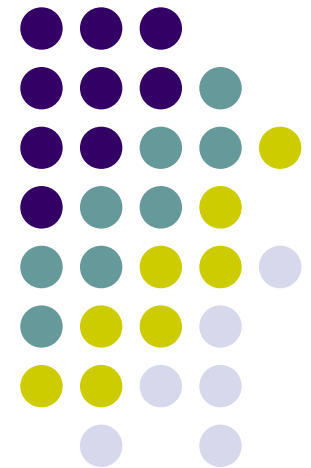


An EU-Asian FTA?

Economic and Policy Considerations

Michael G. Plummer,
The Johns Hopkins University,
SAIS-BO, and
East-West Center

Presented to:
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Goal of Paper

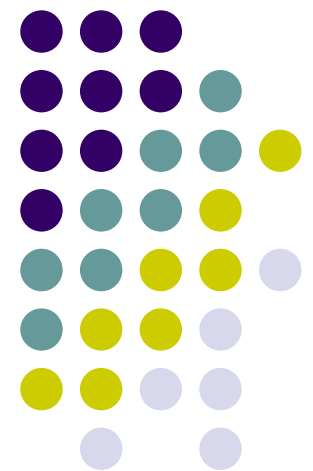
- Regionalism in East Asia has gained significant momentum
- This regionalism has been open, both in terms of its approach and its membership (e.g., to include non-regional partners)
- The EU has been conspicuously absent in this process
- This paper considers the economics of engagement and the costs of disengagement



Outline of Presentation

- I. The EU-Asian Economic Relationship
- II. EU and Asian integration: Lessons and Possibilities
- III. Economic Effects of Various EU-Asia configurations
- IV. Concluding Remarks

I. The EU-Asia Economic Relationship

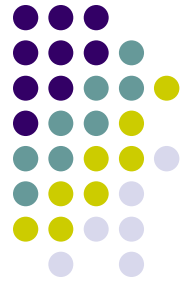




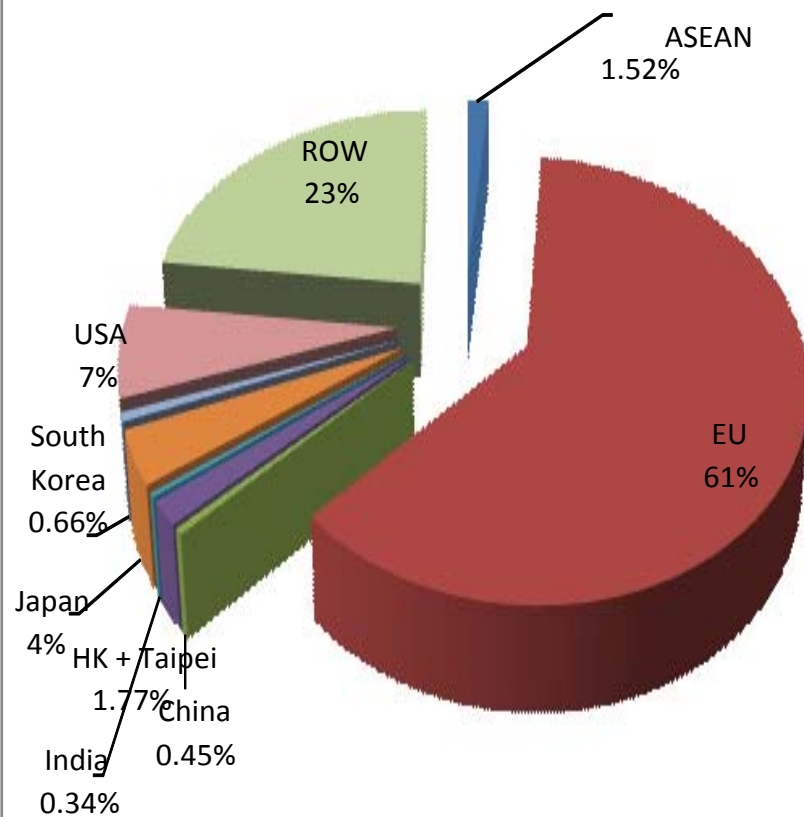
Data Review

- Intra-EU trade and investment obviously have a regional bias. This is after a half-century of discriminatory policies in its favor (beginning with EPU), as well as other “gravity” factors.
- Intra-Asian trade and investment have been growing rapidly but it has been market-driven, rather than top-down (as discussed in earlier sessions and ADB 2008).
- Still the EU and Asia represent key and growing markets for each other. Asia is becoming more important to the EU, and the EU as an export market has been rising (slightly).
- For Asia, the quality as well as the quantity of trade flows matter: disaggregation is important!

