea has developed a strong components industry to supply both local and foreign demand, which the latter increasing. The largest automotive parts manufacturers are Hyundai Mobis and Hyundai Wia, selling most of their output to Hyundai Motors and Kia Motors.

According to the European Automobile Manufacturers Association (ACEA), today, about 2.5 million vehicles are imported into the EU annually, worth EUR 29.1 billion. Korea is the second largest importer of cars into the EU in terms of units (348,263 in 2014), representing a 14 % share, up from 12 % in 2010 (299,739 units) (Figure 13). EU imports from South Korea increased by 16 % from 2010 to 2014. In comparison, EU imports from Turkey the largest exporter to the EU increased by 22.5 % over the same period, and Turkey now has a 29 % share of the EU imports (700,152 units in 2014), up from 23 % (571,291 units) in 2010.

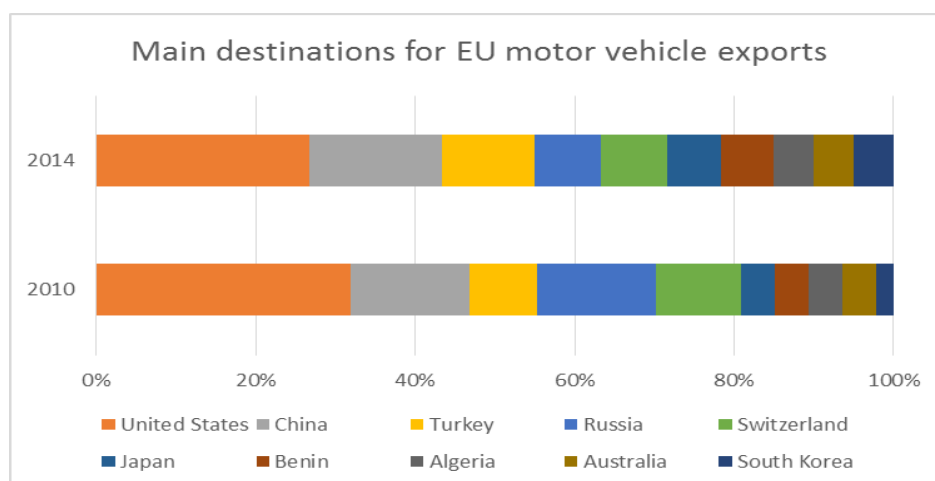
On the export side, the EU exported 6 million motor vehicles in 2014, worth EUR 124 billion, which is 27 % up on the 2010 figure (62 % up compared to 2009). The largest increase was indeed to Korea (+166 %) (Figure 14).

Figure 13. Origin of EU motor vehicle imports



Source: ACEA from Eurostat

Figure 14. Main destinations for EU motor vehicle exports



Source: ACEA from Eurostat

Despite a shrinking EU market for passenger cars, Korean automobile imports into the EU are increasing year-on-year. According to ACEA, in the first year of implementation of the EU-Korean FTA, South Korea exported just under 381,000 domestically manufactured passenger cars to the EU, up 41 % from the same period one year earlier. Over the same period Korea imported over 80,000 European passenger cars, which represents an increase of 7 %. EU exports to Korea are still limited to less than 8 % of the total market, and consist almost exclusively of premium cars. ACEA considers the increase to be due to changing Korean consumer demand, rather than the effects of the FTA itself. As a result it expects, the Korean car market to remain a difficult one to access.

According to the Economist, Hyundai, the largest carmaker in Korea, has much to gain from a strong export position. Nearly 40 % of Hyundai vehicles sold worldwide are manufactured in Korea, making it vulnerable to changing trade and exchange rate trends. The carmaker's export growth in April was particularly pronounced, at 17.7 % year on year, although it has seen its market share slip in both the US and EU in recent years. In the US, its market share declined from 5.1 % in 2011 to 4.4 % this year, while in Europe it has fallen from 3.6 % in the first quarter of 2013 to 3.3 % in the corresponding period of this year.

Maintaining strong export growth is key to reviving Hyundai's earnings prospects. In April, the carmaker announced that its net profit had slipped in the January-March 2014 period to its lowest point for five quarters. Robust US export growth should also help to offset a decline, but the company has also faced uncertainty due to industrial action by its often-restless unions that in June 2015 demanded an 8.2 % rise in monthly pay, along with performance pay totalling 30 % of Hyundai's 2013 net profit.

The carmaker is also under increasing pressure in its home market, where FTAs have added to competition. According to the Korea Automobile Importers and Distributors Association (KAIDA), US carmakers reported a 43 % rise in sales in the Korean market between 2011 and 2013, while German and Japanese carmakers have seen a fivefold increase during the same period. German marques had the biggest share of Korea's imported car market last year, at 67.5 %, followed by Japanese producers, with 14 %. US carmakers saw their share of South Korea's imported car market fall from 7.9 % in 2011 to 7.5 % in 2013.

