EU-ASEAN: Facing Economic Globalisation

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## Contents

### Introduction

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### A. Structural Change, Growth and Bazaar Effects in the Single EU Market

Paul J.J. Welfens and Dora Borbély

1. Introduction................................................................. 7
2. Theory of Structural Change, Innovation and Growth .......... 11
   2.1 Basic Dimensions of Structural Change ....................... 11
   2.2. A Global Perspective of Structural Change ................. 15
3. Empirical Analysis.......................................................... 16
   3.1. Selected Innovation Traits and Structural Change ....... 16
   3.2. The Bazaar-Effect.................................................... 28
   3.2. Net Bazaar Effect.................................................... 34
4. Policy Conclusions......................................................... 35
Appendix 1: NACE rev. 1.1. Classification (in parts).............. 41
References........................................................................ 42

### B. Political Cooperation Between the EU and ASEAN: Searching for a Long-Term Agenda and Joint Projects

Yeo Lay Hwee

1. Introduction..................................................................... 44
2. Thirty Years of ASEAN-EU Relations in a Nutshell ............. 44
3. The Changing Dynamics.................................................... 48
   3.2. EU at a Crossroads.................................................... 49
   3.3. ASEAN at a Crossroads.............................................. 51
   3.4. Political Cooperation – Searching for a Long-term Agenda ... 52
References........................................................................ 54

### C. The Trade and Aid Policy of the European Union: A Historical Perspective

Andrew J. Crozier

1. The Trade Policy of the European Union............................. 57
2. The Aid Policy of the European Union............................... 63
3. Trade and Aid in EU-ASEAN Relations............................. 66
References........................................................................ 69
D. The Process of Economic Integration in ASEAN+3: From Free Trade Area to Monetary Cooperation or Vice Versa? .......................... 71
Günter S. Heiduk and Zhu Yiping
1. Introduction ............................................................................................. 71
2. Experiences with Monetary Integration - The Case of the EU .......... 72
3. Integration Policy and Trade in ASEAN+3 .......................................... 74
4. Trade, Exchange Rates and Monetary Integration: Experiences in the EU and ASEAN+3 ................................................................. 79
   4.1. Interdependencies Between Intra-Regional Trade and Monetary Cooperation: Evidence From EU Experiences ...................... 79
   4.2. Trade and Exchange Rates in ASEAN+3 During and After the Asian Crisis ................................................................. 80
5. Present Currency Cooperation in ASEAN+3: Loose-Binding Contingency Plan ................................................................. 84
7. Conclusion ............................................................................................ 93
References ............................................................................................... 94

E. Financial Market Integration and Growth in the EU ......................... 96
Paul J. J. Welfens and Martin Keim
1. Introduction .......................................................................................... 96
2. Financial Market Integration in the EU ................................................ 100
   2.1. The Integration Process in the EU ............................................... 100
   2.2. The European Monetary Union ................................................. 102
   2.3. The Institutional Framework ..................................................... 104
   2.4. Financial Market Integration ...................................................... 111
   2.5. Effects of Financial Markets in the Euro Area ......................... 114
   2.6. Eastern EMU Enlargement ......................................................... 118
3. Theory of Financial Market Integration ............................................ 121
   3.1. From Basic Theory to Endogenous Growth Approaches ......... 121
   3.2. Monetary Integration, Financial Market Integration and Welfare Effects ............................................................. 125
4. Integration of Financial Markets in the Euro Zone and Global Dynamics ................................................................. 129
5. US Financial Market Crisis ................................................................. 130
6. Policy Conclusions ............................................................................. 133
References ............................................................................................... 135

F. Toward East Asian Economic Integration: Classification of the ASEAN+3 Economies Using Fuzzy Clustering Approach ............. 138
Noer Azam Achsani and Hermanto Siregar
1. Introduction ........................................................................................... 138
2. Classification of ASEAN+3: A Fuzzy Clustering Approach ............ 140
3. Empirical Results ................................................................................ 141
4. Policy Implications ............................................................................. 144
Appendix 1. Membership Values of Each Country as the Result of Fuzzy Classification into 3 Clusters. ...................................... 145
Appendix 2. Membership Values of Each Country as the Result of Fuzzy Classification into 4 Clusters. ...................................... 145
References ................................................................................................................. 146

G. Further Evidence of the Impact of Foreign Bank Presence in Thailand ................................................................................................. 147