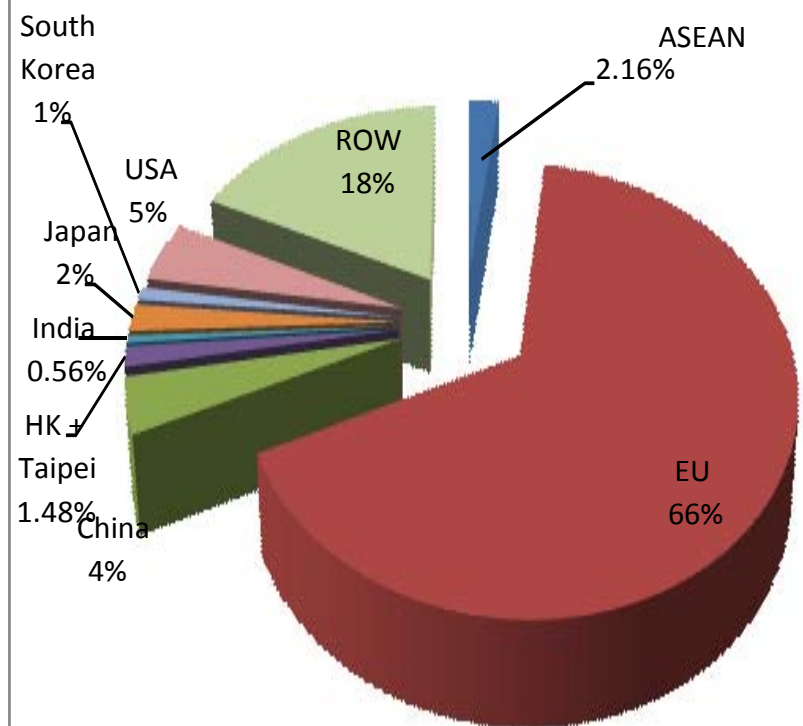
EU Direction of Trade, 1990 and 2006



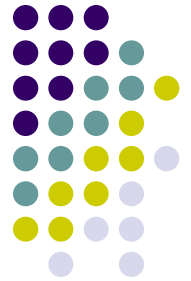
Exports, 1990



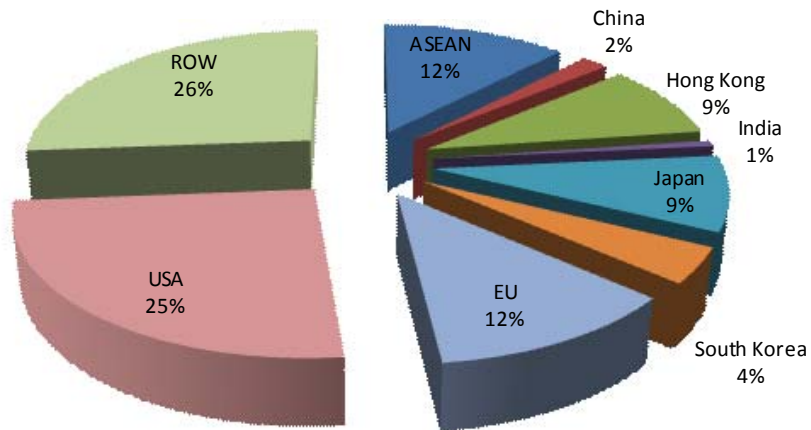
Exports, 2006



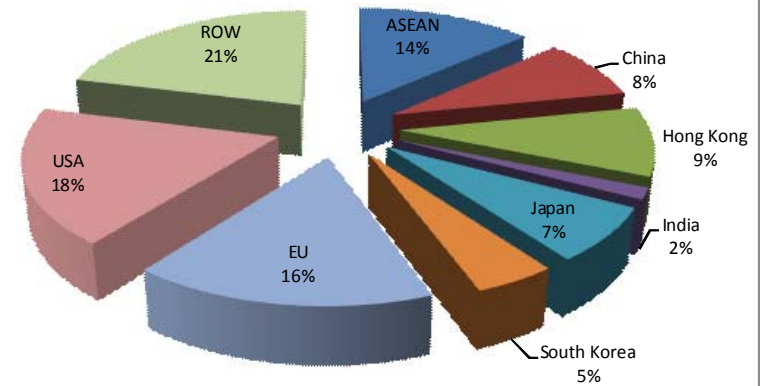
Asian Exports to Selected Countries, 1990 and 2006



