

## European Union – East Asia Trade Relations in the 21st Century

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### ABSTRACT

The East Asia has been for many decades home to the fastest growing economies in the world. Their dynamic growth and economic transformation have created new conditions and challenges in doing business, that must be faced by many trade partners around the world, including the European Union. On the one hand, emerging Asian markets have brought a new competition pressure for EU producers. On the other hand, they have become an attractive and prospective demand markets for EU exporters. In the analysed timeframe (2001-2016) the EU merchandise trade with the EA-15 economies has experienced tremendous increase in both exports and imports. It has been also observed a tremendous shift towards China and developing countries of the ASEAN which have emerged as important trade partners for the EU. Changes in trade patterns and expanding number of FTAs with and within the region of East Asia have also induced the need of adopting a coherent long-term EU strategy towards EA-15 economies and constructing a new framework for bilateral cooperation.

Keywords: European Union, East Asia, Southeast Asia, merchandise trade

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### INTRODUCTION

The East and Southeast Asia has been for many decades home to the fastest growing economies in the world. An enormous growth of economic potential of the region in the 21<sup>st</sup> century has also been accompanied by the growing importance of those economies in the international trade. The increasing openness to the global trade system and the intensive development of merchandise trade with and within the East and Southeast Asian economies may be described as one of the most important processes accelerating and shaping the globalisation over last decades. Moreover, since the end of the 1990s those countries have joined the process of trade regionalism, participating actively in proliferation of free trade agreements with and within the region. All those processes have created new conditions and challenges not only for countries in the region, but also globally for all trade partners.

The European Union is one of the most important trade and economic partners of Asian countries. Their dynamic growth and economic transformation have created new conditions and challenges in doing business, that must also be faced by European partners. In this context an unprecedented growth of economic importance of Asia in global economy has forced the EU, for which international trade has always been an

important element of economic growth and prosperity, to adapt to new changing international economic order.

The general objective of the paper is to identify main trends in international trade of the European Union<sup>1</sup> with East and Southeast Asian economies (Japan, South Korea, China, Hong Kong SAR, Taiwan and 10 countries of the ASEAN - hereinafter referred to as EA-15) in the 21<sup>st</sup> century (the analysed timeframe includes years 2001-2016). The general objective will be achieved through operational objectives including: identification of trade volume tendencies between the EU and EA-15 partners and geographical trends/shifts in trade between the Parties. The tendencies will be analysed in the context of framework of bilateral cooperation between the EU and the mentioned Asian countries.

The first part of the paper includes a short description of the economic transformation and growing importance of the EA-15 economies in international trade and economic system. Then some general picture of the cooperation framework between the EU and the EA-15 is presented with a focus on current status of concluded and potential free trade agreements (FTA) with countries of the region. The third part refers directly to the general aim and includes the analysis of main trends in merchandise trade between the European Union and EA-15 partners.

## **1. EAST ASIA IN THE GLOBAL ECONOMY OF THE 21<sup>ST</sup> CENTURY**

The East Asia has been for many decades home to the fastest growing economies in the world. The economic rise of the region has been staggering, starting with Japan and the 'Asian tigers' (Hong Kong, Singapore, Taiwan and South Korea). The success of those countries was followed by China, whose emergence gathered pace with economic reforms from the end of the 1970s and has changed substantially the economic environment not only in the region, but also globally.

The analysed region is highly diversified in economic terms and the countries' development success has not followed a single way. Although the general trend of impressive growth in many of the EA-15 countries, the region's economies are not homogeneous in terms of economic development and structure. Though this diversity, some common elements have emerged over recent decades in development strategies of the region's countries. Nearly all the high-performing EA-15 economies supported growth and prosperity by investing in human capital, cumulating financial capital and undertaking institutional changes, including expanding the role of markets. Those steps were initiated by deliberately introduced domestic economic and structural reforms and were accompanied by the expansion of infrastructure and growing openness to global trade and economic system. Greater openness and lower transportation costs have also induced the emergence of intra-regional production network. This has been a natural

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<sup>1</sup> All calculations are made for the EU of 28 countries, although some member states joined the EU in 2004, 2007 and 2013 respectively.

consequence of the economic evolution of the region's economies, encompassing diminishing competitiveness of regional high-performers (such as Hong Kong, Japan, South Korea and Taiwan) in labour-intensive goods/activities and the shift towards the development of domestic markets and specialisation in high-skills activities. As a result of intra-regional specialisation and the scale of production, the region has gained a powerful advantage, especially in manufacturers, at the global stage (AG 2012).

The trends of economic development initiated in many of EA-15 economies in the second half of the 20<sup>th</sup> century have been also continued in the 21<sup>st</sup> century, ensuring the region its historical importance in global economic system and making the East Asia a new engine of global growth. The economic potential of the EA-15, measured by nominal GDP in current prices, almost tripled in 2001-2016 growing from 7 255.5 bn USD in 2001 to 21 136.2 bn USD in 2016. This has resulted in an increased share of the region in global GDP from 21.6% to 28.1%, which has been a consequence of impressive economic growth of China, South Korea and many ASEAN countries. The growth is even stronger (from 22.3% to 31.0%) when taking into account the GDP based on PPP. Such an enormous economic progress achieved by many region's economies is also parallelly visible in impressive growth of GDP per capita (tab. 1). All those figures reflect that first two decades of the 21<sup>st</sup> century have strengthened the economic potential and position of the countries in the global economy.

Although in recent years the economic growth has slowed down, it is still forecasted that the biggest economies of the region will continue to develop rapidly in forthcoming years (e.g. average forecasted GDP growth in 2018-2022 for chosen countries are as follows: Vietnam (6.2%), China (5.9%), Indonesia (5.4%), Malaysia (4.8%), Thailand (3.2%) or South Korea (3.0%)) (IMF 2017). The combination of economic outlook and the size of the economy mean that the largest contribution to global and regional economic growth over next years will come from China. However, also ASEAN countries are expected to grow rapidly making Southeast Asia an important player in economic, political and demographic terms. More advanced economies of the region, including especially Japan and South Korea, are expected to grow at more moderate rates, facing more and more the problem of aging population (AG 2012).

An enormous growth of economic potential of the EA-15 countries in the 21<sup>st</sup> century has also been accompanied by the growing importance of those economies in the international trade. This is a natural consequence of economic development based on export-oriented strategies implemented by most of the region's economies. The increasing openness to the global trade system has been one of the most important components of development over last decades. It has stimulated not only economic growth (firstly as an incentive to take advantage of large endowments of relatively cheap and unskilled labour, and subsequently moving up to the value-added chain with adopted - and lately even invented - new technologies) and integration between the EA-15 countries, but also influenced substantially the world trade system, international division of labour and diffusion of global value chains. In this context the intensive development of international trade with and within the East and Southeast Asian economies may be described as one of the most important processes accelerating and shaping the globalisation over last decades. It should also be stressed that many of the region's countries have recognized the importance of trade liberalization and have become one of the major beneficiaries of opening global trading system (Krueger 2005).

The growing trade openness of East and Southeast Asian countries has been not only the aftermath of their export expansion and willingness to secure unrestricted access to global markets for products made in the region, but has also been driven by the need of assuring undeteriorated supply of resources (including energy) vital to their production. It has been especially important for those of EA-15 economies where domestic raw materials endowments are at scarce (AG 2012).

In terms of international trade the first two decades of the 21<sup>st</sup> century have brought dynamic changes and elevated the merchandise trade volume to historical peak values. In the years 2001-2016 the EA-15 total merchandise exports more than tripled, rising from 1 524.0 bn USD to 5 176.7 bn USD. The growth of EA-15 exports in the analysed years surpassed the average world growth and the average drop over last 3 years (2014-2016) was more moderate than the total global rates (-5% for EA-15 vs. -8.4% globally). It has resulted in a growing share of the region in total world exports from 24.60% in 2001 to 32.45% (tab. 2).

The most remarkable processes in terms of export expansion in the 21<sup>st</sup> century are visible in reference to China. In 2001-2016 Chinese exports grew by almost 7 times (from 266.1 bn USD to 2 098.2 bn USD) and the Chinese share in world exports increased from 4.30% to 13.15% in 2016, making the country the biggest exporter in the world (since 2009 when it surpassed Germany (including intra-EU trade) and since 2014 when it surpassed the EU-28 (excluding intra-EU trade)). China's global predominance in exports is even more visible when analysing sectors of merchandise trade: manufacturers (18.6% of total world exports in 2015; excluding intra-EU trade), iron and steel (16.7%), office and telecom equipment (34.0%) or textiles (37.4%) and clothing (39.3%) (WTO 2016). Such a dominant position has been achieved through a high dynamics of exports growth which in pre-crisis time (2001-2008) amounted to 27.2% (average per year), slowing down to 16.4% in 2009-2013. In 2014-2016 Chinese export decreased by -5.4% (a/y).

The above numbers must also be analysed with taking into consideration a special role of Hong Kong SAR that handles an important part of the Chinese mainland's external trade. In 2016 the value of Hong Kong SAR's re-exports amounted to 491.2 bn USD of 516.7 bn USD of total HK's exports (value of HK's domestic exports amounted to only 25.5 bn USD in 2016) (WTO 2017). In 2016 about 60% of Hong Kong's re-exports originated from the Chinese mainland and about 13% of the Chinese mainland's exports (267 bn USD) was handled by Hong Kong SAR (Tsui 2017).

In the analysed period also the ASEAN have strengthen its position in international trade. Its share in total world exports increased to 7.15% (2016) making Southeast Asia an important trader at the global stage. Although the ASEAN's nominal exports almost tripled in 2001-2016, it should be highlighted that the performance of individual countries in the region has been diversified. In the 21<sup>st</sup> century the export growth from Brunei, Indonesia, Malaysia and the Philippines was below the world's average and those countries – despite nominal increase – have lost its share in global trade (tab. 2). On the opposite side there is Vietnam, which recorded the most impressive relative growth (more than 11.7 times in 2001-2016) in exports among all EA-15 countries. The Vietnamese share in world's total exports increased to 1.11%, making the country an important and prospectively developing trade partner in Southeast Asia.

