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**Bilateral trade development during economic downturn:  
The EU trade negotiations with Singapore**

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## Abstract

This thesis examines the bilateral trade development between the European Union (EU) and Singapore in the aftermaths of the 2008 economic turmoil, with emphasis on the top traded commodities. Furthermore, this thesis also contains an empirical study with an attempt to analyse the impact of the financial crisis, as perceived by European companies operating in Southeast Asia, on a more corporate level. In addition, their perception of a proposed EU-Singapore free trade agreement's (EUSFTA) impact on European companies' business activities in Southeast Asia will be explored.

This endeavour should be seen in the EU's attempt to maintain its position competitiveness in world trade, which have been challenged by the rapid growth of East Asia, particularly at a time when multilateral trade agreements has been a slow process. It has been found that the bilateral trade between the EU and Singapore has, despite rapid growth in absolute values during the past decade, not developed at the same pace as intra-regional trade in Southeast Asia. Trade patterns reveal that the financial crisis that commenced in 2008 has affected commodities to various degrees, depending on industry sector. The recession is perceived to have affected European companies' business activities in Southeast Asia to various degrees. While assessing the EUSFTA positively, European companies expect a rather limited impact on their business activities in the region.

However, the findings serve to caution against a possible backlash in the EUSFTA negotiations and make a strong case for the possibilities and benefits the agreement would generate both parties, in particular the EU. Considering that Singapore has signed FTAs with Japan, the US, Australia, India, and more recently China, the question is not "What advantages can EU business get from an EUSFTA?", but "What disadvantages can EU business suffer for not having an EUSFTA?"

**Keywords:** ASEAN, AFTA, AEC, EUSFTA, European Union, Singapore, decoupling, Southeast Asia, foreign trade, free trade agreement, economic integration

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## **Abbreviations**

**AEC** – ASEAN Economic Community

**AFTA** – ASEAN Free Trade Agreement

**ASEAN** – Association of Southeast Asian Nations

**BTA** – Bilateral Trade Agreement

**DDA** – Doha Development Agenda

**DOTS** – Direction of Trade Statistics

**EC** – European Commission

**EU** – European Union

**EUSFTA** – EU-Singapore Free Trade Agreement

**FDI** – Foreign Direct Investment

**GDP** – Gross Domestic Product

**GPN** – Global Production Networks

**HS** – Harmonized System

**IMF** – International Monetary Fund

**MNC** – Multinational Corporation

**NEG** – New Economic Geography

**PTA** – Preferential Trade Agreement

**SITC** – Standard International Trade Classification

**UN** – United Nations

**WTO** – World Trade Organization

**WCO** - World Customs Organization

# 1. Introduction

## 1.1 Context

The perfect storm; a metaphor used to describe the financial crisis in 2008-2009. No other economic downturn since the interwar period has been as severe as the recent recession. At a time when the world have faced the deepest economic downturn since the Great Depression, and the multilateral agreements within the World Trade Organisation (WTO) have shown poor progress, bilateral free trade agreements (FTAs) have recently experienced resurgence in international trade diplomacy. The number of bilateral and regional FTAs has increased rapidly, especially during the last two decades (Kawai & Wignaraja, 2009). This should be seen in the light of the European Union's (EU) attempt to maintain its position in international trade.

At the same time, this role has been challenged by the rapid growth of East Asia driven by the expansion of international trade and Foreign Direct Investment (FDI). East Asian governments have embarked on policy initiatives for formal integration through bilateral and multilateral FTAs where South East Asian Nations (ASEAN) is emerging as the integration hub for FTA activity in East Asia signing FTAs with Japan, Korea, China, India and Australia (Kawai & Wignaraja, 2007). Hence, the multitude of bilateral FTAs put companies from ASEAN's FTA partners at a different level playing field compared to European companies. In order to remain competitive, the EU needs to strengthen the economic ties with rapidly growing economies in Southeast Asia.<sup>1</sup>

Originally the EU had initiated efforts to form a region-to-region FTA with ASEAN, comprising the ten member states in Southeast Asia. The negotiations started as early as in 2007, which if materialized would have created one of the largest trading bloc in the world by bringing nearly one billion people under it. But negotiations stalled due to inherent difficulties such as solving issues related to cultural differences, gaps in governance, transparency and negotiation style (Lindberg & Alvstam, 2009). In March 2009, both sides agreed to a temporary suspension of the negotiations. In order to overcome the hurdles, the EU have ultimately changed its approach toward forming the regional agreement and embarked on bilateral trade talks with the member countries starting with Singapore.