Exports, 1990



Exports, 2006



EU Exports to Major Asian Markets, 2006

(by 1-digit SITC)



Exports to:	World	ASEAN	China	India	Japan	South Korea
Product Category	(As Percentage of Total Exports)					
Food and live animals chiefly for food	3.37	2.88	0.97	0.84	5.38	2.93
Beverages and tobacco	1.55	1.65	0.41	0.25	2.77	1.32
Crude materials, inedible, except fuels	2.15	1.80	7.55	3.66	3.21	2.67
Mineral fuels, lubricants and related materials	4.87	2.40	0.39	0.80	0.34	0.22
Animal and vegetable oils, fats and waxes	0.22	0.09	0.05	0.05	0.35	0.36
Chemicals and related products, nes	14.66	12.58	8.49	8.37	20.01	15.35
Manufactured goods classified chiefly by materials	14.58	11.47	13.02	34.19	9.79	11.95
Machinery and transport equipment	42.73	54.97	58.82	41.63	34.67	44.21
Miscellaneous manufactured articles	11.39	8.50	6.33	6.66	20.13	17.13
Commodities and transactions not classified elsewhere	4.49	3.67	3.98	3.54	3.34	3.87
Total (US\$ Billion)	1,534.28	60.55	79.29	30.23	55.26	28.32

Direction of Asian Exports to Major Markets by Sector, 2006 (by 1-digit SITC)



Exports to:	World	ASEAN	China	Hong Kong	India	Japan	South Korea	EU	USA	ROW
Product Category	(As Percentage of Total Exports)									
Food and live animals chiefly for food	2.64	2.78	1.14	1.32	0.74	6.86	3.06	2.27	2.08	3.09
Beverages and tobacco	0.20	0.54	0.10	0.28	0.04	0.21	0.07	0.09	0.04	0.23
Crude materials, inedible, except fuels	2.05	1.45	6.68	0.40	3.93	4.42	3.86	1.75	0.82	1.29
Mineral fuels, lubricants and related materials	6.16	12.43	6.29	4.20	13.45	13.88	10.88	1.28	1.75	6.41
Animal and vegetable oils, fats and waxes	0.55	0.50	1.17	0.04	3.22	0.22	0.15	0.66	0.17	0.83
Chemicals and related products, nes	7.14	8.43	14.08	4.45	12.96	5.20	11.33	6.33	4.23	7.27
Manufactured goods classified chiefly by materials	14.11	15.25	12.43	12.70	16.93	13.17	21.31	11.87	11.01	17.67
Machinery and transport equipment	50.54	49.21	48.00	59.31	42.46	35.82	36.63	54.68	58.62	46.86
Miscellaneous manufactured articles	14.57	6.69	7.82	15.29	5.16	19.32	10.90	19.15	19.87	13.64
Commodities and transactions not classified elsewhere in the SITC	2.05	2.72	2.30	2.02	1.10	0.90	1.80	1.92	1.41	2.71
Total (US\$ Billion)	2,825.96	380.20	236.80	263.72	43.19	203.89	125.62	457.60	518.97	595.98

Similarity of EU Exports to Asia



Table 3 :Correlations of EU Exports to Asian Economies

(Spearman Rank Correlation Coefficients)

	China	Indo	Japan	Korea	Malaysia	Phil	India	Sing	Viet	Thai
China	1									
Indonesia	0,658	1								
Japan	0,6223	0,494	1							
Korea	0,7515	0,588	0,728	1						
Malaysia	0,6834	0,673	0,569	0,6569	1					
Philippines	0,5839	0,593	0,51	0,5843	0,6245	1				
India	0,7828	0,664	0,539	0,6641	0,6693	0,541	1			
Singapore	0,6838	0,583	0,622	0,6888	0,7042	0,585	0,6	1		
Vietnam	0,5996	0,606	0,421	0,5214	0,5555	0,555	0,6	0,48	1	
Thailand	0,7237	0,695	0,594	0,6682	0,7023	0,639	0,7	0,64	0,63	1
World	0,774	0,661	0,731	0,772	0,7326	0,63	0,7	0,75	0,6	0,722