**Table 1. The economic potential of the EA-15 economies (2001 vs. 2016)**

	Population (mio)			GDP current prices (bn USD)			GDP on PPP (Intl. dollars (bn) and % of world total)				GDP per capita (USD)			Average annual GDP growth (%)			
	2001	2016	change 2001=100	2001	2016	change 2001=100	2001	%	2016	%	2001	2016	change 2001=100	2001-2005	2006-2010	2011-2016	
<b>Japan</b>	127.1	126.5	99.5	4161.0	4412.6	106	3322.3	6.40	4901.1	4.15	32729.95	34870.93	107	1.4	0.0	0.8	
<b>Korea</b>	47.4	50.8	107	533.2	1321.2	248	826.8	1.59	1916.4	1.62	11258.82	25989.88	231	4.8	3.8	2.8	
<b>China</b>	1276.3	1381.5	108	1336.9	11383.0	851	4054.8	7.81	20853.3	17.65	1047.5	8239.9	787	10.1	10.9	7.2	
<b>HK SAR</b>	6.7	7.4	109	169.4	322.4	190	184.8	0.36	427.6	0.36	25170.41	43827.7	174	5.2	3.2	2.4	
<b>Taiwan</b>	22.4	23.6	105	300.2	508.8	169	485.7	0.94	1126.0	0.95	13399.5	21606.7	161	5.4	4.0	2.1	
<b>ASEAN</b>	<b>Brunei</b>	0.3	0.4	127	6.2	9.1	146	22.8	0.04	32.9	0.03	18681	21496	115	1.9	-0.3	-1.2
	<b>Cambodia</b>	12.5	15.8	127	4.0	19.5	488	14.7	0.03	58.6	0.05	320.0	1234.5	386	9.6	5.7	7.1
	<b>Indonesia</b>	209.2	258.8	124	174.5	937.0	537	1016.0	1.96	3010.7	2.55	834.1	3620.4	434	5.0	6.2	5.3
	<b>Laos</b>	5.5	7.2	131	1.6	13.4	854	10.3	0.02	40.5	0.03	286.1	1865.1	652	6.7	7.8	7.5
	<b>Malaysia</b>	24.1	31.5	131	99.6	309.3	310	308.9	0.60	859.9	0.73	4130.4	9810.8	238	5.7	4.2	5.1
	<b>Myanmar</b>	46.8	52.3	112	7.5	74.0	992	63.3	0.12	311.0	0.26	159.4	1416.4	888	13.2	6.5	8.0
	<b>Philippines</b>	78.6	104.2	133	76.3	310.3	407	274.8	0.53	793.2	0.67	970.4	2978.2	307	5.0	4.9	6.3
	<b>Singapore</b>	4.1	5.6	135	89.3	294.6	330	167.1	0.32	485.0	0.41	21577.49	52755.14	244	6.4	6.2	3.1
	<b>Thailand</b>	62.9	69.0	110	120.3	409.7	341	485.2	0.94	1152.4	0.98	1912.3	5939.6	311	5.9	3.4	3.3
	<b>Vietnam</b>	78.7	92.6	118	32.5	201.4	619	174.7	0.34	592.8	0.50	413.3	2173.7	526	7.4	6.2	5.9

Source: own calculations on (IMF 2017).

**Table 2. Merchandise trade of the EA-15 economies (2001 vs. 2016)**

	Exports								Imports							
	Value (bn USD) and % of world total				Change (2001=100)	Average annual change			Value (bn USD) and % of world total				Change (2001=100)	Average annual change		
	2001	%	2016	%		2001-2008	2009-2013	2014-2016	2001	%	2016	%		2001-2008	2009-2013	2014-2016
<b>Japan</b>	403.5	6.51	644.9	4.04	160	9.9%	5.3%	-3.3%	349.1	5.38	606.9	3.74	174	11.8%	10.8%	-13.6%
<b>Korea</b>	150.4	2.43	495.4	3.11	329	15.9%	11.4%	-7.0%	141.1	2.18	406.2	2.50	288	17.5%	12.4%	-12.1%
<b>China</b>	266.1	4.30	2098.2	13.15	788	27.2%	16.4%	-5.4%	243.6	3.76	1587.4	9.78	652	24.6%	18.0%	-10.0%
<b>HK SAR</b>	191.1	3.08	516.7	3.24	270	9.9%	12.9%	-0.7%	202.0	3.12	547.3	3.37	271	10.0%	15.2%	-4.5%
<b>Taiwan</b>	125.9	2.03	280.3	1.76	223	10.6%	11.2%	-6.4%	107.9	1.66	230.6	1.42	214	12.1%	12.4%	-9.6%
<b>ASEAN</b>	387.0	6.25	1141.1	7.15	295	14.4%	11.8%	-6.0%	347.0	5.35	1079	6.65	311	15.3%	14.4%	-6.4%
Brunei	3.6	0.06	5.0	0.03	136	16.1%	12.3%	-31.3%	1.2	0.02	3.1	0.02	267	12.1%	10.2%	-7.3%
Cambodia	1.5	0.02	10.0	0.06	670	17.8%	12.3%	21.1%	2.1	0.03	12.6	0.08	602	17.6%	16.4%	3.0%
Indonesia	57.4	0.93	144.5	0.91	252	13.5%	11.1%	-9.5%	37.5	0.58	135.7	0.84	361	19.1%	18.8%	-12.7%
Laos	0.3	0.01	3.0	0.02	945	19.2%	21.1%	6.5%	0.5	0.01	4.7	0.03	925	15.5%	20.5%	5.1%
Malaysia	88.0	1.42	189.4	1.19	215	12.4%	9.8%	-10.0%	73.7	1.14	168.4	1.04	228	11.3%	13.6%	-10.2%
Myanmar	2.4	0.04	11.0	0.07	466	16.5%	14.0%	-2.0%	2.8	0.04	16.6	0.10	583	5.9%	29.0%	1.1%
Philippines	32.2	0.52	56.3	0.35	175	6.2%	10.2%	-4.8%	34.9	0.54	86.3	0.53	247	8.1%	9.4%	12.9%
Singapore	121.8	1.97	329.8	2.07	271	15.7%	11.0%	-10.2%	116.0	1.79	282.9	1.74	244	15.6%	11.0%	-12.1%
Thailand	65.0	1.05	215.3	1.35	331	15.5%	10.7%	-2.7%	62.0	0.96	194.7	1.20	314	16.4%	17.0%	-7.5%
Vietnam	15.0	0.24	176.8	1.11	1176	22.6%	23.3%	8.5%	16.2	0.25	174.2	1.07	1074	25.8%	17.2%	8.6%
<b>EA-15</b>	<b>1524.0</b>	<b>24.60</b>	<b>5176.7</b>	<b>32.45</b>	<b>340</b>	<b>15.8%</b>	<b>12.5%</b>	<b>-5.0%</b>	<b>1390.7</b>	<b>21.45%</b>	<b>4457.6</b>	<b>27.47%</b>	<b>321</b>	<b>15.9%</b>	<b>14.8%</b>	<b>-9.2%</b>
<b>WORLD</b>	<b>6195.0</b>	<b>100.0</b>	<b>15955.0</b>	<b>100.00</b>	<b>258</b>	<b>14.7%</b>	<b>10.8%</b>	<b>-8.4%</b>	<b>6484.0</b>	<b>100.0%</b>	<b>16225.0</b>	<b>100.00</b>	<b>250</b>	<b>14.3%</b>	<b>10.4%</b>	<b>-7.8%</b>

Source: own calculations on (WTO 2017).

Also, developed economies of the EA-15 have recorded exports growth over last two decades, but only in South Korea the dynamics was high enough to strengthen its relative position in international trade. In 2001-2016 Korean exports more than tripled, making South Korea the 5<sup>th</sup> biggest global exporter (after China, the EU-28, the US and Japan) with a share of 3.11% of total world exports (2016). In the case of Taiwan, the value of exports more than doubled but, as it was below the global average growth, its importance in total world exports decreased from 2.03% to 1.76% in 2016. Among the group of developed economies, the most remarkable is the erosion of Japanese share in international exports. The country that starting from the 1970s was not only the biggest exporter in East Asia, but also one of the largest exporters in the world (in the mid-1980s Japan accounted for almost 10% of total world exports), during the first two decades of the 21<sup>st</sup> century has continued a decline in its relative importance in the world trade system. Although the Japanese exports have increased by 241.1 bn USD in 2001-2016, the growth dynamics was below the global one. In consequence, the Japan's share in world exports has decreased from 6.51% to 4.04% in the analysed timeframe. However, trade potential still gives Japan the position of the second biggest exporter in East Asia.

The region, although being widely recognised as an important source of exports to other global markets, has also become over last years an important consumer and importer of goods from the world. Dynamic growth and development in combination with the total population of more than 2.22 bn people have transformed the EA-15 economies to important demand market on a global scale. Expanding production in the region as well as growing domestic demand have induced an enormous demand growth for raw materials (including energy sources), semi-products and final goods. Growing import has been essential for sustaining the economic growth, transformation to more advanced economy and production of technologically advanced goods, especially that – as already mentioned – many of EA-15 economies' endowments in raw materials/energy sources are at scarce.

In 2001-2016 the total EA-15 imports increased from 1 390.7 bn USD to 4 457.6 bn USD, which has been translated in an increase in the region's share in global imports from 21.45% (2001) to 27.47% (2016). As in the case of exports, the lion's share of the rise has been induced by expanding Chinese imports that have grown by more than 6.5 times (from 243.6 bn USD to 1 587.4 bn USD), making China the biggest importer in the region (and the second one in the world after the United States) that is responsible for more than 1/3 of total EA-15's imports (the Chinese share in imports of all EA-15 economies increased in 2001-2016 from 17.5% to 36.5%). In 2015, China was the biggest global importer of office and telecom equipment (19.9% of total world imports), and the second one in the world in purchasing fuels and mining products (13.1%), agricultural products (9.5%) and manufactures (9.0%) (WTO 2016).

The ASEAN countries, whose combined imports in 2016 amounted to almost 1 079 bln USD, constituted the second most important import market in the region. The biggest importers within the ASEAN were: Singapore (282.9 bn USD), Thailand (194.7 bn USD), Vietnam (174.2 bn USD), Malaysia (168.4 bn USD) and Indonesia (135.7 bn USD). Those five countries accounted for more than 88% of total imports of the

ASEAN, and of this group the most dynamic growth of imports in the analysed timeframe was noted in Vietnam (more than 10.7 times).