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<sup>1</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).



## 1.2 Problem formulation and objectives

The EU-Singapore FTA (EUSFTA) will further strengthen economic ties between EU and Singapore and mark an important step in the EU's engagement with the ASEAN region. Furthermore, Singapore is the recognised hub of Southeast Asia. Despite the city state's small size and lack of natural resources, Singapore has become one of the world's most developed economies averaging an annual Gross Domestic Product (GDP) growth rate over 7 per cent since its political independence in 1965<sup>2</sup>. In the EU-ASEAN trade context, Singapore stands for over 40 per cent of EU exports, as well as the origin of some 20 per cent of EU imports from ASEAN. With this in mind, the ASEAN business environment as perceived by European companies merit further academic interest. This paper thus attempts to gain new insights into European companies' perception of the regional integration in ASEAN, the impact of the financial crisis on their business activities in the region, and their expectations on the EUSFTA.

This thesis also relates to the theoretical discussion regarding the "decoupling" hypothesis, which has been extensively debated in East Asia in the lead-up to the onset of the recent financial crisis by Athukorala & Kohpaiboon (2009), and more recently discussed by Lindberg and Alvstam (2010). The decoupling hypothesis is a notion based on the empirical observation of continuous increase of East Asian intraregional trade and the parallel decline in relative shares of North America and the EU, i.e. the proposition that East Asia has emerged as "a self-contained economic entity with potential to maintain its own growth dynamism independent of the economic outlook for the traditional developed marked economies" (Athukorala & Kohpaiboon, 2009, p.1).

Singapore is particularly well suited to serve as a case study given the city state's integral role to regional and global production networks (Lindberg & Alvstam, 2010). Its role in global supply chains is demonstrated not only by the flow of goods imported to the EU, but also by the growing presence of European companies in the region.<sup>3</sup> Hence, changes in the global economy will affect its volume of trade more visibly than almost anywhere in the world. During the global downturn which began with the bursting of the information and communication technology sector in the early 2000s, the Singaporean economy was much

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<sup>2</sup> Speech by the Senior Director of the Office of Regional Economic Integration at the ADB Srinivasa Madhur in January 29, 2010, Singapore, at the conference: 'Managing the economic crisis in Southeast Asia'.

<sup>3</sup> Speech by the Ambassador and Head of Delegation of the European Union to Singapore Holger Standertskjöld in May 22, 2010, Singapore, at the seminar: 'The EU-Singapore FTA – a Business Primer'.

more severely hit than other Southeast Asian countries, and the same development has appeared in the recent economic and financial crisis (ibid).

Against this background the observation regarding decoupling is used to discuss to which extent the EU is affected by a possible decoupling from East Asia. A crucial issue thus concerns whether the sharp economic decline of trade since the summer of 2008 has affected bilateral trade between the EU and Singapore more than intraregional trade flows (EU and ASEAN respectively) and whether the EUSFTA agreement can strengthen EU's role and competitiveness in East Asia. Furthermore, by analysing the trade pattern of each commodity group, intriguing insights of which commodity groups have been affected the most by the recession can be explored.

Moreover, Singapore, in particular, have been extremely active on the bilateral front over the last decade, signing FTAs with Japan, the US, Australia, India, and more recently China (concluded in late 2008). With this in mind, the EUSFTA forms a strategic opportunity for the EU to make up for lost ground in the rapidly developing economies of East Asia by being the foundation for ease of market access in ASEAN for European companies.

Previous research has been focused on the long-term development of interregional trade relations between the EU and ASEAN. This thesis aims at describing how the bilateral trade between the EU and Singapore in different commodity groups was affected by the rapid growth of trade volumes in the period from 2000 to 2008, followed by the substantial decline between 2007 and early 2009. Furthermore, this thesis attempts at gaining an eclectic perspective of the impact of the recent economic downturn from the corporate level.

