

Economic Perspectives of European Integration and Implications for Asia

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jointly organized by

The Vienna Institute for International Economic Studies (WIIW),
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Executive Summary

The **first Panel** of the conference focused on 'European integration versus regional economic co-operation in Asia'. From a political and institutional point of view, the most prominent signs of the recently accelerating dynamic of European integration were the completion of a truly single market and the introduction of the euro. The greatest challenge for the future is the (Eastern) enlargement of the Union¹ while at the same time increasing its efficiency and making its institutions more legitimate in the eyes of the European public. Although regional co-operation started much later in Asia and may not be dictated to the same degree by historic necessity as in the case of Europe after the war, the *functional approach* to integration, *progress in stages* and *differentiation* where required, could also offer some interesting insights for Asian countries, which have begun to intensify regional co-operation in the last few years.

The pending enlargement of the Union is a great economic challenge for the accession countries as well as the EU. The accession countries are at a significantly lower level of economic development and hope that EU membership will help them catch up faster. The existing members' economic advantages are less clear. However, calculations make it likely that economic growth will be more dynamic in an enlarged Union for the old members, too. Also, in global competition, division of labour between the high-tech specialized 'rich' old EU members and 'poor' new members supplying well-trained cheap labour may be helpful to strengthen Europe's position. But there are also fears on both sides: The old members are afraid of mass immigration of cheap labour and 'social dumping', namely unfair competition by firms from the new member countries through more relaxed environmental and other standards there. 'Selling out of agricultural land' and 'loss of national sovereignty' are the main concerns in the accession countries. There is also the question of 'net transfers' from the EU budget. Fair compromises are thus needed in the accession negotiations in order to alleviate these bad feelings and for EU enlargement to take place actually in 2004.

Dealing with the topic of 'Asia and Global Economy', various examples illustrated the fact that countries open to globalization are indeed growing faster: Thailand as compared to Myanmar, South Korea as compared to North Korea, and China before and after 1978. Things would of course be even better if one could enjoy the benefits of globalization and at the same time reject the negative effects. In the field of global finance, for instance, proper risk sharing among the government, foreign investors and domestic borrowers is essential. Too many loans, in particular foreign loans can turn out detrimental as illustrated by the Asian Financial Crisis of 1997: 'We cannot control globalization, but can control ourselves.' One very important measure to reduce financial risks connected with globalization could be *regional* economic and monetary co-operation.

That issue was also taken up by the next speaker, on 'East Asian economic and monetary co-operation: from an ASEAN perspective'. After dealing with the current problems *within* ASEAN, such as large and growing disparities between the old and the new members (Cambodia,

¹ According to the 'road map' for enlargement, ten new members will join the EU by 2004 (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic, Slovenia), followed by an additional two countries a few years later (Bulgaria, Romania).

Laos, Myanmar and Vietnam), the 'China threat' and the ailing Japanese economy, *three models* for more intensified economic and monetary co-operation within East Asia or within ASEAN+3 (including China, Japan and the Republic of Korea) were presented:

Firstly, establishing a 'web' of Free Trade Agreements (FTAs) across the region which could subsequently result in a region-wide 'ASEAN+3 FTA'. Secondly, there is the model of a Japan-led East Asian growth through reflating and stimulating Japan via the ASEAN+3 framework. Thirdly, there is the China-led growth model, based on the vast potential of the Chinese market. Through one or two or all three of the above models, economic and monetary co-operation in East Asia is definitely set to grow and intensify – but it will be less an institutional model (as in Europe) than a functional one.

The **second Panel** focused on 'The role of the EURO in international trade and finance'. From the European side, it was pointed out that the euro and the European Monetary System (EMU) respectively have to be seen as part of a broader integration process in Europe, encompassing the creation of a true single market for goods, services, labour and capital, a common framework for macroeconomic policy and enhanced co-operation in structural policy. The competence for monetary policy is now allocated at the European level at the European Central Bank (ECB), and although fiscal policy remains in principle a matter of national competence, it is guided by the rules of the 'Stability and Growth Pact'. At the microeconomic level EMU leads to efficiency gains for member economies through the elimination of exchange risks (reduction of transaction costs, better resource allocation) and increased cross-border price and cost transparency. This, together with a more stable macroeconomic development, will strengthen Europe's international position and competitiveness.