In reference to developed economies of the region, Japan still remains the second biggest national importer in East Asia accounting for 3.74% of total world imports (and 13.6% of the EA-15 imports). A significant position of Japan as an importer, although relatively eroded in the analysed timeframe, has been caused by Japan's low endowments in raw materials and restricted land area especially when compared to the population. That is why most of raw materials, energy source as well as many food products must be imported from abroad. Japan still remains an important global importer of fuels and mining products (4<sup>th</sup> position in the world, 6.2% of total world imports, 2015), agricultural products (4<sup>th</sup>, 6.2%), pharmaceuticals (3<sup>rd</sup>, 4.4%) and clothing (3<sup>rd</sup>, 9.7%) (WTO 2016).

An important East Asian importer is also Hong Kong SAR whose imports amounted to 547.3 bn USD (3<sup>rd</sup> position in EA-15 and 3.37% of total world import). Such a high position is an aftermath – similarly as in the case of exports – of special role of Hong Kong SAR as a regional trade and transportation hub<sup>2</sup> and gateway to the Chinese mainland. Most of Hong Kong's imports have been re-exported and only a smaller part of it has been classified as retained imports (121.1 bn USD of 547.3 of total HK's imports in 2016). It should also be mentioned that in 2016 Hong Kong handled 16% of the Chinese mainland's imports (247 bn USD) (Tsui 2017).

Among other developed economies of East Asia, Taiwanese imports have doubled and Korean imports have almost tripled over the last two decades. In both cases the increase of imports has been slower than the dynamics of their exports growth. It has resulted in the increase of trade surplus recorded by both partners to 49.7 bn USD and 89.2 bn USD for Taiwan and South Korean respectively.

In terms of trade balance it should also be underlined that most of EA-15 economies noted in 2016 trade surplus, with a leading position for China (510.8 bln USD). In the reported year only Hong Kong SAR (-30.6 bn USD) and four ASEAN members (Cambodia (-2.6 bn USD), Laos (-1.7 bn USD), Myanmar (-5.6 bn USD) and the Philippines (-30.0 bn USD)) recorded the trade deficit. This provides that export expansion remains a vital component of East and Southeast Asian development strategies and economic growth.

The general analysis of economic transformation and development in EA-15 economies cannot be comprehensive without a reference to foreign direct investments (FDI). For many decades many of the region's countries have been classified as an attractive place for hosting foreign direct investments that became a crucial incentive for economic transformation and flywheel for growth and development.

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<sup>2</sup> In 2015 the port of Hong Kong was classified as the 5th biggest sea port by cargo volume in the world (20.7 mio TEU) (WSC 2017).

In 2014-2016 East Asia<sup>3</sup> accounted for ca. 15-20% FDI inflows (257-318 bn USD per year) and of 15-23% (237-289 bn USD) of global FDI outflows. Among this group 95% of FDI inflows were located in China and Hong Kong. Both economies were also leading investors: in 2014-2016 China invested abroad 433 bn USD and Hong Kong SAR – 258 bn USD (of total 708.9 bn USD invested by East Asia (classified by UNCTAD methodology)). At the same time Southeast Asia<sup>4</sup> attracted 358.2 bn USD (between 5.8-9.9% of all global FDI per year) and was a source of 177.8 bn USD (2.4-7.1% of global FDI outflows). Most of FDI in Southeast Asia were located in Singapore (57.6% of all FDI inflows in 2014-2016), followed by Indonesia (11.5%), Vietnam (9.4%) and Malaysia (8.9%). Concurrently the biggest investors from this group were Singapore (59.8% of FDI outflows from Southeast Asia in 2014-2016), Malaysia (17.7%) and Thailand (11.3%) (UNCTAD 2017). A country with historically well-established position as an international investor is Japan. In 2014-2016 Japanese companies invested 402.9 bn USD, giving at the end of 2016 to the country the 4<sup>th</sup> position in the world (after the US, Hong Kong SAR and the UK) among the biggest global investors by total FDI outward stock (1 400 bn USD of FDI outward stock in 2016). At the same time, Japan has remained a modest performer in hosting (tab. 3).

Over the first two decades of the 21<sup>st</sup> century the position of EA-15 economies as a place for locating foreign direct investment has been strengthened. The total value of FDI inwards stocks in all analysed countries has increased by more than 5 times, from 1 001.6 bn USD in 2001 to 5 263.8 in 2016. It gives to the EA-15 a share in world's FDI inward stock at 19.69% (compared to 13.73% at the beginning of the century). The highest relative growth has been noted in the ASEAN, including Indonesia, Singapore and Vietnam which become more and more important place for locating FDI in the region (the share of ASEAN in global FDI inwards stock has almost doubled in the analysed timeframe). It should also be stressed that the biggest ASEAN economies (Indonesia, Thailand, the Philippines, Vietnam and Singapore) have been classified - by top executives of multinational enterprises who responded to the world investment report 2017 - as the top prospective host economies for 2017–2019 (UNCTAD 2017).

What stems from tab. 3 is that in the years 2001-2016 have also increased substantially FDI stock in China and Hong Kong SAR which are in this aspects leaders for the whole region. On the opposite side are Japan and South Korea which have remained traditionally closed for inflowing investments. The values of FDI inwards stock in Japan (186.7 bn USD) and Korea (185.0 bn USD) are very modest, especially when compared to the position of those countries as global scale investors (1 400.7 bn USD and 306.1 bn USD for Japan and Korea respectively).

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<sup>3</sup> According to the UNCTAD methodology East Asia includes: China, Hong Kong SAR, Macao SAR, Taiwan, South Korea, North Korea and Mongolia.

<sup>4</sup> According to the UNCTAD methodology Southeast Asia includes: ASEAN countries + Timor-Leste.

**Table 3. Foreign direct investments inward and outward stocks in the EA-15 economies (2001 vs. 2016)**

	FDI inward stocks					FDI outward stocks				
	Value (mio USD) and % of world total				Change (2001=100)	Value (mio USD) and % of world total				Change (2001=100)
	2001	%	2016	%		2001	%	2016	%	
<b>Japan</b>	50 319	0.69	186 714	0.70	371	300 114	4.23	1 400 694	5.35	467
<b>Korea</b>	53 208	0.73	184 970	0.69	348	19 967	0.28	306 145	1.17	1533
<b>China</b>	203 142	2.78	1 354 404	5.07	667	34 654	0.49	1 280 975	4.90	3696
<b>HK SAR</b>	401 187	5.50	1 590 808	5.95	397	347 771	4.90	1 527 880	5.84	439
<b>Taiwan</b>	34729	0.48	75 012	0.28	216	70 758	1.00	320 933	1.23	454
<b>ASEAN</b>	258 965	3.55	1 871 893	7.00	723	110578	1.56	1 012 696	3.87	916
Brunei	4 394	0.06	5 739	0.02	131	517	0.01	2 803	0.01	542
Cambodia	1 729	0.02	16 656	0.06	963	211	0.00	652	0.00	309
Indonesia	15 203	0.21	234 961	0.88	1545	6 940*	0.10	58 890	0.23	849
Laos	612	0.01	5 639	0.02	921	21	0.00	19	0.00	90
Malaysia	33 972	0.47	121 621	0.46	358	8 354	0.12	126 937	0.49	1519
Myanmar	3 767	0.05	22 666	0.08	602	n/a	n/a	n/a	n/a	n/a
Philippines	10 385	0.14	64 249	0.24	619	892	0.01	45 377	0.17	5087
Singapore	138 775	1.90	1 096 320	4.10	790	90 122	1.27	682 404	2.61	757
Thailand	34 098	0.47	188 651	0.71	553	3 456	0.05	85 636	0.33	2478
Vietnam	16 030	0.22	115 391	0.43	720	65	0.00	9 978	0.04	15351
<b>EA-15</b>	<b>1 001 550</b>	<b>13.73</b>	<b>5 263 801</b>	<b>19.69</b>	<b>526</b>	<b>883 842</b>	<b>12.46</b>	<b>5 849 323</b>	<b>22.36</b>	<b>662</b>

\* Data for 2000; in 2001 - negative accumulation of flows

Source: own calculations on (UNCTAD 2017).

In reference to the role of EA-15 economies as a source of investments, the most remarkable change applies to China which has become in the analysed timeframe one of the most important investors globally. Over a dozen or so years the country that was mostly a host market for foreign direct investments has also become an important investor. Chinese investment activities have skyrocketed since the beginning of the present century and the value of Chinese FDI outward stock has increased by more than 35 times, from only 34.65 bn USD in 2001 to 1 280.97 bn USD in 2016. This has enabled to increase China's share in global FDI outward stock by 10 times – from 0.49% to 4.9%. At present China is the third most important investor from East Asia, after Hong Kong SAR and Japan which have been traditionally important source of FDI at the global stage. China has also been classified as one of the most promising source of FDI in forthcoming years (UNCTAD 2017).

## **2. FRAMEWORK OF THE EUROPEAN UNION – EA-15 TRADE AND ECONOMIC CO-OPERATION**

### **2.1 East Asia in the EU's strategy of the Common Commercial Policy**

The dynamic economic development of East Asia and in consequence increasing region's share in the world's production and trade have been creating new challenges for the European Union. The EA-15 economies have become the most dynamic region in international trade which together with the region's participation in global value chains have impacted the pattern of trade not only regionally, but also globally. This changing situation has also required reaction and adjustment at the EU level.

The launch of the EU's trade strategy "Global Europe" might be considered as the breakthrough point for development of bilateral trade framework between the EU and East Asian economies in the 21<sup>st</sup> century. In 2006 the European Commission (EC) issued the Communication "*Global Europe – competing in the world*" in which it presented the priorities of the EU' Common Commercial Policy in the nearest future. The Communication manifested the historic shift of accents in the EU's cooperation with third countries. Among the chief elements of the new strategy, it mentioned bilateral trade agreements which should acquire a new shape and dimension in the system of trade connections between the EU and its major trade partners. The "Global Europe" strategy assumed new economic criteria for the choice of trade partners with whom bilateral arrangements should be discussed, which most prominently included the market potential (market size and its growth rates) and the level of protection on the given market (tariff and non-tariff barriers) with respect to products and companies from the European Union. Also the importance of the negotiations (already commenced by major trade competitors of the EU) on the new trade agreements with selected third countries was emphasised. On the basis of the presented criteria, leading trade partners were indicated, with whom bilateral negotiations on FTA should be initiated (Mazur 2012a). As the aforementioned criteria were fulfilled by many East Asian economies, prioritised partners to start negotiations were - among others<sup>5</sup> - South Korea and the ASEAN. Moreover, in the new strategy it was emphasised that also China met many of

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<sup>5</sup> The list also included: Mercosur, India, Russia and countries of the Gulf Co-operation Council.

the mentioned criteria, but – due to the complexity of trade relations as well as the opportunities and risks for European business from bilateral co-operation – the country required a special attention and an individual approach with regard to trade framework (EC 2006).