4 Comparison of sector specific provisions

According to OICA (the International Organisation of Motor Vehicle Manufacturers), the automobile industry had asked the Commission as early as 2013 to bring to the attention of the Korean authorities that various market access difficulties remained in South Korea. The application of the Automotive Annex is subject to different interpretations and the Korean authorities remain reluctant to dismantle existing

According to OICA, the European automobile industry is currently encouraged by the increase in EU exports of motor vehicles to Korea. Several factors have contributed to this increase, such as European vehicles' reputation for environmental and safety performance (at least until September 2015), as well as a general increase in demand for European brands. These trends reflect shifts in consumer tastes that predate the implementation of the FTA. However, the EU-Korea trade balance – in terms of volume – remains strongly favourable to the Korea partner, which experienced a 172,000-unit trade surplus in 2014. ACEA shares the European Commission's view that, 'in the automotive sector tackling the remaining non-tariff barriers remains a challenge'.

ACEA welcomes the Commission's raising of these issues with their Korean partners. However, ACEA is concerned by the persistence of market access problems nearly three years after the implementation of the FTA, despite them having been raised repeatedly with the Korean authorities. Speaking after the publication of the report, ACEA Secretary General Erik Jonnaert said, 'ACEA appreciates the agreement reached, last October, between Commissioner De Gucht and Korea's Minister for Trade, Industry and Energy, Mr Yoon Sang-Jick, to proceed with the technical amendment of the non-tariff annex on motor vehicles and parts. This provides a good precedent and starting point, which ought to be followed by amendments on the substance of this annex'.

The EU report on implementation states that 'discussions to amend the FTA will continue in the fourth year of implementation, with a view to finding a balanced package of amendments with economic benefits'. ACEA welcomes this commitment and trusts that the Korean authorities will engage constructively with the European Commission in this process. 'ACEA is still hopeful that mutually-beneficial solutions can be found in the long run. We remain ready to continue dialogue with the European Commission in order to achieve the most effective application of the agreement and the facilitation of automotive trade'. 'ACEA hopes that the Commission will take into account the lessons learned in the implementation of this FTA in ongoing and future trade negotiations', added Mr Jonnaert.

4.1 Analysis of the EU-ROK FTA from an institutional angle

Implementation of the agreement

This section begins with a brief review of the implementation of the EU-ROK FTA before discussing the functioning of the bilateral bodies established by it and finally turning to a discussion of the distortive effects of new trade barriers.

Full implementation of the EU-ROK FTA will culminate in the elimination of import tariffs on all products, except for a limited number of agricultural products, by 1 July 2016. Generally the EU-Korea FTA has brought benefits to both parties, but the EU has benefited more than Korea. The EU's trade balance with South Korea went from a deficit of 20 % (EUR -7.4 billion) prior to the provisional application of the FTA to a surplus of 6 % (EUR 2.3 billion) at the end of year two. This was the first time in 15 years that the EU had recorded a trade surplus with Korea (EC 2014, p. 4; Kang and Kim, 2013, p. 1). By the end of year three this surplus amounted to EUR 3.6 billion. From 2011 to the end of year three, EU exports to Korea had increased by 35 % (up from EUR 30.6 billion in the 12-month period before the FTA took effect to EUR 41.4 billion).

The EU's exports grew most in products that were fully or partially liberalised by the FTA (by 46 and 37 % respectively). EU imports of fully or partially liberalised tariff lines grew by 21 % and 26 % respectively. At the same time, the EU's imports of Korean products that were already subject to zero MFN tariffs fell by 23 %. Full implementation in 2016 can be expected to bring additional benefits to the EU.

Despite the economic crisis in the EU, Korean exports appeared to have benefited from the FTA. Imports into the EU from Korea initially rose and then fell by December 2014, indicating a net zero effect of the FTA on Korea's exports to the EU. EU imports from the rest of the world were flat in year three, with only imports from Korea (and Turkey) showing a gain of ca 6 % (EC, 2015, p. 3).

Before implementation, European motor vehicle manufacturers were among the least positive about the FTA²⁴. Their concerns do not appear to have been founded given the success of EU motor vehicle manufacturers in Korean markets in value terms. In terms of volume, Korea sells more vehicles in the EU. Due to their low unit cost however, at this point the ROK exports do not challenge the EU in the value of exports earned (ACEA, 2015). In short, both the EU and Korean motor vehicle manufacturers have benefited during the first four years of the FTA.