The introduction of the euro has also started to change the global financial and monetary landscape, reinforcing the trend towards a multipolar international monetary system. The euro's global role has increased sizeably in the money market and the euro has created the second largest bond market in the world. However, on currency markets, as a trade invoicing currency and with regard to official reserves, the US dollar has retained its dominance. As concerns Asia, EMU carries a number of potential benefits for businesses, investors and countries (easier market access, a deep and liquid financial market, new options for official reserve management). On a different note, EMU can also serve as an interesting case study for Asian policy makers for economic and monetary co-operation. Finally, the economic weight of the Union and the increased international role of the euro imply a major global responsibility paving the way for enhanced partnership between Asia and Europe, e.g. in International financial institutions such as WTO etc.

From an Asian point of view, the major gains of the European economy from the introduction of the euro will be the following: strengthened productivity and growth through reduced transaction costs and intensified competition in the euro area. Also, a shared sense of economic unity could promote unification and further structural reforms (harmonization of the tax systems, welfare policies etc.). And finally, the creation of a huge integrated market with a single currency will promote direct investments.

With regard to the lessons for Asia to be learned from the introduction of the euro, two were considered most important: economic convergence and a mechanism to ensure that the participating countries achieve and maintain convergence, on the one hand, and strong political momentum and national consensus towards the introduction of a single currency, on the other. Economic and financial co-operation, though widening and deepening, is still insufficient in Asia, but may be feasible in the long term. In the meantime, from the viewpoint of Japan, it is desirable for Asian countries to adopt a flexible exchange rate system, with a certain band vis-à-vis the exchange rates of a basket of currencies, the composition of which should reflect the economic interdependence in the region. It was hoped that the policy dialogue and regional surveillance among the ASEAN+3 will be deepened further and that ASEAN+3 will become a forum where exchange regimes and co-operation in the monetary system are discussed.

Referring to the possibility of establishing a tripolar currency system, the opinion was that the status of the yen was still too low to allow for a tripolar monetary system. What steps should Japan take to improve the yen's status? The first and foremost task is to re-establish people's confidence in the Japanese economy, with priority being given to restoring the soundness of the financial system. Furthermore it is vital to establish well-functioning foreign exchange and capital markets. However, the existence of the euro indicates that the modality of the future international monetary system will not be one dominated by the US dollar, but rather one where multiple currencies co-exist. Thus, the euro might support the yen's status rather than undermining it.

European enlargement will necessarily create a new 'Periphery'. This topic was discussed by the example of Russia: The relationship between the EU and Russia is characterized by large inequality and asymmetry with regard to economic strength as well as trade relations. Russia's GDP is currently less than 13% of that of the EU(15) and Russia's significance as a trading partner for the EU is much smaller than that of the Central and East European countries (CEECs) – whereas the EU is the main trading partner for Russia. Russian exports consist mainly of raw materials and energy while imports from the EU comprise final products mainly. Russia also reports a huge trade surplus with the EU (EUR 26 billion in 2001).

Russian trade with the CEECs declined dramatically after the political and economic changes of 1989-1991 and the Russian trade balance with the region became highly positive. Russian fears regarding a deterioration of trade along with the CEECs' accession to the EU are not substantiated – the trade effects should be rather positive. The enlarged EU will account for half of Russia's trade, rules will be harmonized and the size of the EU market is expected to grow faster. However, there are some justified fears concerning, for instance, the Schengen visa regime and the emergence of a new 'Iron Curtain' with adverse effects on border regions and special problems related to the Russian enclave of Kaliningrad. EU membership of Russia (or even an association status) is highly unlikely in the foreseeable future. Options include the establishment of a free-trade zone between Russia and the enlarged Union (aligned to WTO accession and co-ordinated with simultaneous trade agreements with other CIS countries), enhanced partnership in the framework of the Northern Dimension Action Plan, closer energy

co-operation and resolving the issues related to the Kaliningrad region. Foreign direct investment could become another important force of economic integration.

Coming back to the 'Challenges and opportunities of European integration for the Asian/Japanese economy' it was stated that Japanese companies in Europe reaffirm the attractiveness of a truly unified market by the introduction of the euro, while they are also preparing for the intensified competition in the euro area by means of abolishing or unifying their branches and of establishing a regional head office in Europe. The enlarged market of more than 500 million is considered an extremely promising market when future potential is also considered. Furthermore, the CEECs are attractive as manufacturing bases due to low labour costs, and investment of Japanese companies into those countries has accelerated in anticipation of EU enlargement. There have been some transfers of bases from current EU countries to those countries, and one may expect a further reevaluation of business strategies as soon as the enlargement of the EU has materialized.