Chantal Herberholz
1. Motivation ........................................................................................................ 147
2. Prior Research .................................................................................................... 148
3. Structure of the Thai Banking Sector ................................................................. 150
4. Methodology ...................................................................................................... 152
5. Data Sources and Descriptive Statistics ............................................................ 155
6. Estimation Results ............................................................................................ 159
   6.1 First Set of Regressions ........................................................................ 159
   6.2. Second Set of Regressions ................................................................. 163
7. Conclusion .......................................................................................................... 165
Appendices .............................................................................................................. 167
   A. 1 Number of Commercial Banks Incorporated in Thailand .................... 167
   A. 2 Ranking of Commercial Banks Incorporated in Thailand in Terms of Assets (as of 31 December 2004) .............................................. 167
   A. 3 Estimation Results: 1st Set of Regressions (panel I) .............................. 168
   A. 4 Estimation Results: 1st Set of Regressions (panel I) .............................. 169
   A. 5 Estimation Results: 2nd Set of Regressions (panel II) .......................... 170
   A. 6 Estimation Results: 2nd Set of Regressions (panel II) .......................... 171
References .............................................................................................................. 172

H. ASEAN & India: A Mutually Strengthening Paradigm/Vision ..........177

G.R. Krishnamurthy
1. ASEAN & India .............................................................................................. 177
2. India and ASEAN: A Business Vision ............................................................. 179
3. Singapore Model of Co-operation ................................................................... 180
4. ASEAN & India Summit .................................................................................. 181
5. ASEAN and China .......................................................................................... 183
6. Implications for ASEAN ................................................................................ 184
   6.1. What are the Business Implications of All These to ASEAN Countries? .................................................................................. 184
   6.2. Reasons for Chinas’ Leap in Exports ..................................................... 184
References .............................................................................................................. 185

I. The Outward Investment of China: Causes and Consequences ...........186

Sompop Manarungsan

J. Reflections on the EU Constitutional Crisis ..................................................... 189

Franz Knipping
IV Contents

K. European Community Law and WTO Regulations: The Direct Effect-Doctrine Revisited .......................................................................194
   Alexander Proelß
   1. The European Community as an Actor in International Trade Law.....195
   2. The Doctrine of Direct Effect in Community Law: Theoretical Basis and Practical Implications....................................................196
   3. Direct Effect of WTO Regulations......................................................199
   4. Conclusions .....................................................................................203
   Cases before the European Court of Justice ..............................................204
   References ...........................................................................................205

L. Outsourcing and Offshoring Strategies of Multinational Companies in Asia ..................................................................................206
   Norbert Koubek
   1. Offshoring Strategies as Market Entry Alternatives.........................206
   2. The Extent of Offshoring .................................................................208
   3. Concepts of Globalisation and Offshoring .......................................210
      3.1. The Triad Model and Globalisation ..........................................210
      3.2. Core Competencies and Offshoring .........................................211
      3.3. The Value Chain Concept and Offshoring ................................213
      3.4. The Relationship between Goods and Services, Commodities and Specialities, and Offshoring ............................................214
   4. Trends in Production and Service Offshoring ....................................215
   5. Empirical Evidence .........................................................................217
      5.1. Offshoring Destinations India and China...................................217
      5.2. Offshoring Destinations in the ASEAN Region .........................220
      5.3. Offshoring Destinations in the Triad Region ..............................221
   6. Conclusion .......................................................................................223
   References ...........................................................................................224

M. Regional Economic Integration, Mergers and FDI: Welfare and Policy Implications for ASEAN .............................................................226
   Toby Kendall and Cillian Ryan
   1. Introduction ......................................................................................226
   2. The Model .......................................................................................229
      2.1. Stage 3: The Final-Stage Output Game .....................................231
      2.2. Stage 1: The Choice between Merger, Greenfield FDI and Exporting: .................................................................232
   3. Tariffs and Regional Integration ..........................................................237
      3.1. Tariffs and Merger Activity ......................................................237
      3.2. Tariffs and Greenfield FDI .......................................................239
   4. Welfare and Policy Implications for ASEAN ....................................240
   5. Conclusions .....................................................................................244
   Appendix 1: Regional integration and mergers ......................................245
      Case A: Merger between home firms 1 and n ..................................245
      Case B: Merger between foreign firm 1 and home firm n ...............246
Introduction

Paul J.J. Welfens, Cillian Ryan, Suthiphand Chirathivat, and Franz Knipping

This volume, the outcome of the Jean Monnet sponsored project, EUROPEAN UNION and ASEAN: Historical Dimensions, Comparative Analysis and Politico-Economic Dynamics, seeks to enhance our understanding of the ASEAN and Asian Economies, and to study EU integration as a means of improving our understanding of potential developments in the ASEAN integration process. The previous volume focussed on a wide range of historical, political and social issues in addition to economics matters. This volume is more closely focused, with one or two exceptions, on economics issues with a range of both discursive and theoretical pieces (including the development of some new theoretical tools) to better understand regional economics integration.