Functioning of bilateral bodies set up by the treaty

The bilateral bodies set up by the FTA have as their purpose to smooth adjustments or make improvements to the FTA as the need arises. The ministerial-level EU-Korea FTA Trade Committee meets annually to review the overall functioning of the agreement (see Section 5.1). The fifteen implementation bodies, namely seven Specialised Committees, seven Working Groups and an Intellectual Property (IP) Dialogue, have to date had several opportunities to meet (since 2011) in Seoul or Brussels (EC 2015). The various committees and working groups appear to be progressing with their work and both sides remained fully committed to full implementation of the FTA. This is despite the fact that most of these bodies have not had an opportunity to meet more often.

When the Trade Committee met on 16 October 2014, they assessed the FTA as having a positive effect on both fully and partially liberalised trade as the increase in exports on both sides indicated. Furthermore, both sides agreed to proceed with '[...] the technical amendment of the non-tariff annex on motor vehicles and parts by updating obsolete legal references in the equivalency tables to give certainty to economic operators' (EC, 2015, p. 9).

The implementation issues remaining include trade in services, the interpretation of surimi's 'primary ingredient', and the implementation of Article 13.4 of the FTA with regard to multilateral labour standards and agreements. Issues affecting bilateral trade included: equivalency of organic agricultural products, the moulding of E-marks for tyres, market access concerns for cosmetics exports from the EU, Korea's ban on imported pork from Poland and its exports of live olive founder to the EU (EC, 2015, p. 9). Below is a short overview of each implementation body's recent activities (EC, 2015). As already noted, the bodies have not met but a few times each. Thus they have not had much of an opportunity to do very much. Once the bilateral bodies have had a chance to meet a few more times, there will be more evidence from which a deep assessment of their function can be made.

Potential factors affecting bilateral trade and investment

At present, there is little danger of new trade barriers being introduced in EU-Korean trade, but movements in Asia especially with regards to China are likely to affect South Korea. As a small trading nation in Asia (and the world) Korea is highly sensitive to its partners' woes; the economic slow down of China has had a direct impact on Korea. This is a key issue when considering the AIIB (The Asian

²⁴ This is not dissimilar to their position on the EU-Japan agreement under negotiation.

Infrastructure Investment Bank) and Korea's position. China's 'Silk Road Economic Belt' connecting the EU with China via Central Asia and the Middle-East is likely to benefit both Korea and Japan. There is considerable potential for development along the new old Silk Road, which will bring benefits to the EU and Korea alongside of the FTA.

China is Korea's main trading partner and an attractive investment destination for major Korean firms. For example, some Korean production of mobile phones has moved to China and Southeast Asia. Thus EU imports of these Korean branded goods would not appear as bilateral trade and the FTA will have a negligible effect. From China's perspective, Korea is not nearly as important as other economic and trade relationships. As China is a great importance to Korea the trading relationship is highly asymmetric and Korea can be expected continue to prioritise its relationship with China over other countries in the coming years. China will no doubt be a priority over the EU, which while important, is not as critical to the Korean economy. The relative advantage of being early in concluding an FTA with, among others, the EU is likely to obsolesce as Korean companies with strong EU presence continue to move offshore.

Korea has a tough balancing act between the desire to retain close links with the USA while maintaining close trading links with China. It should be noted that KORUS is a rather small or insignificant agreement from a US economic perspective, but not from a security perspective. Instead of focusing on the KORUS agreement, the US is pushing for Korea to join the TPP. The TPP will replace NAFTA and if Korea also joins, it will replace KORUS. From a management perspective and with the current US political climate stressing small government and minimal regulation, the TPP is preferable and it has both the width and depth that the US is seeking in its trade and investment relations with Asia. From a strategic perspective, TPP of course also has implications for the US 'pivot to Asia' strategy.

Nonetheless, the EU is a major partner for Korea, and Korea is likely to continue to manage the relationship with the EU and all other relationships delicately, not unlike successful, small, heavily trade-oriented European countries, such as those in Scandinavia. It is therefore unlikely that Korea will downgrade the importance it attaches to the FTA with the EU in order to prioritise its relationship with China. Nor would Korea's entry into other agreements (e.g. RCEP, TPP and China-Japan-ROK FTA) be likely to affect previously negotiated and agreed FTAs including the EU-Korea FTA. From an EU perspective the rapid economic and structural change predicted in the in the economies of (East) Asia can be expected to affect the EU's position in that region including *vis-à-vis* Korea. This may also result in a relative shift in the focus of EU attention in the next decade.

In evaluating Korea's FTAs with the EU and the KORUS agreement with the US, Kim (2015) stressed the point that because Korea is heavily dependent on international trade, the impact of its FTAs is not simply bilateral, but includes potential trade diversion effects such as in crude oil imports (Kang and Kim, 2013). According to Kang and Kim (2013), this is because intermediate goods imports from FTA partners are likely to increase in order to facilitate compliance with rule of origin provisions required for preferential access. Thus, in Korea's case it is important to consider FTAs in light of changes in total net exports induced by bilateral trade.