In 2010, the European Commission presented the EU's renewed trade strategy ("*Trade, Growth and World Affairs. Trade Policy as a Core Component of the EU's 2020 Strategy*"), in which it stressed again the importance of new trade agreements to be negotiated with main EU's trade partners. In this context the importance of East Asia was reiterated as most of world's economic growth would be generated outside Europe, with a third from China alone. Therefore the seizing of the opportunity of high levels of growth in the region – through securing the unrestricted access for European goods, services and investments – became priority. The new strategy also underlined that fast-growing regional trade in East Asia and the growing network of free trade areas with and within the region had created new economic conditions and challenges for EU trade and economic activity in the region. In this context the EU expressed the need of expanding and concluding bilateral negotiations with countries of the region, including especially the ASEAN (EC 2010). This approach was strengthened once again in 2013, when the European Commission pointed Japan as an important market and economic partner for the EU, although some relative importance had diminished last years. According to the strategy, better access for EU goods and services should be secured not only in the case of fast-developing countries but also in more economically advanced markets, with many access barriers still present.

In the latest adopted strategy of the UE's trade policy ("*Trade for all*", 2015) it was underlined that the EU's strategy towards Asia should be consolidated and enriched over the next few years. A special attention was given to global value chains and its implications for the current co-operation framework. In this context the EU should not only continue negotiations and conclude FTAs with EA-15 partners, but also it foreshadowed future negotiations on a broader network of investment agreements in the region. Concurrently to FTAs negotiated with chosen partners in the region (see below) the Commission stated that, building on the investment provisions under ongoing negotiations with China, the EU would explore launching negotiations on investment with Hong Kong and Taiwan in future (EC 2015a). Such a new legal co-operation framework would be an institutional response to increasing proliferation of global value chains in which the EU is among the most important partners for many EA-15 countries.

## **2.2 Framework of the EU's bilateral trade relations with EA-15 economies**

### **2.2.1 South Korea**

The official negotiations on the EU-**South Korea** FTA (EU-SK FTA) were launched in May 2007. It took almost two years and eight rounds of talks to achieve the consensus and to initial the FTA by both partners. The new agreement was officially signed on 6<sup>th</sup> October 2010 and entered into force since 1<sup>st</sup> July 2011 (EC 2011). The EU-SK FTA is a comprehensive agreement regulating bilaterally the broad spectrum of economic and trade co-operation rules. The agreement has not only eliminated tariffs on almost all EU-SK manufactured trade (the EU-SK FTA has provided for the elimination of 98.7% of duties (in trade in value) for both industrial and agricultural products within 5 years

of the entry into force of the agreement (7 years respectively for Korea)) and many non-tariff barriers, but also regulated trade-related issues such as investments, public procurement, intellectual property rights (IPR), labour rights and environmental protection (Cooper et al. 2011). This makes the agreement both consistent with the “WTO-plus” option of new FTAs and most comprehensive FTA ever negotiated by the EU and the first with a partner country in Asia (EC 2011). As the EU-SK FTA is the first comprehensive ‘new generation’ free trade agreement signed by the EU with other developed country, it has been treated as a model of trade and economic co-operation to be followed in forthcoming years by new agreements with other EU trade partners, including also the EA-15 economies (Mazur 2012b).

### 2.2.2 Japan

In March 2013 the European Union launched negotiations on a free trade agreement with **Japan**. Economic importance and mutual interests of both partners as well as growing pressure on bilateralisation of trade relations around the world have persuaded the EU and Japan to redefine the nature of their relationship and create a new perspective for economic co-operation model. Both parties, joining the negotiations on the new comprehensive agreement, had their own interests and priorities to be settled within the new trade framework. Both economies, facing the problem of economic crisis and relatively low level of economic activity in reference to GDP growth, recognise the new agreement as a significant incentive for trade and investment expansion and thereby faster economic growth. Although the level of mutual tariff quotas is relatively low nowadays, there are still many obstacles to utilise mutually full potential of business and economic capability of both parties (Mazur 2013).

Japanese side perceives the new agreement as an opportunity to secure access to European market on manufactured goods that still face tariffs when entering the EU. Only 35.9% of Japanese products imported to the EU market is duty-free (against 68.7% EU products imported to Japan) and the average customs tariffs (3.4%) is higher than in the opposite direction (1.7%) (FTA 2013). Thus, Japanese negotiators focus mainly on tariff elimination for products of a great importance to Japanese export to the EU (e.g. motor vehicles, electronics and machinery). It is a crucial issue for Japanese industrial sector, particularly after the EU and South Korea concluded and introduced the EU-Korea FTA in 2011 (Mazur 2013).

From the opposite perspective, also the European Union has a lot of arguments for concluding the new FTA. Although the European exports enter the Japanese market under relatively low tariffs, it still encounters many non-tariff barriers which are recognised by most of studies and public consultations as a major barrier to EU exports to Japan. The EU side argues that European exporters and investors cannot fully utilise the potential of Japanese market due to trade impediments preventing a higher degree of economic cooperation. All of them account for the fact that the country still remains closed, especially for agricultural products, some transport equipment and aeronautical products. The mentioned non-tariff barriers affect mostly those business sectors which cover the lion’s share of EU exports, i.e. processed foods, chemicals (including pharmaceuticals), medical devices, automotive and transport equipment, telecommunication and financial services (EC 2012). A matter of great importance to the European side has been also the lack of transparency and barriers in access to public

procurement in Japan. In the negotiations the EU concentrates not only on eliminating non-tariff barriers to expand the EU's services export but also on the presence - through foreign direct investments - of European companies in Japan. The economic potential of the EU and Japan make the future FTA one of the most important trade frameworks between developed countries (Mazur 2013).

### 2.2.3 *The Association of South-East Asian Nations (ASEAN)*

As far as the **ASEAN** is concerned, the framework of economic cooperation is more complex and diversified. In 2007, the EU and the ASEAN launched negotiations for a free trade agreement between the regions. However, 2 years later, the negotiations were paused due to the slow progress and growing reluctance of some ASEAN members to negotiate and conclude the new comprehensive region-to-region agreement. As an alternative the European Commission proposed to continue negotiations to those countries that wished to sign bilateral FTAs. The new approach of "variable geometry" takes into account different levels of development between ASEAN countries. Such approach has allowed to move towards faster and more advanced bilateral talks with individual ASEAN members (Lim 2012).

The pause did not last long and in December 2009 the Council gave the green light for the Commission to continue negotiations towards free trade agreements with individual countries of the ASEAN (EC 2009). At the same time the EC also announced an intention to start negotiations with Singapore - the most important trading partner among the ASEAN and the country that as a first signalled its strong interest in closer economic relations with the EU. In 2010, it became clear that other countries of the region were also prepared to pursue negotiations in bilateral option. Vietnam, Malaysia and Indonesia were among first countries that expressed (2010-2011) their interest in negotiating FTA with the European Union (Oxelheim 2012). It should also be stressed that the Commission expressed its intention that the strategic and ultimate objective was to reach an agreement with the ASEAN (region-to-region FTA) in future and bilateral agreements that would be negotiated and concluded with individual countries could become valuable building blocks towards that objective (EC 2009).

The negotiations with **Singapore** were launched in March 2009 and the comprehensive free trade agreement (EUSFTA) was concluded on 17<sup>th</sup> October 2014. The EUSFTA is the first agreement of the EU with ASEAN member and the second one with a developed Asian country (after South Korea). In December 2015 the European Commission - after more than three years and several rounds of negotiations - concluded also a free trade agreement with **Vietnam** (EVFTA). This is the second ASEAN member that signed the FTA with the EU. The agreement is described as the most ambitious and comprehensive FTA ever concluded by the EU with a developing country (EC 2016).

By the half of 2017 the European Union concluded - within the bilateral format - individual FTAs only with two mentioned ASEAN members: Singapore and Vietnam. At the same time the EC negotiates new agreements with other four countries of the region: Malaysia, Thailand, the Philippines and Indonesia.

**Malaysia** was the second of ASEAN countries that launched (October 2010) the bilateral negotiations with the EU on a comprehensive FTA. At that time it seemed that Malaysia would be a logical FTA partner, given its position as one of the EU's most important trade partners in Southeast Asia. However, the progress of negotiations was not satisfactory and bilateral talks were paused in April 2012 at Malaysia's request. In March 2017 the EU and Malaysia agreed to re-launch the negotiations in due course. In the meantime Malaysia was also excluded (since 1 January 2014) from the EU's General System of Preferences and lost its preferential access to EU market. As a result, Malaysia falls currently under less preferential regime in trade with the EU than other ASEAN countries.

In March 2013 the EC launched also negotiations for a free trade agreement with **Thailand**. An initial plan presumed to conclude bilateral talks within two years. However, due to the military coup in Thailand in May 2014, the EU - after four rounds - suspended bilateral negotiations. The EU stressed that it would not conclude and sign any agreement with Thailand until a democratically elected government is in place. Since 1 January 2015 Thailand has been withdrawn from the EU's General System of Preferences, and lost preferential access to the EU. In consequence, Thailand is losing its competitive edge in many export-oriented sectors in favour of other ASEAN countries that either have already concluded FTAs with the EU (Singapore and Vietnam) or are still beneficiaries of the unilateral preferences granted by the EU under the GSP (Indonesia), GSP+ (the Philippines) or EBA (Cambodia, Laos and Myanmar; see below) (Mazur 2017).