Note: All observations are included if data are recorded for both countries

Changing Commercial Policies



- The EU and Asia have been reducing external barriers to trade significantly, though the extent depends on the sector.
- We noted above that electronics is the key trade sector between EU and Asia; barriers in this sector are particularly low.
- Still, many tariff spikes and problems in agriculture across the region. Also, there are relatively high tariffs on SITC 7 in certain Asia countries.
- Hence, the potential for trade expansion is large in certain sectors, even if averages are low (note: a problem with the CGE modelling we'll review!).
- Also, non-tariff related issues are significant (why else would electronics MNCs be so keen on integration?).

Foreign Direct Investment



- The EU is a major investor in Asia
- Arguably, however it has not been able to create value chains as effectively as the US, JPN in the region.
- This constitutes another incentive for the EU to work on modern FTAs with the region.
- Asia seeks as much FDI as it can get from the OECD, and hence would welcome this as well.
- Asian MNCs have also been expanding their global presence and have a strong interest in this.
- FDI is an obvious area where the EU and Asia (or at least East Asia) can potentially bridge developed-developing divides in international fora).



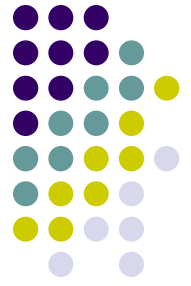
World Shares of FDI Inflows to ASEAN and Selected Other Countries and Regions (Percentage of Total World FDI Inflows)

Year Host	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	% of Cumul. Total (1995- 2006)
United States	17.16	21.50	21.13	24.59	25.79	22.25	19.15	11.97	9.42	18.30	10.68	13.43	18.16
EU 25	38.34	31.78	29.11	39.62	45.74	49.26	45.83	49.41	45.51	27.52	51.43	40.66	42.77
Japan	0.01	0.06	0.66	0.45	1.16	0.59	0.75	1.49	1.12	1.05	0.29	-0.50	0.57
China	10.95	10.62	9.25	6.41	3.67	2.88	5.63	8.48	9.49	8.17	7.66	5.32	6.41
South Korea	0.36	0.51	0.54	0.72	0.90	0.64	0.50	0.55	0.78	1.21	0.75	0.38	0.66
East Asia	13.59	14.28	12.64	9.24	7.07	8.26	9.50	10.88	12.88	14.33	12.29	9.63	10.49
ASEAN	8.22	7.76	7.01	3.14	2.62	1.67	2.48	2.90	4.34	4.75	4.34	3.94	3.79
World (US\$billion)	343	393	489	709	1,099	1,411	833	622	564	742	946	1,306	9,457

FDI Flows to ASEAN Countries by Source

HOST SOURCE	Brunei	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Singapore	Thailand	Vietnam	Total Cumulative 1995-2006 *
Japan	414	3.369	20	8.936	120	3.243	16.301	20.099	2.765	55.266
USA	90	1.972	6	13.643	406	3.461	23.303	6.397	915	50.192
Canada	14	113	3	378	62	8	1.232	518	48	2.376
European Union	6.990	7.823	189	11.427	1.887	1.795	58.294	9.809	3.737	101.951
France	139	983	167	355	729	276	2.805	763	1.084	7.301
Germany	20	1.210	1	4.187	9	-291	-684	2.060	82	6.594
Netherlands	2.637	4.308	0	1.642	8	627	20.218	453	1.519	31.412
United Kingdom	4.178	1.238	9	3.741	1.137	847	29.554	5.270	864	46.837
China	8	873	42	114	197	306	967	46	294	2.847
ANIEs	77	1.240	124	2.818	302	1.152	7.050	5.636	5.481	23.881
Korea	39	1.040	111	196	56	245	1.092	500	1.785	5.065
Hong Kong	33	162	2	1.895	247	699	1.693	3.638	1.476	9.844
Taiwan (ROC)	5	38	10	728	0	207	4.265	1.497	2.220	8.972
ASEAN	1.429	4.428	281	9.030	1.051	1.247	9.401	7.778	3.254	37.900
Brunei Darussalam		-28	0	298	0	0	218	11	3	502
Cambodia	0	0	0	3	0	0	6	18	1	28
Indonesia	57		0	280	41	39	4.092	54	61	4.625
Lao PDR	0	0		0	0	0	1	-1	12	12
Malaysia	240	1.344	97		57	88	4.536	470	612	7.445
Myanmar	0	0	0	0		0	100	3	0	104
Philippines	5	13	0	97	4		273	234	49	675
Singapore	1.119	2.955	6	8.097	750	1.116		6.983	2.000	23.026
Thailand	8	144	168	215	198	4	142		517	1.396
Vietnam	0	0	9	38	0	0	33	6		86