From a Korean perspective the FTA may not hold many benefits for the Korean economy in relation to global competitiveness issues and structural change in the future, and Korea is keen to exploit these. A report by the Korea Institute of International Economic Policy (KIEP) addressed this concern stating that Korean exporters need to increase their utilisation rate of tariff preferences in the FTA to continue to reap benefits (Garikipati, 2015). Improvements are needed in Korea's business environment, productivity and the industrial structure for Korea to remain competitive.

Kang and Kim (2013, p. 7) noted:

With more countries committing themselves to comprehensive FTAs with the EU and the U.S. and Korea relocating more of their production bases abroad, it is more likely that exports from domestic production will be replaced by overseas production. As a result, Korea's relative advantage as an early comer in the FTA is likely to be obsolete. In this context, it is necessary to increase the utilisation rate of the FTAs in the short run and to use the FTA as occasions to strengthen industrial competitiveness in the long run.

In 2013, South Korea's total growth rate was 3 % of which 1.19 % was attributable to the country's seven FTAs (Kim 2015, p. 4). The implication here is clear: the FTAs have supported Korea's economic growth. The upshot is that while the EU-Korea FTA is likely to offer opportunities into the near future, as the global competitive situation evolves each side will have to take advantage of the opportunities available to them whether in Asia or elsewhere.

4.2 Overview of the key issues under discussion in the implementation bodies

The Customs Committee met on 18-19 June 2014 it they discussed many issues including the procedures and methods of origin verification and rules of origin, the 'primary ingredient' of processed surimi, and the transposition of Product Specific Rules on origin (from HS code 2007 to 2012). The Committee discussed the possibility of concluding a Mutual Recognition Agreement of Authorised Economic Operators.

The Committee on Trade in Goods met on 16 September 2014 when it endorsed its decision on the adoption of the Tariff Rate Quota administration rules. Many other issues were discussed including: the equivalency of organic agricultural products, the Appendix 2-B-3 (electronics) review, and the Korean safety certification requirements for machinery and cosmetics. The EU reiterated its request to include a clause (amending the FTA) on goods re-entering after repair and to include in Annex 2-C truck-tractors in the scope of the non-tariff annex on motor vehicles and cars.

The Committee on Outward Processing Zones (OPZ) on the Korean Peninsula met on 17 September 2014 when it discussed establishment criteria for OPZs. The Korean side updated on the inter-Korean factory park, Gaesong Industrial Complex, located in North Korea. While both sides noted the political sensitivity of these issues, they agreed to continue their discussions at the working level.

The Committee on Sanitary and Phytosanitary Measures met on 10 October 2014. A large number of issues were discussed including, Korea's exports of chicken-ginseng soup and live olive founder to the EU, cooperation on animal welfare issues, EU exports of beef, pork, raw milk, dairy products, fruits and vegetables to Korea.

The Committee on Cultural Cooperation met on 10 October 2014 when it approved the arbitration panel (Article 3bis of the Protocol on Cultural Cooperation, for which the Trade Committee has no jurisdiction). The Committee agreed to take specific actions to keep film professionals informed of their decisions.

The Committee on Trade and Sustainable Development met on 8 December 2014 to discuss a range of topics from labour policies to climate change. Both sides exchanged views on some key aspects of Multilateral Environmental Agreements, discussed guidelines regarding Corporate Social Responsibility and took up the topic of the ILO Fundamental Conventions regarding collective bargaining, freedom of association and forced labour.

The Committee on Trade in Services, Establishment and Electronic-Commerce met on 16 December 2014. Both sides agreed to engage so that they could deliver the principles of a regulatory framework on postal services to the next Trade Committee. The remaining issues to be considered are courier services,

financial services, distribution services, the investment legal framework (Article 7.16 of the FTA), and the general business climate in services.

The Working Group on Motor Vehicles and Parts met on 17 June 2014 when it discussed market access issues including emission fleet average systems, tyre marking, Korea's new regulations on energy efficiency of tyres, auxiliary braking systems for large-sized buses and Korean legislative proposals for fuel economy. They agreed that the Trade Committee should agree on the update of Annex 2-C regarding towing hooks and devices to secure driver's visibility.

The Working Group on Pharmaceuticals and Medical Devices met on 18 June 2014 to discuss Korea's pricing system of pharmaceuticals, what would be appropriate recognition of innovative drugs' value, Active Pharmaceutical Ingredients, Korea's implementation of serialisation for drugs, the revised Korean price volume agreement, the EU's draft amendment to the Medical Device Legislation, among others. Afterwards, an expert group worked toward identifying opportunities for regulatory harmonisation.