In December 2016 the EU also launched FTA negotiations with the **Philippines** and in September 2016 with **Indonesia**. Those are last two ASEAN countries that joined the bilateral talks on a free trade agreements with the EU and in both cases the negotiations are at an early stage. The strategic plan is to conclude a comprehensive agreement covering a broad range of regulations leading to the elimination of customs duties and other barriers to trade, liberalization of trade in services and investment flows, access to public procurement markets, additional disciplines in the area of competition policy and protection of IPR. The prospective agreements should also include commitments in areas such as environmental protection and social development, which have been promoted by the EU in trade co-operation with developing countries (EC 2015b). From the EU's perspective the agreements are crucial for securing access for European exports and investments to the most populated markets of the ASEAN.

Three other ASEAN members - **Cambodia, Laos and Myanmar** – classified as the Least Developed Countries fall under the most privileged of the EU's trade regimes and their motivation for bilateral agreement with the EU (and thus also reciprocal preferences for EU exports to their markets) is modest. Of those countries only Myanmar launched (March 2014) with the EU negotiations on an investment protection agreement that should improve the legal environment for EU investors in this country, regulating a.o. investor to state dispute settlement system. However, currently there are no specified plans about any further negotiations on FTA in future.

#### **2.2.4 China + Hong Kong SAR + Taiwan**

The trade potential of **China** and the dynamics of economic process and transformation make the country – as was stated in the EU’s “Global Europe” strategy – ‘the single greatest test of Europe’s capacity to make globalisation an opportunity for jobs and growth’ (EC 2006). Although the underlined importance of China for the EU’s trade relations with Asian countries and – in general – even for the shape of the EU’s Common Commercial Policy, the European Union has not elaborated yet anything that could be considered as a coherent strategy. Even in the latest trade strategy presented in 2015, the European Commission did not articulate 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 of the most important issues, silenced in the strategy, has been the recognition of China as a ‘market economy’, which would reduce the possibilities for the EU’s activist trade defence policy (Dreyer 2015). China’s growing share in international trade (see p. 1) and activism in establishing many new bilateral trade agreements with many developed and developing economies around the world have created a necessity for the EU to articulate an external trade and investment strategy with China (INTA 2016).

The legal framework for bilateral EU-China co-operation is still the Trade and Economic Cooperation Agreement (TECA) signed in 1985. In 2007, both partners launched negotiations for the EU-China Partnership and Cooperation Agreement (PCA), but since 2011 talks have been stalled due to divergences between the expectations of the parties. The EU expected that the new agreement would serve as a single framework covering the full range and complexity of EU-China relations, including a.o. transition towards a more open and plural society, sustainable development as well as trade and economic relations. The Chinese side expected that the new agreement would be more as an upgrade of the 1985 TECA. This fundamental divergence on the shape and content of the new agreement and some contentious issues that appeared during the negotiations (including the recognition of the ‘market economy’ status for China) has resulted in the failure of the negotiations (Zhang 2011).

In November 2013, the EU and China launched negotiations on a comprehensive EU-China investment agreement (CIA) that – once concluded – would replace existing bilateral investment treaties between individual EU member states and China (many of them were concluded in the mid-1980s and are already outdated). The main goal of the agreement is to liberalise market access and provide a high level of protection to investors and investments in EU and China markets (INTA 2016). The Chinese FDI regime belongs to the most restrictive of 58 countries surveyed in the context of investment restrictiveness (OECD and G-20; 22 sectors surveyed; OECD 2016) and those existing restrictions for foreign investors in many Chinese services and goods markets induce a strong motivation for the EU to negotiate the CIA. In 2016, the EU and China announced that the negotiated agreement would be a comprehensive agreement with wide scope, ensuring the improved market access and balanced level of protection for investors and their investments. The main challenges to be faced during next phase of negotiations include also (mainly Chinese) the transparency of regulatory environment as well as licensing and authorisation procedures (Pelkman et al. 2016).

The conclusion of the comprehensive investment agreement, which is being negotiated, has been treated as a prior condition for beginning to explore a potential free trade agreement between the EU and China. Although the Chinese side has already suggested

further deepening of bilateral relations through an FTA, the EU is far more reluctant - at present - to make binding declarations. In this context the EU underlines that it would be ready to start the process towards a bilateral free trade agreement, once the prior conditions are met by China, including first and foremost the successful implementation of further domestic economic reforms and enhancing the Chinese participation in multilateral/plurilateral trade system (e.g. Trade in Services Agreement, the Environmental Goods Agreement or the Information Technology Agreement).

The EU-China comprehensive investment agreement is also described as a benchmark for similar potential agreements to be negotiated in future with **Hong Kong SAR** and **Taiwan**. Those two economies are considered as prospective partners for a similar bilateral investment, as the dissemination of supply chains within the EA-15 requires a broader network of investment agreements with the region (INTA 2016). In this context the agreement with China and the investment provisions to be agreed under negotiations are considered as a benchmark and prerequisite for exploring the launch of negotiations with Hong Kong and Taiwan.

### 2.3 Variable trade regimes

The complexity of the EU's trade relations with EA-15 results in situation where individual economies of East Asia fall under different trade regimes within the EU's Common Commercial Policy. The level of preferences in access to European market and the current legal status of the countries in EU's trade framework have resulted from the level of economic development as well as political and economic decisions initiating processes of enhanced cooperation between the parties.

Among the group of EA-15 economies the most privileged in trade with the EU are those countries that are either classified as less developed countries, and as such are beneficiaries of the EU's Generalised System of Preferences, or have decided to negotiate and conclude a free trade agreement with the European Union.

The first group includes Cambodia, Laos and Myanmar which are classified as the Least Developed Countries (LDCs) and therefore benefit from the most privileged trade regime under EBA (*Everything but Arms*) - an instrument within the GSP that grants to LDCs duty free and quota free (DFQF) access to the EU markets for all goods except arms and ammunition. Moreover, in the most privileged group is the Philippines which has been beneficiary of the enhanced trade preferences granted by the EU under GSP+ since the end of 2014. The system provides additional preferences to countries which ratified and implement international conventions relating to human and labour rights, environment and good governance. Also Indonesia and Vietnam benefit from special preferences in access to the EU market under the unilateral preferences granted within the standard rules of the GSP.

The most privileged (bilateral) rules in trade with the European Union have been applied hitherto only to South Korea that has concluded and implemented FTA with the Union. However, some newcomers are on the horizon and in the forthcoming years Korea should be joined by Singapore and Vietnam that have already concluded the agreements (at present under ratification). Moreover, negotiations with Japan,

Indonesia and the Philippines are ongoing and those countries are next potential partners to conclude similar comprehensive trade and economic agreement with the EU.

Less privileged in trade with the EU are economies that trade with the Union on the WTO standard rules (based on the Most-Favoured Nation). Those are economically developed Hong Kong SAR, Taiwan as well as Singapore and Japan (until entry into force of the mentioned concluded (Singapore) and negotiated (Japan) agreements). Moreover, the group includes also those countries that have been withdrawn from the Generalized System of Preferences last years<sup>6</sup>, ie. China, the most important EU trade partner in the region, as well as Thailand and Malaysia that due to achieving higher level of economic development do not longer qualify for preferences granted under the GSP. In this context those countries could benefit from more privileged trade with the EU once they negotiate and conclude (potential) free trade agreements in future.

As stated above, there is no one coherent strategy of the EU towards East Asian economies in terms of trade framework. Divergences between the region's economies in the level of economic development and approach to external economic strategies as well as the complexity of current trade and economic relations result in a diversified framework of cooperation with EA-15 economies. The system has been evolving and should aspire to higher bilateral openness and enhanced economic cooperation, but the pace of the process – also due its political character – is difficult to be defined.

### **3. EUROPEAN UNION – EA-15 MERCHANDISE TRADE IN THE 21<sup>ST</sup> CENTURY**

The first two decades of the 21<sup>st</sup> century have witnessed not only tremendous economic growth and trade expansion of the EA-15 economies, but also dynamic development and structural shifts of trade flows between the European Union and those countries. At present (2016) 10 of 30 most important trade partners of the EU are located in East and Southeast Asia with some prospects for further advancement in future.

In the years 2001-2016 total trade volume of the EU-28 with the EA-15 economies grew from 537.5 bn EUR to 1 153 bn EUR, which increased the share of those countries in total extra-EU trade from 28.9% to 33.4%. This process has been influenced mostly by growing importance of China as a trade partner for EU countries, followed by dynamically growing trade volume (but on a smaller scale) with some other EA-15 countries such as Cambodia, Myanmar, Vietnam or South Korea (tab 4.). Undoubtedly the Chinese global export expansion has been the most important factor influencing changes in merchandise trade between the EU and EA-15 economies. Since the beginning of the century EU-Chinese total trade increased more than 4 times making China the second most important EU trade partner in the world (after the US). In 2016 the share of China in EU trade amounted to 14.9% (compared to 6.1% in 2001). Consequently China became also the most important partner for the EU in the analysed region, replacing at this position Japan. In 2016 the half of total EU – EA-15 trade was bilateral trade exchange between EU countries and China. This is mostly the aftermath

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<sup>6</sup> According to the GSP criteria, a country that has been classified by the World Bank as a high or an upper-middle income country for three consecutive years should not benefit from such preferences.

of the dynamically increasing import from China to EU in recent years, and to a lesser degree EU exports expansion to the country (see below).

Concurrently to the above the analysed years have brought a sharp decrease in EU trade volume with Japan, not only in relative terms but even in nominal values. Total trade volume with Japan decreased from 126.8 bn EUR in 2001 to 124.7 bn in 2016, which is a far disappointing result especially when compared to dynamic development of trade relations with many other countries of the region. At the beginning of the 21<sup>st</sup> century Japan was the biggest EU trade partner in the region and the third biggest globally with share of 27.2% of EU trade with EA-15 (6.8% of total EU trade). Starting from the first half of the 1990s, when Japan was the most important Asian trade partner for EC countries, the share of the country in both total EU imports and exports has declined substantially. The structural changes in global trade and economy (a.o. shifts in EU Asian import from Japan to China and South-East Asian countries) as well as economic situation in both partners (a.o. modest economic growth and consumer demand) have determined that today's EU-Japanese merchandise trade lost its historical dynamics and significance. Japanese share in total EU external imports and exports is currently only one-third and a half respectively of the values recorded two decades ago (Mazur 2016).

