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EU-Asia trade: in need of a strategy

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Trading with Asia has become this century's new gold rush as the world's fastest growing region, with dynamic powerhouse economies, turns into a global geo-economic hub. Power and global geo-politics too are rapidly tilting towards Asia. However, over the past few years Europe's commercial relationship with the continent has lost much pace relative to concurrent developments. The European Union (EU) has slowly ceded its position as the largest trading partner of several Asian countries, mainly to China. In addition, EU Free Trade Agreement (FTA) projects in the region have been painstakingly slow, with only one agreement signed so far (with South Korea). As the EU as a whole continues to punch below its weight, it risks lagging behind developments in Asia which it failed to foresee. Asian intra-regional trade has been growing exponentially. Its noodle bowl of FTAs has expanded fast, with major pluri-lateral initiatives in the offing potentially leading to a Free Trade Area of the Asia-Pacific (FTAAP). A coherent and long-term EU trade strategy for Asia is in order, which assesses on-going developments in Asia, anticipates future commercial trends in the region and lays out a comprehensive action plan for the EU. This paper looks at the current state of trade relations between the EU and Asia-Europe Meeting (ASEM)'s members[1] (hereafter referred to as Asia); notes critical shortcomings therein; outlines major developments in Asia; and provides recommendations for the EU.

[1] ASEM's Asian members include Australia, Bangladesh, Brunei, Cambodia, China, India, Indonesia, Japan, Republic of Korea, Laos, Malaysia, Mongolia, Myanmar, New Zealand, Pakistan, the Philippines, Singapore, Thailand, and Vietnam.

Highlights

- The EU remains Asia's largest trading partner, but its position is fast eroding relative to competitors.
- Intra-regional trade in Asia is booming and South-South trade routes are getting stronger.
- The EU needs a trade strategy for Asia that defines its priorities and relations with the region over the long term.

EU TRADE WITH ASIA

EU trade with Asia is undoubtedly important and has been growing over the past years. At €863 billion at the end of 2011, trade amongst ASEM members represented 60 per cent of total global trade. Asia accounted for 42.5 per cent of total EU trade in 2011. Europe remains Asia's largest trading partner. Significant initiatives with Asia are in the pipeline: FTAs with Singapore and Malaysia will be signed in 2013; FTA negotiations will be launched at the EU-Japan Summit in the spring of 2013; EU-China Investment Agreement negotiations will be set in motion this year; and FTA negotiations with India and Vietnam will continue. These agreements could greatly facilitate trade flows with Asia and integrate the EU much more into the Asian economy.

EU member states do trade with Asia, but the regional framework and rules are provided by the EU. The Union negotiates FTAs with third countries and, since the Lisbon Treaty, it has exclusive competence on negotiating investment agreements. Despite the crisis, EU member states have made strong individual efforts to advance their interests in Asia. But these have been dispersed and uneven across the bloc. Just four member states accounted for 64 per cent of total EU exports to Asia, while five absorbed more than 65 per cent of imports in 2011. Germany represents 20 per cent of those imports and around 33 per cent of exports.

Vast potential for trade with Asia remains untapped. The UK trades more with Ireland and Sweden than with India. More than 75 per cent of Latvian or 73.5 per cent of Portugal's trade takes place within the EU. Amidst on-going financial, debt and fiscal crises in Europe and with some member states facing the very real possibility of a triple-dip recession, Asia could provide much respite. The International Monetary Fund (IMF) projects Asia's GDP to grow at 6.8 per cent in 2013. In 2012, 27 developing countries in Asia overtook the Eurozone in terms of percentage share of global GDP: 17.9 per cent compared to the Eurozone's 16.9 per cent. According to the IMF, the figure could reach 22.2 per cent for Asia as a whole in just five years; China would account for 14.3 per cent or the equivalent of the entire Eurozone. Furthermore, EU member states' efforts have contributed little to the interests of the Union as a whole as bilateral agendas continue to override a common approach. Different interests amongst member states can also put a brake on the negotiations of bilateral or pluri-lateral deals.