The Working Group on Chemicals met on 18 June 2014 to discuss each side's REACH. They agreed that there would be further technical cooperation between Korea's Ministry of the Environment and the EU's Chemical Agency.

The Working Group on Government Procurement met on 26 September 2014 to exchange information on domestic government procurement and the implementation of the FTA's government procurement chapter.

The Working Group on Geographical Indications (GIs) met on 6 November 2014 when it made significant progress on draft rules of procedure and submitted new GIs, which are to be discussed with the aim of adding them to the list of protected GIs as provided in the FTA.

The Working Group on Trade Remedy Cooperation met on 9 December 2014 to discuss the overall status of trade remedy measures in force in relation to EU-ROK bilateral trade. The parties also exchanged information on dumping and injury investigations, the latest developments regarding third country cases, and discussed the overall policy direction in light of current events at that time.

The Working Group on Mutual Recognition Agreements (MRA) for Services met on 16 December 2014. Both sides agreed to continue their useful exchange of information on MRAs and agreed that professional associations (e.g. engineers and architects) should be encouraged to continue to work together.

The IP Dialogue was held on 25 September 2014 where both sides provided updates on IP legislative and policy developments. The EU noted the need to align Korean legislation with the FTA provisions on public performance rights. They also covered IP enforcement issues including their approaches and strategies toward third countries.

5 A comparative analysis of the EU-Korea FTA and the KORUS FTA from both a trade and institutional angle

There are a few points of note in terms of the comparison between the EU-Korea FTA that entered into force on 1 July 2011 and the KORUS FTA that entered into force on 15 March 2012. First, the KORUS agreement was nearly completed when negotiations were then halted. This allowed the EU to proceed quickly and secure the EU-Korea FTA agreement before KORUS was ratified. Second, the US is Korea's number two trading partner and the EU is number three (European Commission Directorate-General for Trade, 2015). For the US, Korea is its sixth most important trading partner while for the EU Korea is its eighth most important (Workman, 2015). Of Korea's total outward FDI, 21 % and 25 % go to the US and

the EU respectively (Kim 2015, p. 2). Thus while the FTAs have increased the importance of each party to one another they are relatively more important for Korea's economic growth than for either the EU or the US in terms of the direct economic impact. Finally, and perhaps most importantly, as Korea has recently opted to join the Trans-Pacific Partnership Agreement (TPP), the TPP will replace the KORUS agreement if the former is ratified. In that case, the TPP will assume more significance for Korea than the than the FTA with the EU.

According to the Korea Economic Institute (Song 2011, p. 2) in their 2011 assessment of the two agreements, '[...] the United States has achieved a more favourable result in animal and vegetable products and in the transportation sector, while the EU has more favourable results in processed food, fisheries, chemicals and allied industries, and in the machinery and electrical sectors'. This would suggest that despite the fact that the EU-Korea FTA negotiation teams used the progress made in the KORUS negotiations as a foundation for their agreement, their objectives were not completely aligned and the agreements are not merely copies of one another.

The main points motivating the conclusion of the EU – Korea FTA in comparison to the KORUS FTA are the following:

- The EU was South Korea's 2nd largest trading partner.
- EU's exports to South Korea had an average annual growth rate of 7.5 % from 2004 to 2008; the US exported ca. USD 10 billion per year to Korea.
- In 2009, total EU trade with Korea was US\$ 78.8 billion; compared to that with the US of US\$ 66.7 billion.
- In 2009, EU's import tariffs averaged 5.6 %; those of the US avg. 3.5 %
- Korean exports of midsize cars, flat display colour TVs, textiles and shoes were expected to increase.
- Growth and employment from Korean exports expected to be ca. 46 % of GDP.
- New trade in goods and services would amount to US\$ 24.8 billion for the EU and US\$ 16.7 billion for Korea.

The following section proceeds chronologically covering the origins and evolution of first the KORUS and then EU-Korea FTAs from both trade and institutional angles. Korea took the initiative in negotiating FTAs with the US and the EU as part of its trade strategy dating from the early 2000s to be the economic hub in Northeast Asia (Kim, 2015). As the WTO DDA negotiations stagnated, Korea, with its high dependence on trade, shifted from multilateralism to bilateralism. Its bold approach to free trade agreements aimed to strengthen South Korea's geostrategic relationship and bring benefits to the country in terms of economic development and opportunities for its companies. On the US side, the motivation came from promoting US agricultural and service sector exports and to facilitate direct investment into South Korea. It was linked to US trade promotion authority²⁵, granted under President G W Bush, in order to maintain the US's competitive advantage (Lee, 2010). However, it was President Obama who eventually pushed the KORUS agreement through to ratification.