### **1.3 Research Purpose**

The purpose of this thesis is twofold. Firstly, the aim is to describe and analyse the bilateral trade between the EU and Singapore in the most important commodity sectors, in wake of the 2008 economic crisis. Secondly, the impact of the financial crisis as perceived by European companies operating in ASEAN shall be explored. Furthermore, a European corporate perception of the EUSFTA's impact on European companies' business activities in ASEAN shall be analysed. In order to meet the research purpose three questions are elaborated upon.

*How did the bilateral trade between the EU and Singapore in the most important commodity sectors develop over the past decade, and to what extent has the general decline in trade between the EU and the city state, respectively, caused by the recent economic turmoil, affected their bilateral trade flows?*

*How have the recent financial and economic crisis affected companies' business activities in ASEAN, as perceived by European companies?*

*What proposed impact may a future EUSFTA have on business activities in ASEAN, as perceived by European companies?*

## **1.4 Disposition**

After outlining the background and purpose of this research in chapter one, the second chapter describes the methodology used. The following chapter contains an overview of the chosen theoretical framework, covering central concepts and relevant theories ranging from neo-classical integration theory to foreign trade theory. Additionally, the contextual dimension of the upcoming FTA between the EU and Singapore is presented. The fourth chapter entails an empirical study of the bilateral trade development between the EU and Singapore in wake of the 2008 economic crisis, which entails a comprehensive examination of the trade statistics of the two realms by means of trade data. Emphasis is laid on the top traded 15 commodity groups during the period 2007 to 2010. It also contains an empirical study on the regional outlook about the business environment in Southeast Asia, and the impact of the financial crisis, as perceived by European companies. Furthermore, a European corporate perception of the impact of the EUSFTA is included. In the fifth chapter, the analysis of empirical findings collected through primary and secondary data is presented. The sixth and final chapter addresses main conclusions resulting from this study.

## 2. Methodology

*This chapter provides the reader with the methodological approaches chosen in this thesis. In order to increase the credibility of this research the author of this study reflects on the chosen research design, approach, and discusses data collection methods.*

### 2.1 Research design

When starting the research process it became clear that there are different research traditions within economics. The first research approach is to work in a *deductive* way, in which a conceptual and theoretical structure is developed and then tested by empirical observation (Hussey & Hussey, 1997). The reverse of the deductive research is to work in a more *inductive* manner, in which theory is developed from the observation of empirical reality. The deductive research approach frequently makes use of quantitative data. Yet, the latter method approach is not easily tested quantitatively, which is one of its weaknesses. However, both have been criticized for their tendency to simplify compound phenomena and their incapability of capturing theoretical complexity (Remenyi et al., 1998, Thietart, 2001). Given the criticism against these approaches there is an alternative to these approaches by using a more *abductive* approach, which can be seen as a mixture of deductive and inductive approaches. This approach is frequently used in those cases where the general theoretical framework is vague, incomplete or non-existent (Lindberg, 2007b).

As the aim is to analyse bilateral trade development between the EU and Singapore during economic downturn and find patterns by drawing on a considerable amount of empirical observations, an approach not covered by earlier studies, this research can be marked as an explorative study. It is explorative in the sense that it is not given beforehand what the precise empirical field will look like. The methodological sources consist of a combination of literary studies and articles, which are one type of secondary data. The theoretical chapter includes academic literature, reports from international organisations, scientific journals and articles in newspapers that all have their origins in the fields of international trade policy, economics and economic geography.

Furthermore, when doing research studies, it is conventional in research to make a distinction between the qualitative and quantitative (Thietart, 2001). Given that the purpose of this paper is twofold, I have chosen a multi-method design where both quantitative and qualitative approaches are used but they remain relatively independent until the interpretation stage

(Saunders, Lewis & Thornhill, 2006). By combining qualitative and quantitative research it helps to bridging the gulf between 'macro' and 'micro' levels. The results are then triangulated to form a comprehensive whole. According to Thiétart (2001), triangulation allows the research design to be put to the test by ensuring that findings are not just a reflection of the methodology used. By employing the multi-method approach, this thesis can not only analyse and describe the trade development during economic downturn, but also to provide the reader with a perspective of how the European companies' experience the current business environment in Southeast Asia and how the FTA, once ratified, may influence their business activities in the region.