The contribution by Welfens and Borbély takes a closer look at key issues of structural change and trade dynamics in the context of economic globalization and EU integration. The authors present fresh theoretical approaches and a battery of empirical material, which partly puts the focus on the issue of international outsourcing and offshoring. The analytical findings, based on input-output analysis, do not support the bazaar hypothesis according to which Germany's export dynamics reflect structural weaknesses. For example, the fact that the share of imported intermediate inputs in Germany's exports has increased largely reflects successful international specialization and a profitable global division of labour. Moreover, exports are also contained in imports, and with respect to major German trading partners, one may assume that the share of exported intermediate inputs in Germany's imports of goods and services has increased. As regards the specialization of selected EU countries - including countries from eastern Europe - and Asian countries, one can identify clear patterns on the EU15 market, which largely are in line with a modern interpretation of the Heckscher-Ohlin approach: Asian countries are often strongly specialized in labour intensive products. Only after some transition and modernization process does one find that China and selected ASEAN countries have established a comparative advantage in technology intensive goods and in science-intensive goods; export unit values have also improved in some fields over time for some countries. The considerable role of foreign direct investment inflows for such specialization dynamics is emphasized, and major policy conclusions are derived. For the EU, economic globalization has created many opportunities. However, there is also additional adjustment pressure in the wake of the US financial market crisis. With the US banking crisis unfolding and showing negative spillover effects, one should not rule out that the combination of the banking crisis and the impact of US policy intervention - e.g., expansionary monetary policy, which implies additional side-effects of much higher oil prices as well as a depreciation of the US dollar - will lead to new social conflicts in the context of enhanced redistribution conflicts at the national and international level; this could slow down structural change and Schumpeterian dynamics.
Whether globalization will be sustainable is still an open question, and there is no doubt that policymakers would be wise to organize the process of globalization in a consistent manner. Excessive financial globalization with inadequate regulation could undermine the long term benefits from globalization in the real sphere.

In order to place the ensuing analysis in its wider EC-ASEAN context Yeo Lay Hwee in Chapter 2 provides an account of the evolution of co-operation over the last 35 years. Hwee notes that global and particularly intra-regional distractions such as the compromise reform treaty to replace the ill-fated constitution and a return to nation-centred, non-interference policies in ASEAN due the situation in Myanmar may slow the development of a truly integrated long-term agenda. An alternative, optimistic, hypothesis might be that the two regions will look outwards to distract their members from internal tensions and to focus on their unity of purpose.

Andrew Crozier provides another perspective by examining the trade and aid policy of the European Union in Chapter 3, noting its key role in the development of the EEC and its roots in the realisation in the US, Britain and France in the late 1930s that an alternative to the post-depression retrenchment was a necessity. Crozier discusses both the internal development of the Single market and the EU’s approach to external trade and aid. Focussing specifically on the EU-ASEAN context he examines why trade and investment relations did not develop as quickly as expected between ASEAN and the EU. This conundrum is especially puzzling given that one of the motives for the development of ASEAN was to increase trade diversification and reduce its members’ dependence on Japan. Of course, the asymmetric nature of the relationship whereby the EU accounts for about 33% of ASEAN exports while ASEAN is still a relatively small market from a EU perspective (about 5%) is a part of the explanation, a problem ASEAN nations share with EU neighbourhood states when trying to claim a place on the EU agenda.

The next set of papers is concerned with lessons for closer cooperation within ASEAN itself drawing, in part on the EU experience. Günter S. Heiduk and Yiping Zhu in Chapter 4 examine the process of economic integration in ASEAN+3 and considers whether current and future integration policy should rely on free trade arrangements or concentrate on an integration strategy which gives priority to monetary cooperation. The conventional view is that regional integration policy should start with a free trade and free factor movement strategy. This fits with the hypothesis of the optimum-currency-area theory, which argues that monetary union is achieved when goods and factor markets are open and deeply integrated. Empirical studies on the interdependencies between integration in the real and in the monetary sector show that the development of intra-regional trade influences exchange rate stability, but also that a currency union has positive effects on trade and factor movements. To put the second hypothesis in an empirical context, regional integration policy must develop an optimum sequencing and timing of the steps towards monetary and real integration.