In the first three years of the KORUS agreement, both the US and Korea have experienced positive results (Kim *et al* 2015). Korea's exports to the US rose by 32 % in the first three years while Korea's imports from the US rose by 11 %. In terms of trade increase under the KORUS, it was 82 % for exports and 8 % for

²⁵ Trade Promotion Authority, also called fast-track trade authority, was granted by the US Congress to the President under the Bipartisan Trade Promotion Act of 2002 (P.L. 107-210).

imports. Kim *et al* (2015, p. 7) in their analysis of the Korean portion of overall US trade in products, judged KORUS FTA as having contributed to both the intensive and extensive margin.

According to a Korea Institute for Economic Policy (KEIP) analysis (Kim *et al* 2015, p. 2), there was a real possibility of a decrease in exports to the US if Korea had not entered into the KORUS agreement. According to this assessment '[...] the KORUS FTA has had the effect of virtually doubling Korea's exports of automobiles and parts (127.96 %) and metals (109.16 %) [...]' while the FTA also had a significant effect on '[...] imports from the US of automobiles and parts (132.1 %) and products of other manufacturing (16.77 %) industries [...]' (Kim *et al*, 2015: 2). They further found that Korea's utilisation rate of (the preference) for imports from the US was higher than the rate of utilisation by the US of imports from Korea at 60.7 % compared to 43.8 % (p. 3). The unimpressive utilisation rate of Korean exports to the US market, especially in the automobiles and parts sector, indicates that the US market has not yet gleaned the benefits of price competitiveness of those Korean imports.

With regard to FDI flows, US investment in Korea rose under KORUS from US\$ 5.5 billion in April 2012 to US\$ 10.4 billion at the end of 2014 (Kim *et al* 2015, pp. 3-4). The effect was mostly in the first two years of the FTA (2012 and 2013 at US\$ 23.3 and US\$ 24.2 billion respectively) with a slight reduction in FDI flows in 2014 (US\$ 19 billion). Much of the increase in FDI flows from the US has been in transport vehicles (manufacturing sector) with a 3000 % increase and business services at 455 % (p. 5).

All elements of the KORUS FTA are to be implemented by 2017, including revision of all relevant laws that was completed in late 2015, with a few exceptions that are in the final revision stage²⁶. The office of the USTR as well as the former US chief negotiator for KORUS, Wendy Cutler, expressed satisfaction that the FTA had improved Korea's investment environment for US companies (Kim *et al* 2015). The remaining issues being monitored and/or negotiated are: automotive regulation, certificate of origin verification, pharmaceutical patent linkage, pharmaceutical price reduction policy, transfer of financial data, express delivery packages and processed organic food certification. Some of these (notably certificate of origin verification, express delivery packages and financial data transfer) have revealed a divergence of views between South Korea and the US, which are likely to require detailed regulations or additional specific agreements. Several of the newly enforced measures (specifically the systems for evaluating automobile emission figures, reducing pharmaceutical prices and verifying processed organic food) require further review and analysis to determine how consistent they are with the original objectives and purpose of the KORUS FTA (Kim *et al* 2015).

Preliminary bilateral talks between the US and Korea to explore Korea's joining of the TPP have raised the possibility that Korea could well join, in which case the TPP would likely completely supersede the KORUS FTA. Furthermore, joining the TPP would offer benefits for the Korean economy specifically in the raising the standards of labour regulation in some TPP countries such as Brunei and Malaysia. This would be beneficial in numerous ways including reducing competition resulting from low labour standards in these countries.

On the EU side, the EU-Korea FTA was part of 'Global Europe' policy, a diplomatic tool that sought to address the EU's concern over trade diversion and the risk that the US would consolidate its domination of Northeast Asian business through the KORUS agreement. Korea was viewed as a springboard for EU business into the rapidly growing Asian market. There is also the parallel agreement in the EU-Korea Framework Agreement covering comprehensive cooperation beyond trade, such as in human rights, trans-national crime, climate change and energy security. The KORUS FTA does not contain these elements.

²⁶ KORUS provided for a bi-national consultative committee to review trade remedy decisions involving one another.

The results of EU-Korea FTA after three years of implementation revealed very different patterns of economic growth especially in the initial period. This has mainly been due to the weak EU economic performance, but it is also due to the structural changes in the South Korean economy and the relatively more important relationships with China and the US despite those countries' interest in wider pan regional economic and commercial relations and Korea's relatively small scale as an economic power. In comparison, the implementing bodies of the EU-Korea FTA are more active and likely to keep the EU-Korea FTA humming along well enough. This is in comparison with parallel bodies in the KORUS agreement, which have not exhibited much activity to date. The US has also been preoccupied with negotiating or concluding other major agreements, such as the TPP and TTIP in particular and does not have as robust an institutional infrastructure for oversight and management of implementation of FTAs as that set up by the EU.