Hence, I have also interviewed representatives from European companies in Singapore with a regional outlook about the business environment in Southeast Asia and about their possibilities of benefiting from the AFTA agreement, as well as the upcoming FTA between the EU and Singapore. Thus, a crucial complement to the trade statistics is an extensive research method by means of these qualitative interviews. Five qualitative interviews have been conducted with company representatives from the European business community in Singapore. The chosen individuals were selected with regards to their position in the companies, holding some responsibility for their business activities in Southeast Asia and have a deep knowledge of the development of the business environment in the region over a longer period.

Apart from conducting interviews with corporate managers, I have carried out three interviews with officials from the EU-delegation, Ministry of Trade and Industry of Singapore and International Enterprise Singapore<sup>4</sup>. These interviews provided me with unique insights of the FTA negotiation process and the scope of the agreement. In addition, I have attended a number of conferences in Singapore. These conferences were very important to the research as they provided an opportunity to meet people who are directly involved in the EU-Singapore FTA negotiations. I have conducted the interviews and attended these conferences during my internship at the Embassy of Sweden in Singapore, which took place between January and June 2010.

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<sup>4</sup> Known formerly as the Singapore Trade Development Board, IE Singapore is the lead agency spearheading Singapore's efforts to promote the overseas growth of Singapore-based enterprises and international trade.

## 2.2 Research approach

This thesis is based on international trade policy, multilateralism, economic geography and economic integration from a broad perspective. In order to employ a theoretical base and answer the research questions, this research is marked by a rather abductive approach in which the empirical observations and theoretical framework are continuously confronted against each other. This is emphasised by several authors (Saunders, Lewis & Thornhill, 2006, Hussey and Hussey, 1997) where inductive and deductive research approaches are seen rather complementary than exclusionary.

The first step in the research process is the observation that bilateral trade agreements (BTA) and regional trade agreements (RTA) are here to stay, especially when multilateral agreements within the WTO have shown poor progress, at a time while the EU is trying to maintain its position in world trade. This observation results in an initial problematisation, which, in turn, brings about an initial empirical description of the context. Intriguing questions thus arise: "What impact has the economic crisis had on ASEAN's economic dependence on the EU?" and "What is the potential impact of the EUSFTA on bilateral trade flows, and on business activities in Southeast Asia as perceived by European companies?". This description is followed by a formulation of the research problem and the research questions (cf. chapter one). Next, the theoretical framework (chapter three) is presented, stemming from the neo-classical integration theory, geographical economics, and theories related to foreign trade and direct investments. The theoretical framework is followed by empirical in-depth investigations of first, foreign trade statistics, and, secondly, the conducted interviews are explored and presented.

Thus, a key part in the study is the statistical description in chapter 4.1, which serves as a means to explore to what extent the recent economic downturn has affected bilateral trade flows between the EU and Singapore, with the aim to assess the causes that can explain such a pattern in trade. The method chosen is to embark from primarily international trade statistics. As stated earlier, these have been complemented by abducting qualitative interviews with company representatives from the European business community in Singapore as regards to what extent the data can be interpreted and analysed from a more abstract, corporate, level. The following chapter (chapter 5) involves an empirical confrontation of the theories. The last chapter (chapter six) contains a reassessment of the theories and, finally, presents the theoretical and empirical conclusions.

## 2.3 Data collection

### 2.3.1 Official sources of statistics – a critical assessment

As Lindberg (2007b) summarises; there are two secondary sources of national trade statistics, the first one based on primary data provided by customs authorities, compiled primarily from export and import declarations by businesses, the second being national account statistics derived from different kinds of data, such as companies' VAT accounting, foreign exchange transactions and business surveys.

The main source of data for this study is the International Monetary Fund's (IMF) Direction of Trade Statistics (DOTS) which is published both monthly, quarterly and annually, and presents official statistics provided by national authorities and/or statistics derived from partner records. Statistics are also provided by the EU's high-quality statistical information service, Eurostat, where the perspective of bilateral trade development in physical commodities are analysed. Trade statistics are included to describe and analyse the bilateral trade between the EU and Singapore by analysing the trade pattern at the aggregate level during a longer time period (2000-2010) and at a disaggregated level of the top traded 15 commodity groups quarterly during the period 2007 to 2010. These measurements will be used to describe and analyse the impact of the financial crisis on a macroeconomic level and, hopefully, insights of which commodity groups have been affected the most by the recent recession can be explored.