The integration concept of ASEAN+3 thus far has had a strong trade bias. Monetary cooperation continues to be relatively weak. However, the Asian crisis has shown that distortions in the monetary sector can significantly slow down
intra-regional integration in goods and capital markets even if trade barriers are continuously removed. The paper first argues that a stable and balanced integration by reducing tariff barriers between ASEAN and each of the three East Asian countries cannot be expected to occur because of the China-pull effect. Second, incentives for further integration of goods and capital markets especially among ASEAN countries could result from intensifying monetary integration. On the basis of trade data and correlations between macroeconomic indicators, the paper suggests that there should be closer monetary cooperation among an Asian core of Thailand, Singapore, Philippines, Indonesia, Malaysia, and China.

The second paper in this section considers the lessons which can be drawn from the EU Single-European market, and the liberalization of services including financial services, the EU27 enlargement, and the Euro in particular. Both the EU and ASEAN are facing economic globalization in the sense that there is a long run increase in the trade of financial services, in foreign direct investment in the banking and insurance sector and a growing influence from global international organizations such as the IMF and the Bank of International Settlements (BIS). Thus, drawing on a wide range of European data, in chapter 5 Welfens and Keim review the main developments in the EU and draw the key lessons for regions facing increased globalization. The authors also focus on the international banking crisis.

They note that if one considers the interdependencies of the overall economic system, it is not very realistic to expect major benefits from financial market integration if there are blockages to structural change in labour markets. The high unemployment rate in the Euro area represents a blocking factor in this respect. At the same time, they argue one should take into account that more integrated financial markets – in a period of global financial market liberalization as enshrined in GATS – could be subject to larger shocks and more extreme bubble problems than was previously the case. To the extent that stock market bubble problems are related to short-sighted speculations, it is worth considering strong tax incentives for long term investment while short-term yields could be taxed more heavily. Such a development is unlikely to happen unless OECD countries agree upon some joint framework in this respect.

In addition to arguing for employment and social security reforms the authors focus considerable attention to the impact of financial market liberalisation and the implications for state-owned savings banks in several member states, a problem also facing ASEAN members if they are to pursue the GATS in full. The GATS envisages that such banks, which are often crucial in mobilising local and SME savings and are major providers of start-up finance, should no longer earn privileged backing by government, since prevents the establishment of a level playing field with private banks. The authors are unconvinced as to the economic benefits of full compliance arguing that because such enterprises perform such a crucial quasi-social development role that governments should be allowed to preserve these institutions passing on the benefits of their triple-A ratings.

The chapter also considers issues which arise elsewhere in the volume such as the role of FDI (See also Chapters 12 and 13) and lessons from increased monetary integration relevant to the argument in Heiduk and Zhu above should the six Asian countries he identifies choose to pursue greater monetary cooperation.
In an alternative approach to Heiduk and Zhu to classifying ASEAN+3 countries, Achsani and Siregar in Chapter 6 utilizes Fuzzy Clustering to identify which countries are natural partners at similar stages of development. By studying a range of macroeconomic data based on the Maastricht criteria, and by essentially minimizing the variance or dissimilarity between members within a cluster, they show that the countries can be classified into five clusters. From a policy perspective, Singapore, Japan, Korea, and China can be seen as the leading economies in the region and the authors argue that in order for a single market to function effectively, these countries should consider limitations and bottlenecks faced by other countries within the region when taking initiatives.

The next set of chapters provides a series of reflections on Thailand, India and China in the ASEAN context. In chapter 7 on the impact of foreign banks on the Thai commercial banking sector, Chantal Herbolz notes that research has previously suggested that the relaxation of restrictions on foreign equity participation in locally incorporated banks led to increased efficiency in the sector. This chapter provides further analysis of the presumed benefits of opening up to foreign financial institutions, and the findings confirm a positive impact of foreign bank participation. The main finding is that increases in the asset share of foreign-owned banks incorporated in Thailand appear to have lowered net interest margins, personnel expenses (scaled by total assets) and return on assets in commercial banks incorporated in Thailand, which indicates that foreign entry has tended to increase competition and efficiency. The results further indicate that foreign bank participation has had an impact on both foreign-owned and domestically-owned banks incorporated in Thailand. Comparisons between domestically-owned and foreign-owned commercial banks incorporated in Thailand suggest that foreign-owned banks incorporated in Thailand have performed better in terms of net interest margins, non-interest income (scaled by total assets) and return on assets, while nevertheless incurring higher personnel expenses than their domestically-owned counterparts.