In general, the trade and investment patterns have been positive except for the period of the global financial crisis of 2009 (Kang and Kim, 2013). Although Korea's exports to ASEAN and China rose, exports to the EU dropped in the first and second years of the FTA's implementation. This was in part due to the economic instability in the EU, the sharp fall in domestic demand and low investment sentiment among firms. In the same period, Korea's imports from the EU rose by 22.2 %, far higher than Korea's overall import increase of 6.8 % (Kang and Kim, 2013, p. 3). The tariff cuts on EU imports into Korea were effective especially in year two when Korea's overall imports dropped by 3.4 % but imports from the EU rose by 8 % (Kang and Kim, 2013, p. 3). This trend appears to have been due to the FTA and compares with the EU's relative low level of exports to Japan and China. The EU's FDI into Korea was robust in year one but limp afterwards due to conditions in the home markets.

The EU-Korea FTA had trade creating effects for Korea. Korea's exports to the EU are concentrated in ships, automobiles and electronics, representing nearly 60 % of the country's total exports to the EU. Crude and refined oil imports from the EU rose from less than 1 % before the FTA's implementation to 17.2 % in 2013, one third of which is refined and re-exported (Kang and Kim, 2013, p. 6).

At the same time, the South Korean economy is undergoing structural change especially in areas where price competitiveness is a key factor. As already noted, Korean companies have moved some production of, for example, mobile phones to China and Southeast Asia in order to retain their international competitiveness in that market segment. As noted above this will have an impact on the pattern of trade and trade balances as the EU imports of these goods will now be arriving into the EU from China or Southeast Asian countries although branded with Korean corporate names.

In summary, while the KORUS and EU-Korea FTAs have certain similarities, there are three main issues to keep in mind. First, the KORUS FTA is not a high priority for the US in the context of its policy on preferential and mega regional agreements. It is in the US' interests to fold KORUS into the TPP to minimise costs and to streamline policy processes and the implementation and management of the over time. Second, the FTA implementation bodies overseeing and monitoring the functioning of the FTA are rather different in the EU-Korea structure as compared to the KORUS one. The EU-ROK structure and methods appear to be more robust than those in the KORUS FTA. Third, Korea's objectives with the FTAs can be likened to other small trading-heavy countries in that it needs to maintain good relationships with all of its trading partners, but will necessarily have to prioritise its top trading and investment partners. This is important when considering the role of China and its relative importance to the South Korean economy.

6 Conclusions: Lessons from the EU-Korea FTA

South Korea has implemented an extensive FTA programme, the more recent one being the FTA with China. Assessment of the EU-Korea FTA as well as comparative assessments of the latter with other FTAs requires consideration that the Korean economy is small and changing rapidly. Economists and experts expect that the impact of FTAs will diminish with time and that the FTAs already in place today will become less important than when they were first signed. Korea's long-term strategy will be to continue to promote integration into the regional and global economies. Major corporations (which are central to Korean economy) understand that they need FTAs and other economic agreements to survive and thrive in the global economy. The government's position is to consider the impact on the economy as a whole rather than on specific sectors.

The EU-Korea FTA sent major shock waves through Japan and other countries in Asia, especially in East Asia. Japan realised its vulnerability to the EU's increased imports of Korean goods (especially motor vehicles/automobiles and electronics), which threatened to affect the EU's trade with Japan and Japanese companies. The triple shocks of Fukushima (3/11) compounded the impact on Japan, paving the way for Japanese leaders to promote Japan's negotiations with the EU on an FTA and the TPP and others (RCEP, a China-South Korea-Japan FTA, etc.) and to sell them to the public and win general acceptance of such agreements. Major Japanese corporations that are well integrated into the world economy strongly support Korea's FTAs policy, and analysts, government officials and business leaders understand that Japan needs FTAs to force through tough and unpalatable changes (structural changes) in the Japanese economy.

The Korea -China FTA negotiated over three years and officially signed in June 2015 signifies China's deepest FTA to date. This will eliminate 90 % of tariffs. Strategically, the FTA could be seen as a prelude to China negotiating a China-Korea-Japan FTA and proceeding with RCEP. Since China is Korea's largest trading partner, the FTA could be seen as critical to Korea and its future economic integration into the Asian region. South Korea is heavily dependent on the Chinese economy thus the economic slow down in China has a direct impact on South Korea. This is a key issue when considering the AIIB and South Korea's position.