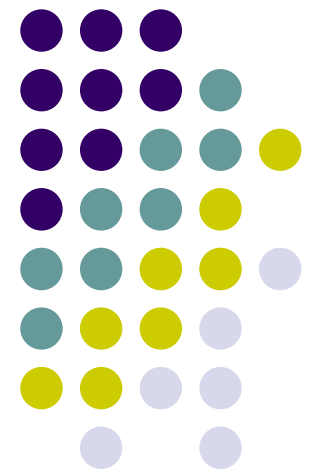




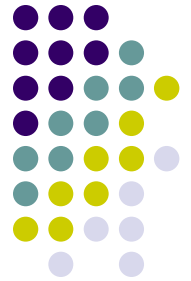
Potential for FDI

- While FDI restrictions in developing Asian countries tend to be low in manufactures, they are high particularly in certain Asian services sectors. These hinder potential.
- A modern FTA, for example, would include such restrictions as priority areas.
- Problem: National treatment versus best practices in these arrangements.

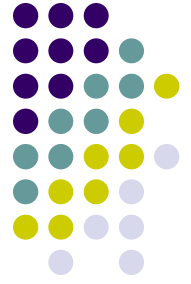
II. EU and Asian integration: Lessons and Possibilities



Comparative context of integration



- I. The comparative context of integration in the EU and Asia: Lessons all the way 'round.
 - The Political Economy of EU Integration:
 - a. Evolution: strategic, political, economic
 - b. Top-down approach.
 - c. Relatively shallow until SMP; since then deep (subsidiarity, sovereignty issues, importance of institutional development).
 - d. Role of Outside forces: USSR, USA: positive.



Asian Integration

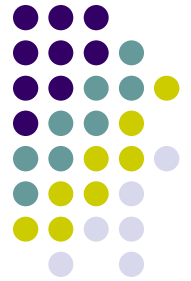
- The political economy of Asian integration:
 - a. Market-led (see ADB/EAR)
 - b. Early stages for evaluation, but some modern bilaterals and AEC, for example, seek deep integration.
 - c. Institutional development is a big challenge, perhaps endogenous to market-led approach.
 - d. Role of outside forces: positive and negative.



Lessons for EU, Asia

- Lessons are many from both experiences, I would argue. Importantly:
 - a. EU teaches the need for institutional development and deep integration.
 - b. Also teaches (negatively) perils of top-down approach that focuses merely on national treatment and subsidiarity, rather than best practices.
 - c. Asia stresses importance of market-led, open integration.
 - d. It also underscores necessary primacy of best practices. A non-binding commitment?

Asia, EU integration and TD?



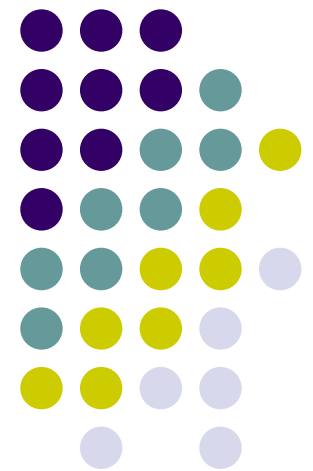
- Given its open nature, the EU has little to fear from any Fortress Asia. But we would argue that it has much to fear from being left out of the process (missing link in analysis: disaggregated estimates).
- The effect of European widening and new arrangements (neighborhood policy, EPAs) will be mixed. major negatives have already been absorbed... Indeed, even the SMP may have had a negative effect on Asian trade.
- new arrangements could potentially be positive.

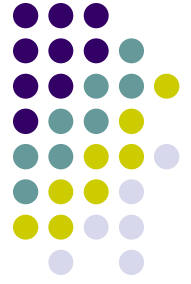


What kind of EU-Asia Accords?