The commodity groups have been provided by the Harmonized Commodity Description and Coding System (HS), which is an internationally standardised system for classifying traded products, developed and maintained by the World Customs Organisation (WCO)<sup>5</sup>. The system is used by more than 200 countries as a basis for their customs tariffs and for the collection of international trade statistics. Moreover, the system uses a six-digit code to identify commodities, in which the commodities are classified by what they are made of and not according to their stage of fabrication, use or origin. This study is aggregated at a two-digit level, divided in to 98 chapters, and presented in 15 sections due to the limited timeframe of this research. These have been complemented with the Standard International Trade classification, abbreviated as SITC, which is a product classification of the United

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<sup>5</sup> WCO (formerly the Customs Co-Operation Council) is an independent intergovernmental organization with over 170 member countries based in Brussels, Belgium. Cf.

[http://www.wcoomd.org/home\\_hsoverviewboxes\\_hsharmonizedsystem.htm](http://www.wcoomd.org/home_hsoverviewboxes_hsharmonizedsystem.htm)

Nations (UN) used for external trade statistics. The SITC classification is not as detailed as the HS but is widely used for analytical purposes to describe and explain broader patterns of shape and development in trade flows.

Commodities have been classified in three different segments, scale-intensive commodities, resource-based commodities and differentiated commodities. Scale-intensive commodities are commodities which require labour-intensive production. The categories have originally been distinguished based on primary factors in production of each commodity group. The definition of a simple commodity is a good for which there is demand, but which is supplied without qualitative differentiation across a market. A company's product is a differentiated product if it is uniquely different than those of competitors and has an added value, for example electronic equipment. This categorization is not absolute, as for example differentiated commodities and scale-intensive commodities tend to overlap. The aim of this is to analyse if industry-specific characteristics of a countries in relation to their share of total trade indicate a particular trend, for example if the differentiated have been affected the most by the recent financial crisis.

When examining the official statistics, one has to be aware of the aggregation problem at a two-digit level that arises from the fact that the classified groups consists of heterogeneous products. The HS-classification also causes some asymmetry among the commodity chapters since some are more disaggregated than others. E.g. computer/machinery (chapter 84) and electrical equipment (chapter 85) are broad concepts including a large variety of separate commodity items, while laminated textile fabrics (chapter 59) and knitted fabrics (chapter 60) are more narrowly defined.

Although Singapore is one of the most trade friendly countries in the world, there is also the problem of transit trade. The city state is a major reference point for transit trade. Thus, the issue of how to define Singaporean origin in exports to the EU and other parts of the world has become a problem, which has more recently been pointed out by Lindberg and Alvstam (2010). They argue that, since a fair share of Singaporean exports in goods as well as in services consists of products in transit, the reported value is biased. This inaccuracy occurs in both directions, over- or underrating the value of Singaporean exports, and causes a problem in the FTA negotiations between the EU and Singapore, e.g. difficulties at establishing the country of origin when classifying a commodity or service at the entry of the EU. Consequently, it may have reverse effects for other members of ASEAN. Albeit, statistics



excluding and including transit trade can be found in the Singaporean National Statistics, which are regarded as potential implications for future research. Moreover, trade statistics regarding bilateral trade between Singapore and Indonesia have until only a couple of years ago been classified in Singapore, although it has been resorted from the Indonesian side. With this in mind, the reported data may be underestimating the intra-trade flows, and in some cases, severely so.

Hence, the official statistics point to the need to interpret the data, of the trade flows and trade patterns that will be presented, with caution. Therefore, statistics have also been provided by other international sources, such as the UN Comtrade, as well as National statistics of Singapore and the government-owned IE Singapore, to compare and conduct crosschecks with the collected data. The main reasons to use the IMF statistics are the frequent updating of data and the relatively short time lags.