The second most important EU trade partner in the region is the ASEAN. The importance of the ASEAN in the EU's trade relations has remained rather stable in the analysed timeframe (the share of the ASEAN in total extra-EU trade has decreased slightly from 6.2% in 2001 to 6.0% in 2016), however there have been more noticeable changes in trade when analysing bilateral relations with individual countries of Southeast Asia. The group includes countries which trade volume with the EU has increased the most from all EA-15 economies: Cambodia and Vietnam. Although tremendous growth of EU's bilateral trade with the mentioned countries has resulted partly from the statistical effect of the low trade volume at the beginning of the analysed period, those countries have expanded their trade with the EU substantially and became an important trade partners in the region. Especially Vietnam's role as the EU's trade partner has increased (in 2001-2016 EU-Vietnam trade increased from 6.6 bn EUR to 42.4 bn EUR) and the country became the second most important trade partner for the EU in Southeast Asia (with a share of 1.23% of total extra-EU trade; just after Singapore). The FTA between the EU and Vietnam, concluded in 2015, will bring – after ratification and entrance into force - a new incentives and opportunities for further expansion of trade between the parties. At the same time – although bilateral trade volume in nominal values is higher than at the beginning of the century - the relative importance of Singapore, Malaysia, Indonesia, the Philippines and Thailand has decreased.

Considering other developed economies of the EA-15, the most dynamic trade growth has been recorded in relations with South Korea. In the years 2001-2016 bilateral trade flows have more than doubled (39.2 bn EUR to 85.8 bn EUR) and Korea has become the third biggest trade partner in the region. The country's position in external trade relations of the European Union has been enforced by the bilateral FTA – a first of this kind agreement concluded by the EU with an Asian country. As for other developed EA-15 economies trade exchange with Hong Kong SAR and Taiwan has increased but less than the average for the region. In consequence both partners' share in EU trade with East Asian countries is lower than at the beginning of the century (in 2001-2016

shares of the partners in total extra-EU trade have decreased from 1.75% to 1.54% and from 2.13% to 1.30% for HK SAR and Taiwan respectively).

### 3.1 European Union's imports from EA-15

From the EU's perspective trade relations with EA-15 countries in the 21<sup>st</sup> century have been strongly influenced and shaped by tremendous increase in imports from the region. The export-oriented strategies adopted by many Asian countries – including fore mostly China - for which the European market has become a natural destination for expansion, have led to a situation in which the EU has faced a strong increase in imports from many EA-15 economies.

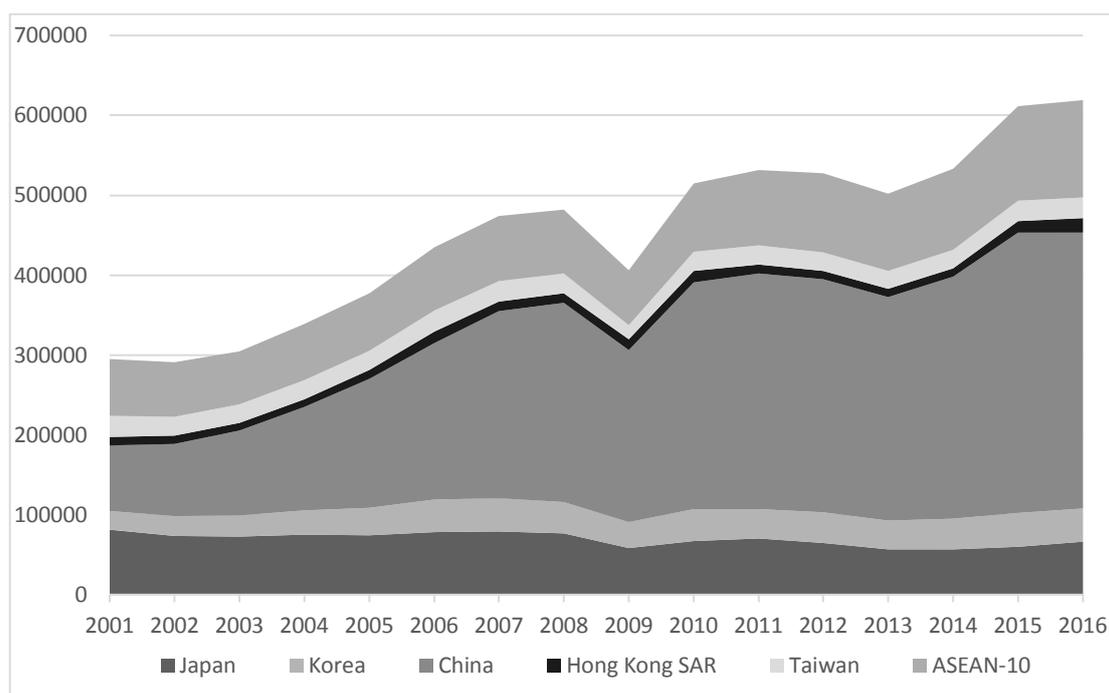
In 2001-2016 the total imports from EA-15 has more than doubled, increasing from 294.9 bn EUR to 619.1 bn EUR (graph 1). In consequence the share of EA-15 economies in total extra-EU imports has grown in the analysed timeframe from 30.1% to 36.2%. The growth has been influenced mostly by increasing imports from China and other developing economies of the region. Since the beginning of the century the imports from China has increased from 82.2 bn EUR to 344.8 bn EUR. It has resulted that China is today not only the biggest supplier of goods to the European Union from EA-15 countries (55.5% of total EU imports from the EA-15), but also globally. In 2016 China – with a share of 20.2% of total extra-EU imports - was the biggest import partner for the EU-28, surpassing in this aspect the US by almost 98 bn EUR. The average growth rate of imports from China in 2001-2016 amounted to 10.0% and was one of the highest in the region (the average growth rate of EU imports from all EA-15 economies and total EU imports amounted to 5.1% and 3.8% respectively). Such growth has also resulted in an enormous increase of the EU's trade deficit in exchange with China - from 51.5 bn EUR in 2001 to 175.0 bn EUR in 2016 (the highest among all EU trade partners).

The analysed timeframe has also witnessed growing imports from South Korea, Hong Kong SAR and the ASEAN (by average annual growth rates at 3.9%, 3.6% and 3.6% respectively). As far as the latter is concerned a special attention should be given to Cambodia and Vietnam whose imports to the EU had the highest growth rates. Both countries, becoming an important location for labour-intensive production relocated from other countries of the region (including not only developed economies, but also China, where costs of production have been rising) have become an important supplier of merchandise imports to the European Union. Although in nominal values imports from Cambodia and Vietnam are still very far from the level recorded in trade with China, both countries have substantially increased their imports to the EU (by 9.3 and 6.9 times for Cambodia and Vietnam respectively). In consequence Vietnam has become the most important supplier of merchandise trade to the EU from all ASEAN countries (almost 1/3 of total EU imports from Southeast Asia). It should be also mentioned that the country has benefited from the preferential access to EU market under the Generalised System of Preferences and the concluded FTA with the EU will secure the preferential access for goods of the Vietnamese origin in future.

The first two decades of the 21<sup>st</sup> century have also brought decreasing imports – in both relative and nominal values – from other advanced economies of the region, namely Japan and Taiwan. In both cases imports of merchandised goods have been replaced by

flows from other developing countries. Some part of imports has also been shifted to South Korea that has become an important competitor in similar sectors (e.g. electronics, car manufacturing) and has benefited from more privileged access to the EU due to concluded EU-Korea FTA. The direct competition pressure from Korean companies in exporting to the EU market has been one of the most important arguments for Japan to start similar negotiations on FTA with the European Union in 2013.

**Graph 1. EU imports from the EA-15 economies in 2001-2016 (mio EUR)**



Source: own calculations on (Eurostat/Comext 2017).

**Table 4. Merchandise trade of the European Union with the EA-15 economies (2001 vs. 2016)**

	Exports								Imports								Balance (bn EUR)	
	Value (bn EUR) and % of total extra-EU exports				Change (2001 =100)	Average annual change (%)			Value (bn EUR) and % of total extra-EU imports				Change (2001= 100)	Average annual change (%)				
	2001	%	2016	%		2001-2008	2009-2013	2014-2016	2001	%	2016	%		2001-2008	2009-2013	2014-2016	2001	2016
<b>Japan</b>	45.56	5.18	58.06	3.33	127	-1.0	10.7	4.4	81.29	8.30	66.60	3.89	82	-0.87	-0.79	8.49	-35.73	-8.54
<b>Korea</b>	15.84	1.80	44.14	2.53	279	7.0	10.7	1.1	23.34	2.38	41.63	2.43	178	7.90	2.50	3.62	-7.50	2.51
<b>China</b>	30.67	3.49	169.8	9.74	554	14.3	16.6	1.6	82.16	8.39	344.8	20.16	420	17.17	6.81	6.77	-51.49	-174.97
<b>HK SAR</b>	21.82	2.48	34.99	2.01	160	0.0	15.8	0.4	10.67	1.09	18.21	1.06	171	2.02	-6.47	29.73	11.15	16.78
<b>Taiwan</b>	13.47	1.53	19.04	1.09	141	-2.1	16.1	5.9	26.17	2.67	25.92	1.52	99	-1.13	5.38	5.67	-12.70	-6.88
<b>ASEAN</b>	43.96	5.00	85.85	4.92	195	3.6	13.2	4.4	71.26	7.28	121.9	7.13	171	1.72	9.08	9.82	-27.30	-36.05
Brunei	0.16	0.02	0.29	0.02	179	0.5	12.9	-20.6	0.06	0.01	0.04	0.00	72	-20.05	-18.24	40.61	0.11	0.25
Myanmar	0.09	0.01	0.56	0.03	631	2.4	68.2	6.6	0.50	0.05	0.99	0.06	199	-13.13	9.00	59.08	-0.41	-0.43
Cambodia	0.11	0.01	0.64	0.04	600	5.3	39.6	46.5	0.49	0.05	4.58	0.27	933	5.87	34.15	22.79	-0.38	-3.94
Laos	0.03	0.00	0.12	0.01	364	10.3	17.1	-19.3	0.15	0.02	0.24	0.01	156	-1.25	16.27	2.18	-0.12	-0.12
Indonesia	4.58	0.52	10.46	0.60	228	3.8	6.7	4.9	11.63	1.19	14.65	0.86	126	2.26	5.25	0.75	-7.05	-4.19
Malaysia	9.49	1.08	13.23	0.76	139	2.8	16.5	-2.7	17.26	1.76	21.85	1.28	127	0.21	5.71	5.45	-7.77	-8.62
Philippines	4.66	0.53	6.18	0.35	132	-3.1	10.3	-4.9	8.01	0.82	6.71	0.39	84	-4.48	6.31	8.13	-3.35	-0.53
Singapore	15.23	1.73	31.48	1.81	207	5.6	18.5	5.3	15.17	1.55	19.46	1.14	128	0.90	4.83	7.35	0.06	12.01
Thailand	7.76	0.88	13.56	0.78	175	2.2	9.3	4.5	13.20	1.35	20.28	1.19	154	4.13	4.32	4.78	-5.44	-6.72
Vietnam	1.85	0.21	9.34	0.54	505	9.0	18.3	23.0	4.78	0.49	33.10	1.94	692	8.79	28.27	22.05	-2.93	-23.77
<b>EA-15</b>	171.3	19.4	411.97	23.6	240	5.9	14.3	1.2	294.9	30.13	619.11	36.20	210	7.27	5.45	7.78	-123.58	-207.15

Source: own calculations on (Eurostat/Comext 2017).