- As suggested by theory, and underscored by such studies as Kawai and Wignaraja (2008) and other empirical work, in general wider arrangements are better than smaller ones. Hence, perhaps ASEM would be optimal unit?
- However, ASEM is not a negotiating forum; its agenda is not primarily economic. It now has 45 partners (incl. ASEC).
- And given the diversity that exists in Asia, such an ASEM FTA would be based on common-denominator approach and would be shallow (like an FTAAP).
- We are seeing this in ASEAN+1 arrangements (including the ASEAN-India, ASEAN-A/NZ accords last month).
- From this (economic) perspective, bilaterals would seem best and easiest, but could lead to noodle-bowl issues.
- Again, this underscores the need for best practices template.
- P4 Model? US is thinking about it....

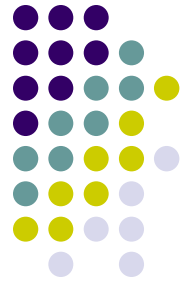
III. Economic Effects of Various EU-Asia configurations





Empirical Estimates: EU-SK

- Last but not least, it is useful to note the economic stakes involved in various EU-Asia accords and the implications of Asian integration for the EU. Some modelling work is out there, almost exclusively CGE-based.
- We don't have time to go into the characteristics of these models, but fortunately they are very familiar to this group.
 - a. EU-SK (Francois 2007): 3 scenarios; Real income rises from 0.1% (parital) to 0.5% (full) in EU; in Korea, respectively 0.6% to 2.5%). In sum, very small effect (for example, €2-€4 billion for EU).



Empirical Estimates: EU-India

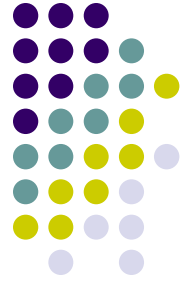
- b. EU-India (Decreux and Mitaritonna 2007):
 - i. As in Korea case, scenarios a function of inclusion of services.
 - ii. EU trade with India is so small (0.4 percent of GDP) that aggregate gains would have to be small.
 - iii. Indeed they are in best case (25% cut in serv protect): 0.04% for India; 0.028 for EU.

Empirical Estimates: EU-ASEAN



c. EU-ASEAN:

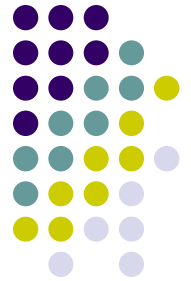
i. CEPII (May 2006): Full lib of trade; 50% of services (note: FDI is also in model). Effect on ASEAN: 2% of GDP. Like EU-SK case, gains mainly due to services. EU gains 0.1%. Again, extremely small.



Empirical Estimates, con'd

- d. Foquin (2006): Asian integration and its effects on the EU.
 - i. As in case of other studies, various scenarios, including different degrees of liberalization and either ASEAN “hub” or full Asian grouping.
 - ii. Ultimate effect on EU: negligible (given base).

Effects of Asian Integration on the EU: Status quo accords, A+3, FTAAP



Impact of 4 Commercial Policy Scenarios
Plummer and Wignaraja (2007)
 (Real Income based on Equivalent Variation and expressed as % of GDP)

	(1) Fragmentation Scenario	(2) ASEAN+3 FTA	(3) FTAAP (APEC)	(4) Global Free Trade
ASEAN	1.72	2.02	1.62	2.20
NortheastAsia	-0.02	0.37	0.96	1.23
Rest of Asia	-0.01	-0.06	-0.22	0.61
USA	-0.01	-0.02	0.12	0.24
Europe	-0.01	-0.01	-0.04	0.30
ROW	-0.01	-0.01	0.01	0.34
World	0.01	0.09	0.25	0.51

Effects of ASEAN+3 and ASEAN+6 on EU



Welfare Effects of ASEAN+6 and ASEAN+3 FTAs
(Lee and van der Mensbrugge 2008, percent changes)

A. ASEAN+3

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
China	0.9	0.76	2.58	4.68
Japan	0.13	0.32	0.35	0.77
Korea	0.74	1.40	1.64	3.05
ASEAN	0.32	1.69	1.71	4.81
India	-0.7	-0.10	-0.09	-0.14
US	-0.02	-0.03	-0.02	-0.02
EU-15	-0.02	-0.03	-0.01	-0.01
New EU members	-0.01	-0.01	-0.00	0.03
East Asia	0.17	0.65	1.21	2.46
World	0.03	0.13	0.26	0.55