The long-term impact of FTAs (led by the EU-Korea FTA) on Korea is highly likely to be two-fold. First, the deepening of the Korean economy's links with the global economy will further stimulate the competitive Korean (large) corporations, and second, it will bring about a major restructuring of the domestic-based Korean companies (SMEs) and a further movement away from small 'Mom & Pop' companies / stores / businesses. The heavy emphasis on technology in Korea, and the leading role of IT in a highly networked Korean economy, is also bringing about a restructuring of the domestic economy. In this area, Korea is at the cutting edge. As a small trading nation in Asia (and the world) Korea is highly sensitive to its trading partners' woes. As China is its main trading partner, Korea will necessarily have to keep that relationship in its sights as a priority over the EU, which while important is not as critical to Korea's economy as China. From China's perspective, Korea is important but not nearly as important as China is to Korea.

The trade deals being negotiated within Asia are likely to become more important than the EU-Korea FTA in the not too distant future due to the structural changes in the Korean economy and to its leadership role in negotiating major relatively deep FTAs in Asia. Korea is likely to have a tougher balancing act with the US. There are security and political reasons that require to Korea to balance agreements with the US and China. In this context KORUS is relatively less significant for the US than it is for Korea. Instead the US is positive about Korea and the TPP, which is a far larger deal with wider and deeper implications for the US economy and for its 'pivot to Asia' strategy. Nonetheless, the EU is a major partner, and South Korea is likely to aim to continue to manage all relationships delicately, not unlike successful, small, heavily trade-oriented European countries, such as in Scandinavia.

China's 'Silk Road Economic Belt' connecting the EU with China via central Asia and the Middle East is likely to benefit both the EU and Korea as well and Japan (and of course China).

It appears that there is little appetite for anything that would frustrate the aims of the current EU-Korea agreement, yet movements in Asia especially with regards to China are likely to affect Korea. Whether Korea moves to adjust its FTA with the EU in order to protect its relationship with China is unclear, but does not seem likely. Nor would Korea's entry into other agreements (e.g. RCEP, TPP and China-Japan-ROK FTA) be likely to affect previously negotiated and agreed FTAs including the EU-Korea agreement.

As the EU-ROK FTA is the first ever comprehensive FTA, as well as the first FTA completed with a fully industrialised and developed economy, it serves as a test for the EU's ability to implement beneficial FTAs according to the policy on FTAs adopted as part of the 'new Global Europe Strategy' in 2006. The EU-Korea FTA is also the first with an economy characterised by important non-tariff barriers to trade (technical barriers to trade, regulatory provisions in the services sector, a lack of access to government procurement markets) and other less evident trade barriers (such as anti-competitive practices that restrict access to markets by companies from the other party). At the same time, Korea has production structures that are more similar to the EU compared to non-industrialised and developing economies, and potentially higher economic structural complementarity and therefore a much higher share of intra-industry trade.

The free trade agreement between the EU and Korea is evidence of the benefits of free trade for economic activity. The positive economic stimuli should also be a strong argument in support of the current TTIP negotiations. Controversy has raged over the past few months about the potential advantages and disadvantages of free trade in general and bilateral free trade agreements in particular. The proposed TTIP currently being negotiated between the European Union and the United States has been a major catalyst for the debate in Europe. Critics of agreements such as TTIP mainly fear loss of sovereignty in the areas of consumer and environmental protection, data security, forced privatisations of public services and excessive power accruing to large companies. Furthermore, several interest groups that generally reject any trade pact doubt the positive effects of such agreements for trade, economic output or the labour markets on either side of the Atlantic.

The EU-Korea FTA has so far had positive results in bilateral trade in both directions, as trade intensity has intensified between Europe – especially a limited group of European countries – and Korea. However, this is also due to factors beyond the FTA, namely macroeconomic factors (such as sluggish demand in the EU and euro depreciation *vis-à-vis* the Korean won) and microeconomic factors such as overcapacity in some sectors where South Korea was relatively strong compared to Europe, and especially the relocation of production from Korea to other Asian countries, most notably China. This has diverted trade and depressed Korean exports to the EU to the benefit of other countries' exports.

It is also worth noting that some bilateral trade developments between the EU and South Korea should not be considered as permanent effects of liberalisation between the two, and may be subject to change. In fact, EU exports to Korea have generally grown stronger than EU imports from Korea since 2010, but EU imports from Korea grew much more in 2014, which could signal an on-going shift in bilateral trade trends that should be monitored in the future.

This might be due to changing macroeconomic conditions, changing consumer preferences for foreign goods, but also on the changing landscape of trade agreements over time. In fact, the impact of the EU-Korea FTA also depends on other FTAs being signed between the two partners, which might result in trade creation and diversion and thus reshape the bilateral trade patterns accordingly. In particular, the KORUS FTA between Korea and the US, which entered into force in 2012, might have different effects from those forecasts. Therefore, it is difficult to assess the impact of any FTA, even more so when the

major trade barriers today are not tariff barriers, but non-tariff barriers including technical standards and regulations.

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