The **third Panel** was on 'Strategies for closer economic co-operation between Europe and Asia'. On the Japanese side it was argued that Asia and Europe should co-operate to improve global economic management and to strengthen their economic and intellectual relationships for their mutual benefits. Major areas of co-operation could be: the World Trade Organization (WTO) to fend off protectionist pressures; reform of the international financial system regarding, for instance, sovereign debt restructuring mechanism, crisis prevention, management and resolution. Asia and Europe should also co-ordinate their development aid, for instance in providing better access in agriculture, textiles and other labour-intensive products and co-operation in implementing ODA. The deepening of economic relationships should include trade, direct investment as well as financial capital flows. The role of the euro in Asia should be strengthened to prepare for a multipolar currency system. Deepening intellectual relationships would include the transfer of knowledge, experience and lessons from the European integration process to Asia. Another area of common interest would be the better understanding of China's role in Asia and the world. The Asia-Europe Meeting (ASEM) has already developed as a trans-regional co-operative forum and should be extended further, including joint studies of issues of common interest, communication with news media, and the exchange of students and citizens to promote mutual understanding.

The issue of 'Foreign direct investment (FDI) in inter-regional integration' was presented from the European side and the main finding was that international integration by FDI is *more regional than global*. In the last couple of years, intra-European FDI alone made up 50% of the global flows. About 30% of EU direct investment went to the USA, but only about 5% found its way to Asia (of which less than 1% went to Japan). A similar picture emerges if FDI stocks are considered instead. The role of the CEECs as a destination for European FDI is increasing and the EU is the most prominent source of FDI for this region. The primary destinations of investment are Poland, the Czech Republic and Hungary. In terms of per cent of GDP, Hungary and the Czech Republic clearly take the lead. The CEEC industries typically most highly penetrated by FDI are the food industry, the paper industry, chemicals, office & computing machinery, radio, TV & communication equipment and motor vehicles. With state-owned assets sold out and liberalization completed before the date of EU accession, significant

restructuring of FDI in the direction of modernization and greenfield investments will have to take place in order to keep up the pace of capital inflows into the region.

In conclusion of the conference, a '**Special Lecture**' on 'Asia Strategies of the European Union' was given. The speaker from the European Commission presented the new 'Strategic Framework for Enhanced Partnership'² currently guiding the EU's policy towards Asia. He then pointed to open questions and the new challenges regarding the EU-Asia relationship after the events of September 11, 2001.

The (six) main objectives of the new Asia strategy mentioned were the following: to contribute *to peace and security in the region and globally*, through a broadening of the EU's engagement in the region; to further strengthen *mutual trade and investment flows* and the dialogue on economic and financial policy; to promote the *development of the less prosperous countries* of the region; to contribute to the protection of *human rights* and to the *spreading of democracy, good governance and the rule of law*; to build *global partnerships and alliances* with Asian countries in appropriate international fora, to help address both the challenges and the opportunities offered by globalization, and finally to *strengthen the awareness of Europe in Asia and Asia in Europe*. All EU member countries are expected to adjust their national strategies towards Asia according to this Framework. As the Framework is characterized by a relatively high degree of abstraction, it will be supplemented by specific action plans and country strategy papers. The building of an enhanced partnership with Japan on political, economic and social issues is called 'a priority objective'.³

Important issues considered as not being sufficiently covered in the Framework are the relationship between the major Asian powers Japan, China and India, the role of the USA in the region and the recent moves towards regionalism in Asia, reaching from the increased role of ASEAN+3 to the rising number of Free Trade Agreements in the region partly in force, partly envisaged for the future. Also, taking into account the September 11 events, a more detailed analysis of Afghanistan, Pakistan and the problems in Central Asia should have been undertaken in the Framework. And probably more attention would have to be paid to the dark side of globalization which is threatening peace, stability and economic prosperity. More generally, the persisting gap of mutual knowledge and understanding of cultures and civilizations needs more attendance. The fourth ASEM Summit in Copenhagen in September this year could be a timely event in setting into motion a process which addresses these issues.

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² 'Europe and Asia: A Strategic Framework for Enhanced Partnerships', Brussels, 4 September 2001, http://europa.eu.int/comm/external_relations/asia/doc/com01_469_en.pdf

³ The 4 Asian 'subregions' covered by the Framework are: South Asia, South East Asia, North Asia and Australasia.