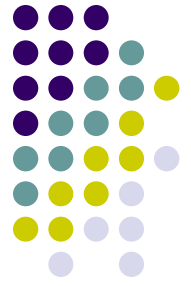
B. ASEAN+6

China	0.43	0.70	2.42	4.51
Japan	0.21	0.30	0.31	0.79
Korea	1.06	1.32	1.55	3.00
ASEAN	1.45	1.95	2.01	5.32
India	-0.34	-0.03	0.73	1.56
US	-0.03	-0.03	-0.03	-0.02
EU-15	-0.03	-0.04	-0.02	-0.02
New EU member	-0.01	-0.02	-0.01	0.04
East Asia	0.45	0.64	1.17	2.47
World	0.09	0.15	0.28	0.62



Conclusions regarding CGE estimates

- In sum, economic effects of EU-Asia FTA configurations and Asian integration on the EU in the literature are estimated to be small or negligible in just about all cases.
- Temptation to see these results and conclude that the regionalism issue is over-emphasized and is political, not economic.
- We maintain that this is incorrect, in that:
 - a. There are downward-biases in the CGE approach, especially as it excludes key features of high-quality agreements.
 - b. We know from the political economy literature that trade policy is made at the sectoral level.
 - c. So it would be useful to complement these estimates with disaggregated estimates, which are more interesting to policymakers.



The disaggregated matching approach

- We use a “matching technique” (e.g., Kreinin and Plummer 1992) to identify the most important EU exports that will be potentially affected by Asian regionalism (and prospective accords with non-regional members, e.g., the US).
- Hypothesis: The higher the protection in Asian markets in products which are important to the EU, the greatest the potential for trade and investment diversion. Moreover, the more competition the EU faces in key product areas, the greater the potential for trade and investment diversion (due to greater elasticity of substitution).



Data

- We use 2007 EU exports at HS6 level to major Asian economies (except Vietnam, for which we didn't have recent tariff data).
- We first rank EU exports in order of importance (value) and match with tariffs in the various Asian markets.
- In text, we use a \$1 billion cut-off; in Appendix, we include top 50 exports to each market (about \$1 million).

Key EU27 2007 Exports to Asia and Protection, HS6, Value>US\$1 Billion (China, India, Japan)



<i>EU commodity exports to China (2006 tariff data)</i>		VALUE	TARIFF
1 880240	Aeroplanes & other aircraft	5.083,00	3
2 999999	Commodities not specified according to kind	3.692,00	NA*
3 870324	Vehicles of a cylinder capacity >3000cc	2.834,00	28
4 740400	Copper waste & scrap	2.266,00	1,5
5 870323	Vehicles for the transport of persons, 1500-3300cc	1.720,00	28
6 854231	Electronic integrated circuits	1.478,00	6,9*
7 847989	Other machines & mechanical appliances	1.050,00	0
<i>EU commodity exports to India (2006 tariff data)</i>			
1 710231	Diamonds, non-industrial, unworked	7.428,00	12,5
2 880240	Aeroplanes & other aircraft	2.578,00	3
3 999999	Commodities not specified according to kind	1.383,00	NA*
<i>EU commodity exports to Japan (2005 tariff data)</i>			
1 870323	Vehicles for the transport of persons, 1500-3300cc	3.381,00	0
2 300490	Medicaments	2.456,00	0
3 870324	Vehicles of a cylinder capacity >3000cc	2.099,00	0
4 999999	Commodities not specified according to kind	1.809,00	NA*

Key EU27 2007 Exports to Asia and Protection, HS6, Value>US\$1 Billion (Mal, Phil, SK, Sing)



	VALUE	TARIFF
<i>EU commodity exports to Malaysia (2001 tariff data)</i>		
1 854231 Electronic integrated circuits, processors & controllers	2.989,00	0,0*
<i>EU commodity exports to the Philippines (2007 tariff data)</i>		
1 854231 Electronic integrated circuits, processors & controllers	1.026,00	1,5*
<i>EU commodity exports to Korea (2007 tariff data)</i>		
1 999999 Commodities not specified according to kind	1.549,00	NA*
2 848620 Machines for the manufacture of semiconductor devices	1.367,00	1,5
<i>EU exports to Singapore (2007 tariff data)</i>		
1 854239 Other Electronic integrated circuits	1.243,00	0,0*
2 854232 Electronic integrated circuits, memories	1.202,00	0,0*
3 841191 Parts of the turbo-jets/turbo-propellers	1.147,00	0
4 271019 Petroleum oils & oils obtained from bituminous minerals	1.061,00	0



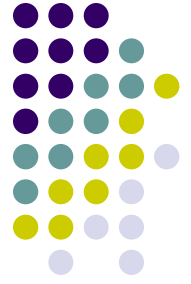
Interpreting Results...