As far as the structure of EU imports from EA-15 countries is concerned the lion's share of the total imports are: machinery and transport equipment (by SITC; 52% of total EU imports in 2016) and miscellaneous manufactured articles (24.0%), followed by manufactured goods classified chiefly by material (10.9%), chemicals and related products (6.5%) and food and live animals (2.3%). Machinery and transport equipment are the most important section in trade with all EA-15 economies<sup>7</sup> but the share of this section in EU imports is higher among highly developed economies of the region (65.5% for Japan, 62.9% for Taiwan and 60.2% for South Korea) than in developing partners (50.4% for China and 45.4% for the ASEAN). This reflects economic structure of the analysed region. On the other hand in the years 2001-2016 imports in the section machinery and transport equipment has decreased nominally (Japan, Taiwan) or relatively as a share of total imports (South Korea) and increased in trade with China. This reflects changing specialisation and growing importance of this country in the production of more technologically advanced goods.

Although the European Union, as a customs union, cooperates with EA-15 at the same legal basis and all EU members apply the same rules to imports coming to the EU, independently on their destination country, the EU - EA-15 trade is highly concentrated within few EU countries. This reflects general economic and trade potential of the biggest European economies. Among the EU countries the most important client for imports from the EA-15 is Germany which accounts for 1/5 of total EU imports from the region. The country is the largest importer from most of EA-15 countries, except Hong Kong SAR for which the dominant importer among the EU is the United Kingdom. The second most important EU importer from East and Southeast Asia is the Netherlands (17.8%), followed by the UK (16.2%), France (7.6%), Italy (7.1%), Belgium (6.2%) and Spain (5.2%). It should also be highlighted that in the analysed timeframe EU members from Central and Eastern Europe, that joined the EU in 2004 and 2007 (CEE-10<sup>8</sup>), significantly expanded trade with EA-15 economies, increasing their share in total EU's imports from that region from 6.4% in 2001 to 10.8% in 2016. It has been a result of higher imports growth rates recorded in those countries (in 2001-2016 the total imports to CEE-10 increased by more than 3.5 times). This tremendous increase is especially noticeable in imports from South Korea to the Czech Republic, Poland and Slovakia, which all together accounted for 19.3% of total EU imports (5.8%, 5.8% and 7.7% respectively) from Korea, compared to only 3.4% in 2001. Such an enormous increase has been an aftermath of Korean investments located over the last two decades in the mentioned countries.

### 3.2 European Union's exports to EA-15

The dynamic economic growth and growing openness of the EA-15 economies to global trade system have brought not only a significant exports expansion of those economies to global markets, but also have created a new conditions and possibilities for other countries - including the European Union - to invest and sell their products in East and Southeast Asia. With more than 2.2 bn consumers, expanding incomes and

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<sup>7</sup> ASEAN countries calculated together as a single entity.

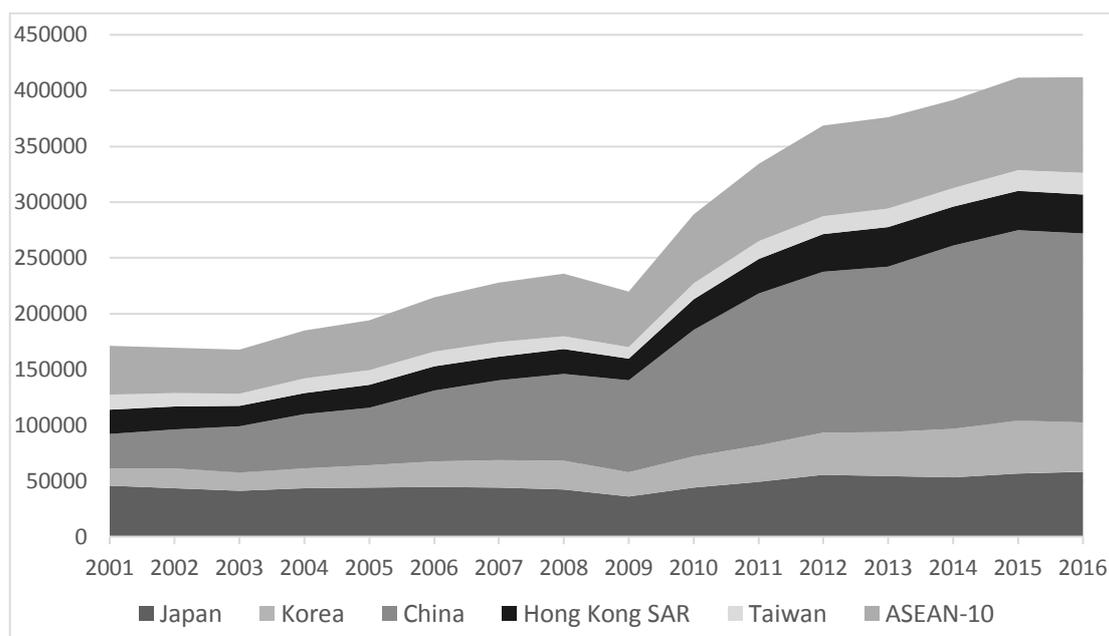
<sup>8</sup> Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.

dynamically growing consumption, the EA-15 economies have become an attractive demand markets on a global scale. In the EU's trade strategy "Global Europe", presented in 2006, the European Commission highlighted that securing unrestricted access for EU products and investments to the Asian markets would be one of the most important challenges and prerequisites for more balanced trade and economic relations of the EU with Asia.

In the years 2001-2016 total EU exports to EA-15 increased from 171.3 bn EUR to 412.0 bn EUR (graph 2, tab. 4). In the consequence the share of EA-15 economies in total extra-EU exports has grown in the analysed timeframe from 19.5% to 23.6%. From the graph 2 it is distinctly noticeable that the exports growth accelerated after the economic crisis of 2008/2009. While in 2001-2008 average annual growth rate of EU exports to EA-15 amounted to 4.7%, it increased to 12.2% per year in 2009-2013. Even over the last years (2014-2016) the EU's exports to EA-15 increased by 2.6% annually despite the general decrease in global trade flows.

The EU's exports expansion to East and Southeast Asian countries has been especially noticeable in the case of China and some ASEAN members: Myanmar, Cambodia, Vietnam and Laos. As for China the annual export growth rate amounted to 14.3% in 2001-2008 and 16.6% in 2009-2013. EU exports to China increased even in 2014-2016 (by 1.6% per year) while the Chinese imports at the same time dropped by 10% annually. This suggests the strengthening of the position of EU exporters at the Chinese market. The potential of Chinese demand market and dynamic growth of EU exports since the beginning of the century has given to China the second position (after US) among the most important export markets for the EU countries. In 2001-2016 China's share in total extra-EU exports increased from 3.5% to 9.7%, making (since 2003) the country the most important export market for the EU in the region.

**Graph 2. EU exports to the EA-15 economies in 2001-2016 (mio EUR).**



Source: own calculations on (Eurostat/Comext 2017).

Regarding the mentioned ASEAN countries the EU's export growth has also been very dynamic, but in this case the trade volume is still very modest (especially Myanmar and Cambodia) and the impressive annual growth rates are to a large degree a statistical effect of relatively low trade volumes at the beginning of the analysed period. The countries' share in total extra-EU exports is still inconsiderable (only 0.03% and 0.04% respectively, 2016). When it comes to Vietnam, the country has achieved a strong growth in imports from the EU in the analysed timeframe which has been accelerated over the last years (the average annual growth rates for Vietnam amounted to 9.0% in 2001-2008, 18.3% in 2009-2013 and almost 23.0% in 2014-2016). The number of the Vietnamese population, forecasted economic growth in the forthcoming years and the concluded free trade agreement with the EU make Vietnam a highly promising market for European exporters for future.

As for other ASEAN countries, the most important destination for EU exports in Southeast Asia is Singapore that accounts for 1.8% of global extra-EU exports. At the same time an erosion of Thailand, Malaysia and the Philippines as export markets for European goods has been observed. Although the nominal value of exports has increased, EU exports to those countries has grown slower than the global exports to the EA-15.

The same also applies to developed economies of the region, namely Hong Kong SAR and Taiwan. In both cases the EU's exports grew below the average for global exports (only by 3.2% and 2.3% respectively) and the position of the partners in the total EU exports has decreased to 2.0% for Hong Kong SAR and 1.1% for Taiwan. However, some acceleration (especially in the case of Taiwan) in the second decade of the analysed period has also been noticed.

The EU has also recorded high growth rates in exports to South Korea – an average annual growth rate in 2001-2016 amounted to almost 7.1%. In consequence Korea has become one of the most important and dynamically developing market for European exporters among Asian countries. The tremendous growth (by 10.7% per year) was recorded in 2009-2013. As the free trade agreement between the European Union and South Korea entered into force in July 2011, European exporters started to benefit from more liberalised access to traditionally restrictive Korean market. It is also worth noting that the dynamic growth in EU exports to South Korea over the last decade has resulted in structural changes in bilateral trade flows. While in the first decade of the century the EU recorded a deficit in trade with Korea (with peak values between 12.8 and 18.1 bn EUR in 2004-2008), since 2013 the value of EU's exports exceeded imports resulting in trade surplus in favour of the EU.