### **2.3.2 The interviews**

During my internship at the Embassy of Sweden in Singapore, January-June 2010, I have interviewed company representatives to develop an extensive reflection of how the European companies operating in Southeast Asia have been affected by the financial crisis from the corporate level. The interviews are extensive in that sense that they provide intriguing insights into more than the specific research problem. The companies included in this research are large to medium sized companies and all have been doing business in Singapore and ASEAN for more than ten years. Companies from various industries have been comprised with the intention to give an eclectic insight of a European corporate perception of the business environment in Southeast Asia. Chemical, machinery, electrical equipment, logistics and pulp and paper were the included industry sectors.

Besides these company representatives, government officials from the EU-delegation, Ministry of Trade and Industry of Singapore and International Enterprise Singapore have also been interviewed. These interviews were highly useful as they provided new perspectives, and thus contributed to giving unique insights of the EUSFTA negotiation process, and the scope of the agreement. Moreover, they complement the statistical survey and the literature study.

The interviews conducted for this thesis were of a semi-structured nature, as some were continuously used, whereas others were designed or adjusted for the specific situation. Following the suggestion of Saunders et al (2006), some questions have been omitted in

particular interviews, given a specific context that has been encountered in relation to the research topic. On the other hand, additional questions have been added to further explore the research questions and objectives, depending on the flow of the conversation. The interviews were usually audio-recorded in order to realize a full collection and assessment of data. In cases where the interviewee preferred that I did not, this wish was respected. As there are several benefits of direct recording, there are also possible drawbacks related to this data collection strategy (Willis, 2006). While it allows the researcher to fully concentrate on the interview without having to take notes, interviewees may feel inhibited by knowing that the conversation is being recorded. Moreover, they may be reluctant to provide sensitive information if they feel it could be tracked to them. Some of the participating companies have expressed their wish to remain anonymous due to some sensitive topics such as the companies' relationship with various authorities and barriers to trade. Thus, companies' and their representatives' names have not been included in this thesis.<sup>6</sup>

## **2.4 Quality of research**

According to Remenyi et al. (1998), a research design may be judged on the basis of four tests, which are construct validity, internal validity, external validity and reliability. Triangulation has been used in order to ensure that the collected data is valid and reliable, which Loveridge (1990: 18) defines as 'using multiple methods to capture a sense of reality'.

The bilateral trade relations are measured through official trade statistics. To ensure the quality of statistical data, hence to increase the overall reliability, trade statistics have been compiled from several international sources by comparing and conducting crosschecks with the collected data. Additionally, in order to increase the level of reliability, I have made an effort to make as many interviews as possible. Furthermore, consideration of company representatives from various industries has been conducted in this study to ensure that these represent a variety of perspectives. Thus, this has contributed to increase the external validity of this study.

In order to evaluate construct validity, it is necessary to establish correct operational measures for the concepts behind the used interview guide, as lack of standardisation may lead to concerns about reliability (Remenyi et al., 1998). The researcher should be aware of this issue

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<sup>6</sup> Interviews were made with major Swedish companies operating in Singapore (anonymous) during the period January-June 2010.

when preparing the questionnaire used for data collection. Semi-structured interviews have been used to explore and explain themes that have emerged from the use of the questionnaires. Using semi-structured interviews may be a valuable way of triangulating quantitative data collected by other means such as questionnaire (Saunders et al., 2006). The interviews have been analysed qualitatively to clarify the content of some of the statistical results. Thus, this was essential to get at the meaning behind some of the data. While the observations have certainly been correct, in some cases, the interviews were followed up by email contact in order to clarify unclear points of the primary data collected. However, the researcher should also be aware of that there is no given and generally accepted interpretation. Thus, there is always a probability that interviewees might define theoretical constructs differently.

## **2.5 Delimitations**

In what follows, bilateral trade development between the EU and Singapore in the wake of the 2008 economic crisis will be explored. The study of various physical commodities' trade pattern during economic downturn is limited to a two-digit HS level classification, with emphasis on the 15 top traded commodities. Within the context of the FTA, the analysis is narrowed down to foreign trade in goods. Thus, e.g. trade in services, FDI and foreign exchange transactions, are principally not discussed. Furthermore, the analysis of the EUSFTA's estimated impact on European business activities in Southeast Asia, particularly Singapore, is preliminary as the agreement is yet to be signed and implemented. The time period chosen for the study is 2000-2010, most notably 2007-2010, when it comes to the commodity disaggregation. Additionally, limitations are regarded as potential implications for future research.