- China shows most “revealed” potential for trade and investment diversion.
- Largest effects in aeroplanes, vehicles (for China, JPN, India).
- Auto exports to Malaysia don’t make the cut-off...but this could be due to 103% tariff!
- Electronics show up in most countries (esp. In ASEAN) but protection tends to be low.
- Pharmaceutical exports show up everywhere with \$1m cut-off: protection varies from 0-10% across Asia, so relatively low.



Trade Potential Exercise

- We noted above that Asian integration would have a small or negligible effect on EU (less than \$2 billion in Lee van der Mensbrugghe)
- Yet, if we just take vehicles exports (870323+870324), EU exports came to \$11 billion. Multiplied by applied tariff in the various markets and assuming an elasticity of substitution of unity, get trade diversion of \$1.5 billion...close to some of the entire CGE estimates for the EU.
- Political economy implications are evident!



Political economy of protection in the EU

- Note that political economy of protection is a bit odd in the EU (example: auto protection in US and the EU).
- However, we note that in most of these key exports, there is not only a wide-variety of competition in Asia, but also a wide-variety of EU exporters.
- France, Germany and the UK, the most influential in EU commercial policy, are affected the most in key products.



Conclusion on Empirical Estimates

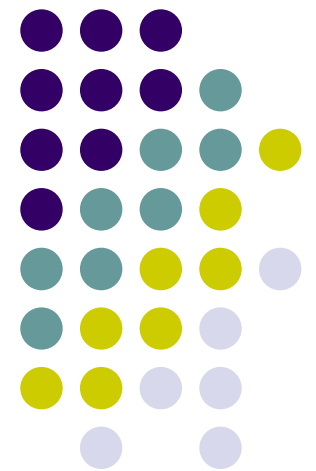
- The modelling results tend to be small and, of course, a function of the liberalization parameters.
- Modelling is becoming more sophisticated to include dynamic effects, but still are characterized by (likely) strong downward biases.
- In any event, the EU will not be positively affected by Asian arrangements. The incentive to cooperate is there, particularly given that certain key sectors are vulnerable to trade and investment diversion.



Beyond tariffs

- As a final note, I would suggest that there exists a less tangible but perhaps even more real danger faced by the EU due to Asian regionalism.
- Asian regionalism flows from the need to reduce transactions costs to MNC activity in the region. As it proceeds apace, it will create its own networks.
- Countries/regions that are excluded could see the “gravity” of economic interaction shift away from them. We might call this “preference exclusion”.
- This is a real risk to the EU (and one that the US, for example, has endogenized in its policymaking).

Concluding Remarks

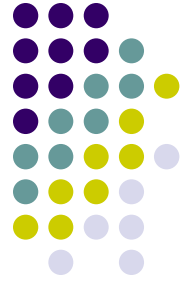


Economics of EU-Asian FTAs



1. The EU-Asian economic relationship is clearly important for both sides.
2. Barriers to this interaction sap trade and FDI potential.
3. EU and Asian economic integration programs will no doubt reinforce a “separation” trend due to trade and investment diversion, as well as “policy preferences” trend (e.g., Asian integration with itself, other OECD; EU with its economic enlargement and EPAs).

Benefits and Best Practices



4. While CGE results of EU-Asia are small, we suggest they are downward-biased. We also showed that certain EU exports will be particularly vulnerable to Asian integration without EU.
5. EU-Asian forms of FTAs would likely generate relatively large benefits to both sides (the dual: disengagement could lead to T&I diversion but also “preference exclusion”).
6. EU-Asian accords: more inclusive preferable to less inclusive, *ceteris paribus* (but, in my view, India may be a problem). But this would lead to weak agreements.
7. Still, the type of FTAs formed will be key. This brings us to “Best Practices”.