In a wide ranging discussion in Chapter 8, G.R. Krishnamurthy provides a contrasting analysis of Chinese and Indian engagement with ASEAN, the US and the EU. The chapter explores the role played by the dialogue partners in the ASEAN Regional Forum, the possible channels of co-operation between ASEAN and India (a knowledge-based giant in the region) and explores several future scenarios including the role the European Union and NAFTA may play with businesses located in ASEAN.

Focusing on China in Chapter 9, Sompop Manarungsan, examines the causes and consequences of Chinese outward investment as a result of the growth in its external reserves. The chapter highlights the growing competition between the US and China in several spheres (energy, finance and raw materials) as well as the consequences of growing Chinese expertise in R&D and brand and service development.

The next two chapters focus more directly on lessons from the EU. In Chapter 10 Franz Knipping builds on Hwee’s analysis in Chapter 2 and reflects on the EU constitutional crisis and its rejection by France and the Netherlands. He attempts to draw lessons from this experience for future development of the European pro-
ject, and in particular, the implications for the political leadership of the EU. In Chapter 11 Alexander Proeß examines the role of the European Community as the first international organization to join the WTO, and analyses the legal interaction between the laws of the Community as an organization on the one hand and international trade law on the other. In particular he investigates whether WTO regulations are capable of having a ‘direct effect’ on the Community’s legal order. He concludes that they do not, but that the European Community, when compared with other major economic members of the WTO, is not alone in this and hence it is not a function of the Community’s supranationality. However, he goes on to argue that the denial of the direct effect should not be overestimated and that in practice the European Court of Justice follows a rather trade-friendly approach. While it is difficult to draw direct comparisons with the ASEAN experience he nevertheless observes that the denial of the direct effect in the European Community does not result in legal uncertainty.

The final set of papers complements Manarungsan’s earlier analysis of China’s outward investment by focussing on Foreign Direct Investment (FDI) into the ASEAN region. In chapter 12 Koubek notes that Offshoring to Asia has become an important strategy for many western companies to enhance competitive advantage. However, the majority of analysis in the literature thus far has focused exclusively on a specific topic such as offshoring strategies or typical offshoring locations. Yet little has been written about the interrelation of strategic aspects and regional considerations on the one hand and adequate underlying theoretical aspects on the other. Thus, this chapter combines three different theoretical perspective, the TRIAD model, the core-competence concept and value-chain analysis to provide a comprehensive picture of today’s offshoring activities. Using a variety of indicators Koubek argues that offshoring leads to economic convergence and while western multi-national companies appear to be benefiting the most from such relocations, certain countries such as India and China are also benefiting significantly. However, the author argues that the ASEAN countries are also demonstrating high potential and are quickly catching up.

The final chapter observes that the most common form of FDI is not new ‘greenfield’ investment, but rather occurs in the form of mergers and acquisitions. Mergers have been notoriously difficult to explain in traditional economic theory, however, using recent theoretical developments in the theory of mergers and technology transfer Kendall and Ryan in Chapter 13 present a three-stage Cournot game in which foreign firms choose between exporting, FDI and acquiring a domestic firm as means of supplying the domestic market. The analysis discusses the welfare and policy implications of the new theory for ASEAN. They observe that reductions in intra-union tariffs associated with ASEAN is likely to favour foreign predators over (possibly) more efficient domestic-market leaders due to the external tariff-jumping motive, promoting the investment described in Koubek’s paper. Regional integration in this new theory results in both mergers and FDI becoming more profitable for the foreign firm, relative to exporting, and regional integration is thus likely to promote foreign ownership in the region. However, while such mergers are frequently portrayed as market concentrating, in this model, the beneficial effect of the technology transfer is pro-competitive and consumers in the
region will benefit. While likely consumer gains suggest that ASEAN competition policy towards acquisitions should generally be *laissez faire*, there may be a role either for supranational ASEAN or national regulation where a foreign firm has an incentive to outbid a more efficient domestic rival for a target firm in an ASEAN member state.

In providing this eclectic collection of essays from diverse Asian and European perspectives and from a range of academics and practitioners, we hope that the reader will gain an insight into the complexities of the challenges for the future facing the EU and ASEAN member states.

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