The continuing debt crisis in Europe has remarkedly slowed down EU trade with Asia in 2012. Malay and Thai exports to the EU dropped by nearly 15 per cent in 2012 as compared to 2010. India's exports to the EU in November 2012 fell by 13 per cent as compared to November 2011; while Japanese exports to the EU in October 2012 fell by 20 per cent as compared to October 2011, registering a 13-month consecutive fall. China's exports to the EU fell sharply, while overall trade plummeted by 4.1 per cent between January-November 2012. Overall, South and East Asia's exports to the EU have fallen 7.2 per cent year-on-year. More notably, the EU faces serious competition from the US and China in Asia. US trade with Asia lagged behind the EU by less than a €100 billion in 2010. China on the other hand has replaced the EU as the number one trading partner for a number of Asian countries. With the exception of Brunei and the Philippines, China counts itself amongst the top three trading partners for all Asian countries. This is no longer the case for the EU. In East Asia, the US replaced the EU as China's top export market in 2012, while US-China trade has grown by 8.5 per cent year-on-year.

At the EU level, progress on FTAs with Asia has lagged behind over the past few years for a number of reasons. First, the EU has historically been rather slow in latching on to the global shift from the wedged multilateral trade deal at the WTO level towards bilateral FTAs. Negotiations with India, South Korea and ASEAN began only in 2007 after the launching of the Global Europe Strategy in 2006. So far, only one FTA has been signed (with South Korea). Secondly, there has been a general lack of foresight and planning. An FTA project with ASEAN was dropped two years into negotiations for political reasons regarding Myanmar. A slower bilateral track was adopted that not only compromised a region-to-region relationship, but also subsequently affected the EU's overall strength as an economic actor in Asia. Not one FTA has been signed with an ASEAN member to date. FTAs with Singapore and possibly Malaysia, if signed in 2013, will take years to ratify. Scoping exercises are on-going with Thailand, but are yet to begin with Brunei, Indonesia and the Philippines.

To capitalise on Asia's emerging market boom, bold and creative thinking is required

Trade Commissioner Karel de Gucht insists that the EU-ASEAN project remains the main goal down the line once the 'building blocks' of FTAs are completed. However, combining various FTAs will be as complicated as, if not more than, having attempted the region-to-region FTA itself. Bringing the other FTAs to the level of the most advanced FTA in the region, that with Singapore, will arguably be quite controversial. Third, the EU has insisted on signing Partnership and Cooperation Agreements (PCAs) before FTAs, which are taking multiple years to negotiate and ratify. The EU and Vietnam only signed a PCA in June 2012 after talks began in June 2008. Now such PCAs are being negotiated in parallel to trade deals.

The EU's insistence on near-perfect FTAs has not proved very effective either and its financial crisis has significantly lowered its leverage. The Bilateral Trade and Investment Agreement with India remains elusive after more than six years of negotiations. An EU memo reads: 'If we were to complete all our current free trade talks tomorrow, we'd be adding to the EU economy 2.2% of our GDP, or €275 billion. In terms of jobs, they could generate 2.2 million new jobs or 1% of the EU total workforce'. The political will required to make the necessary break-through progress on negotiations is still amiss.

TRADE IN ASIA

Aside from continued (though slowing) economic growth in Asia, four major macroeconomic developments have turned the region's commercial environment far more dynamic than EU-Asia engagement, as well as more challenging for future EU-Asia relations. First, Asian intra-regional trade has grown significantly. It now stands at 57.3 per cent, compared to that in the EU at 67.2 per cent. Geography and some countries' unilateral liberalisation have been key factors behind the phenomenon; recession in the EU and the US is another recent one. At 14 per cent per year, intra-regional trade has grown faster than Asia's trade with either the EU or the rest of the world (11 per cent). Such growth is set to continue. As China shifts its export-oriented economy to a consumption-based model, countries like Vietnam, Indonesia and Malaysia, with their inexpensive and abundant labour supplies, are poised to become Asia's next production bases. This means that in the future, it will be much harder to penetrate Asia or sway trade away to far-away Europe.