The last two decades have also witnessed the erosion of Japan as an important export market for the EU. As the EU's exports growth to the country has been modest (only 1.6% per year), Japan has lost its position of a leading client of European exports which it yet had in 2001. In 2001-2016 Japan's share in total extra-EU exports decreased from 5.2% to 3.3%. Japanese share in total EU external exports is currently only a half of the values recorded two decades ago. Despite disappointing dynamics of EU exports to Japan, it should also be highlighted that after the economic crisis of 2008/2009 the EU has recorded more balanced trade with this country – the EU trade deficit with Japan decreased from the highest value of 35.5 bn EUR in 2007 to only 8.5 bn EUR in 2016.

However, it has resulted more from decreasing EU imports from Japan rather than from the modest growth of EU exports. Japan still remains a relatively closed country with many – mainly non-tariff – barriers impeding the full use of the potential of highly developed and populated Japanese market.

Although the EU has recorded a strong growth in exports to many EA-15 countries, European exporters do not fully utilise the potential and growth of the region's economies. Although in 2001-2016 the EU's exports to East and Southeast Asia increased in nominal values, still the region's share in extra-EU exports is much lower than compared share for imports. This relative imbalance and the inadequate presence of EU exporters at EA-15 markets is also perceivable from the trade intensity index<sup>9</sup>, presented at the graph 3. In the analysed timeframe the index value for all EA-15 economies<sup>10</sup> was below 1, which means that the EU exports to the region's countries was smaller than would be expected on the basis of the importance of partners in world trade. Only South Korea and China, that have recorded high growth in imports from the EU in the analysed period, were close to 1<sup>11</sup> and experienced a trend of growing index. This means that in both countries EU's export is almost equal to the expected value on the basis of the partner country's importance in world trade. In the case of other EA-15 economies the index is below 1 with tendency to decrease (for HK SAR, Taiwan and ASEAN) over last years.

As far as the structure of EU exports to EA-15 countries is concerned almost half of the exports in 2016 were classified under machinery and transport equipment (49.1%), followed by chemicals and related products (15.4%), miscellaneous manufactured articles (12.6%), manufactured goods classified chiefly by material (8.4%) and food and live animals (5.2%). When compared to EU imports from East and Southeast Asian countries, there is perceivably higher share of chemicals and related products as well as food and live animals in the EU's export. This is the aftermath of the EU's leading position in global trade system as the biggest world's exporter of chemicals, pharmaceuticals (1/3 of total world's exports) and the second global supplier of agricultural products (WTO 2016). Although the lion's share of European export to EA-15 still makes machinery and transport equipment, especially exports of foods have developed over recent years (in 2001-2016 an average export growth rate in the section amounted to 8.8%). In 2016 China, Japan and Hong Kong SAR were among ten most important clients of European exports of agricultural products (respectively 8%, 4% and 3% of total EU's exports), animal products (17%, 8%, 5% + South Korea with a share of 4%) and foodstuff (7%, 4%, 3%) (Eurostat 2017). Further liberalisation of trade in agricultural and food products has been highlighted as one of the priorities during the ongoing bilateral talks on FTAs with some of EA-15 economies as those markets -

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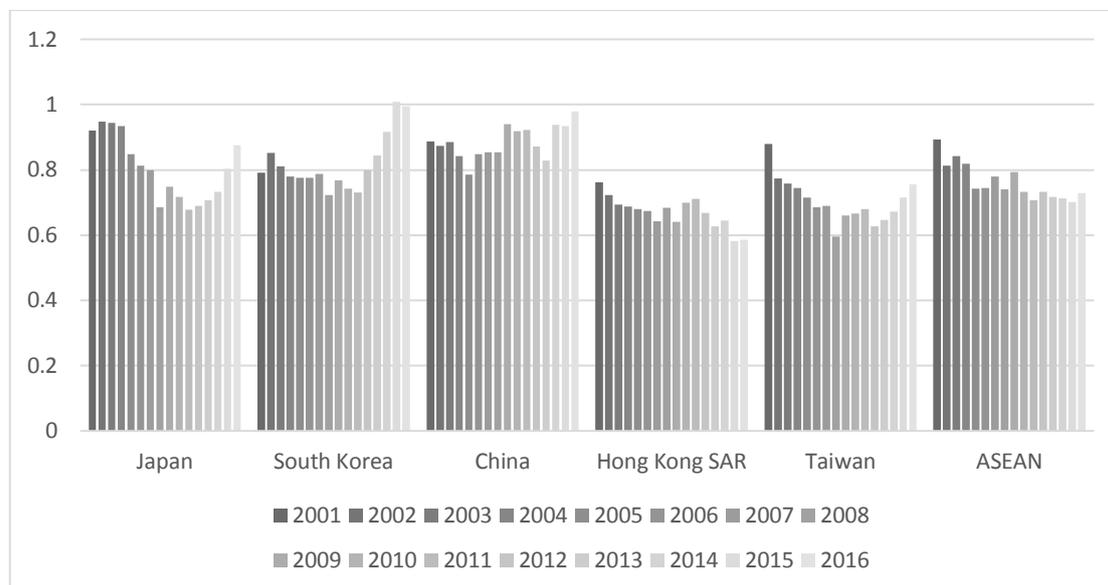
<sup>9</sup> The trade intensity index is used to determine whether the value of trade between two countries is greater or smaller than would be expected on the basis of their importance in world trade. It is defined as the share of one country's exports going to a partner divided by the share of world exports going to the partner. An index of more (less) than 1 indicates a bilateral trade flow that is larger (smaller) than expected, given the partner country's importance in world trade (WITS 2017).

<sup>10</sup> ASEAN countries calculated together as a single entity.

<sup>11</sup> In 2015 trade intensity index reached 1 for South Korea.

due to their size, dynamic economic growth and booming consumption - are attractive destination for EU exporters.

### Graph 3. EU Trade Intensity Index with the EA-15 economies in 2001-2016



Source: own calculations on (Eurostat/Comext 2017, WTO 2017)

Similarly as in the case of imports, the EU's exports to EA-15 is highly dominated by the EU biggest global exporters. Germany is the biggest supplier to all economies of the region<sup>12</sup> with a share of 36.5% of total EU exports in 2016 (in exports to China Germany accounts to 45.3%, for South Korea and Taiwan it is 39.4% and 39.8% respectively). The predominance of Germany in EU exports to East and Southeast Asia over next EU exporters is huge. Following positions are occupied by France (11.8%), the UK (11.4%), Italy (8.6%) and the Netherlands (8.1%).

## CONCLUSIONS

The first two decades of the 21<sup>st</sup> century have brought an enormous growth of Asian economies and their importance in global trade and economic system. The economic processes developing in East and Southeast Asia (EA-15) have created new conditions and changed the economic environment not only within the region, but also have strongly influenced production and trade patterns at the world scale. On the one hand emerging markets with their attractive conditions for locating investments and production, with abundant cheap labour workforce and growing competitiveness in many economic sectors have brought a new competition pressure to economies in other world's regions. On the other hand those markets, with huge populations, growing incomes and purchasing power have become an attractive and prospective demand markets for producers and exporters around the world. In this context 'growing Asia'

<sup>12</sup> Except Hong Kong SAR for which the biggest supplier of goods is the United Kingdom.

has become the biggest challenge for the EU's Common Commercial Policy in the 21st century.

The analysed timeframe has witnessed dynamic changes in trade between the EU and the EA-15 economies with total imports and exports more than doubled. In some cases – especially China and some less developed ASEAN countries - the trade volume has even multiplied. The traditional imports from developed economies of the region (e.g. Japan) have been replaced with new suppliers from China, and over the recent years also from developing Southeast Asian countries. The most influential factors creating new trade patterns with EU countries were: firstly growing economic potential of China and secondly changing trade and production networks within the EA-15 economies, including the development and proliferation of intraregional value chains. It is also noticeable that imports' growth pace has slowed down after the economic crisis of 2008/2009. The reasons for that might be listed as: relatively modest economic growth and consumer demand in EU countries, growing interest of many EA-15 economies in export expansion to other markets (e.g. Africa, India, South America) as well as shift more towards domestic consumption. For the EU the dynamic growth of imports has also resulted in the huge imbalance in trade with many EA-15 economies, although over the recent years the situation started to improve due to relative stabilisation of imports and expanding EU exports (mainly for developed economies such as South Korea, Japan, Taiwan and Singapore).

As mentioned growing EA-15 economies have also created new business opportunities for European exports that increased in the analysed period relatively stronger than imports. EU exports to many EA-15 economies have grown over recent two decades faster than the global EU exports - with China, developing countries of ASEAN and South Korea as leading destinations for EU export expansion. However, the dynamic growth of exports to the mentioned economies does not mean that the EU companies have fully utilised the opportunities of emerging Asian markets. Bilateral trade is still highly imbalanced for the EU, and in many sectors access to Asian markets remains restricted. Moreover, many of the region's countries have joined intra- and interregional free trade agreements, granting trade preferences to other countries and making the functioning of the EU business at their markets even more demanding and difficult.

Changes in trade patterns, expanding 'spaghetti bowl' of FTAs with and within the region of East and South East Asia and new plurilateral initiatives (such as RCEP or TPP) have induced the need of constructing a new framework for co-operation between the EU and EA-15. The EU joined the 'race for Asian markets' relatively late and the strategy of 'Global Europe' (2006), which presumed to entwine the region's economies with the web of FTAs with the European Union, has been implementing slowly (Khandekar 2013). Until now only one agreement - with South Korea - was signed and entered into force (2011); two others (with Singapore and Vietnam) have been concluded and are under ratification. There are also ongoing negotiations with Japan and 4 ASEAN countries (Malaysia, Thailand, the Philippines and Indonesia), but the conclusion and final shape of those FTAs are still difficult to predict. The great unknown is also the future framework of co-operation with China. All these elements visualise an utmost need of coherent long-term EU strategy towards EA-15 economies, taking into consideration dynamic developments in Asia and potential future trade framework (FTAs) with and within the region.

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