Secondly, there has been an impressive proliferation of FTAs in Asia: from 53 in 2000 to more than 250 in various stages of development, of which 150 are exclusively intra-regional. ASEAN for instance has signed FTAs with almost every important regional actor: Australia, China, India, New Zealand, and South Korea, as well as with very advanced economies like Japan. The bloc has also launched the US-ASEAN Expanded Economic Engagement initiative, intended to boost bilateral trade and investment ties. This trend is set to increase. Although not the main reason behind the level of economic integration in Asia, these FTAs hold vast potential to boost existing commercial exchanges as they seek to remove trade barriers and reduce or eliminate customs duties. For instance, with the entry into force of the Indo-ASEAN FTA on 1 January 2010, bilateral trade more than doubled in just three years: from $32 billion to $75 billion. Some of these FTAs have also been evolving into 'deep integration' FTAs by including regulations on services and investment, intellectual property protection and competition policy.

Third, three extensive pluri-lateral free trade initiatives in the region are in the offing. Japan, China and South Korea will soon begin negotiations on a trilateral FTA while the ASEAN Framework on Regional Comprehensive Economic Partnership (RCEP) aims to create a large free trade area by combining ASEAN's existing FTAs and including agreements covering services and investment. The US-backed Trans-Pacific Partnership (TPP) includes 11 members and could expand to 14 to include Japan, South Korea and Thailand. Covering a region of 3.5 billion people and an integrated market with a combined GDP of $23 trillion (equivalent to approximately a third of the world's current annual GDP), RCEP would be the world's largest regional trading arrangement, targeting the removal of 95 per cent of tariffs on goods. RCEP's most attractive quality is its flexibility and the fact that it takes into account the development priorities of the parties involved. The TPP would cover a market of about $21 trillion. It would be more comprehensive, developing a new rulebook of sorts on trade and investment in goods and services, and much more exigent than the RCEP or other existing FTAs amongst TPP partners. Both RCEP and TPP are competing tracks for regional integration in Asia. The China-Japan-South Korea trilateral FTA too would create one of the world's largest markets: 20 per cent of global

GDP, 17.5 per cent of global trade, and 22 per cent of global population. Importantly, RCEP negotiations began in November 2012 and aim to conclude by the end of 2015. Attending some TPP meetings personally, President Obama has put much political weight behind concluding the agreement in 2013. Negotiations on the trilateral FTA began in November 2012 and parties hope to finalise it in two years time. The pace of progress and envisaged timeframes of these FTAs are noteworthy.

Fourth, 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 $166.3 billion, rising 83 per cent from 2009.

WHAT THE EU SHOULD DO

Alongside these rapid developments, progress on the EU's commercial relationship with Asia has been sobering, displaying little evidence of strategic direction. Of utmost need is an EU-Asia trade strategy document that can supply effective guidance over the medium to long terms. The EU will not only need carefully to scrutinise developments in Asia, but also maintain an overview of current or potential negotiations of Asian partners with competitors to make its own strategic calculations. The yet untapped trade potential between Asia and a number of EU member states should be exploited. Given the trade shifts within Asia, as well as between Asia and non-traditional markets amidst Europe's economic crisis, redoubled efforts from the EU and its member states will be required to prevent the decoupling of Asian economies from the West. More coherence on a political level amongst member states will further strengthen the position of the Union as a whole, for example on upcoming negotiations with Japan. In Asia, where size does matter, the EU platform would be the only credible means to leverage power.

The EU needs thoroughly to assess the conception and fast development of various pluri-lateral FTA initiatives in Asia, as these might turn out to be massive trade and investment diverters. To capitalise on Asia's emerging market boom, bold and creative thinking is required: can the EU initiate an ASEM-based FTA, or join the RCEP instead of weaving together the EU-ASEAN FTA? Speed in the EU's own negotiations will be particularly vital in 2013. Penetrating such integrated economies at a later stage will be all the more difficult as deep trade links will have already been established through the TPP, RCEP or the trilateral FTA. Advancing the EU's FTA negotiations in Asia will require much more political investment from the EU as well as from member state leaders. Political presence and inter-personal relationships hold great significance in Asia.

The EU-India FTA is particularly important and must be concluded with urgency. 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 begin 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 within EU-India trade, the EU-India FTA could provide a considerable leg-up for the EU in Asia.

Trade policy is a major instrument of EU external relations, but it has remained an undervalued asset. Bilateral trade is an important and tangible indicator for assessing overall bilateral relations. Trade also translates into political influence in Asia. Distinct initiatives in this domain need to be set within a broader strategic vision of the EU's place in a changing region over the medium term, while taking into account concurrent regional endeavours. An EU-Asia trade strategy should be fleshed out.

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