### 3. Theoretical Framework

*In what follows, theories will be presented with the aim to contribute to the discussion of the research problem, and serve as a foundation for the subsequent empirical chapter four. An eclectic approach has been chosen. Thus, the following four theoretical categories can be concluded from the literary review: the neo-classical integration theory, geographical economics, theories related to trade and foreign direct investments. The chapter further outlines the on-going EUSFTA negotiations whose impact on the theoretical framework will be discussed with empirical findings.*

#### 3.1 The classical/neo-classical integration theory

The basis of regional integration agreements is the preferential trading agreements (PTA), which involve states agreeing to provide preferential access to their markets to other members of the regional group (Dicken, 2011). Thus, the underlying principle behind economic integration is, in general, an ambition to increase welfare in the participating countries by reducing barriers to trade within the region and thereby increasing trade. The increase of trade is meant to lead to the increase of the GDP of the participating countries, and hence, to better welfare. However, as argued by Lindberg (2007b), the importance of political objectives of economic integration should not be neglected. By stepping up the economic engagement with one another, economic integration can also serve higher objectives, namely to lessen the chance of armed conflicts among partners.

The degree of economic integration can be categorized by several stages, as explained by classical integration theory, a foundation of which is the customs union concept (Balassa, 1961, Lindberg, 2007b). Table 4.1 below, initially proposed by Balassa, and more recently modified by Lindberg, show the different stages of economic integration.

1. *Preferential trade arrangement/area*: This type of agreement provides lower barriers on trade within commodity groups among participating countries than on trade with non-members.
2. *Free trade area*: in which trade restrictions between member states are removed by agreement but where member states retain their individual trade policies towards non-members.
3. *Customs union*: a type of trade bloc which is composed of a free trade area with common external tariffs (tariff and non-tariff barriers) towards non-members. In

addition, the member states of a customs union leave the decision-making to a common supranational authority regarding trade policy issues.

4. *Common market*: In addition to having a common customs union, free movement of factors of production (capital, labour, services etc.) between member states is permitted (Balassa, 1961).
5. *Economic/monetary union*: This is the most advanced type of regional economic integration, short of full-scale political union. In addition to the precedent stage, broader economic policies are harmonized and subject to supranational control, such as unification of monetary and fiscal policies (Nye, 1971).
6. *Total economic integration*: with the objective of bringing about total economic integration, it follows a coordinated policy in the economic, financial, and social fields; and by pursuing a common policy with regard to foreign trade. Furthermore, at this stage, a supranational authority makes the decisions, which member states are obligated to follow (Lindberg, 2007b).
7. *Political union*: This is the ultimate stage of economic integration, including political integration, where the supranational authority not only controls the politics but is also accountable to a common parliament (ibid).

**Table 4.1: Stages of economic integration**

	<i>Selective tariff reductions</i>	<i>No internal tariffs or quotas</i>	<i>Common external tariffs: supranational authority in trade policy</i>	<i>Free flow of goods, services, capital and labour</i>	<i>Some degree of harmonisation of economic and monetary policies</i>	<i>Unifications of economic policies: general supranational authority</i>	<i>Unification of policies, political institutions</i>
<i>Preferential trade area</i>	<b>x</b>						
<i>Free trade area</i>	<b>x</b>	<b>x</b>					
<i>Customs union</i>	<b>x</b>	<b>x</b>	<b>x</b>				
<i>Common market</i>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>			
<i>Economic monetary union</i>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>		
<i>Total economic integration</i>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	
<i>Political union</i>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>

Source: Lindberg (2007b, p 41), modified from Balassa (1961 p.2) and Nye (1971, p.29)

However, preferential trading agreements have a two-sided quality: while they liberalize trade between members, they, at the same time, discriminate third parties (Dicken, 2011). Consequently, while the attitude towards free trade areas is mainly positive, some economists may argue over their defensive character. Hence, that they represent an attempt to gain advantages of size in trade by creating large markets for its domestic producers and protecting them, at least in part, from outside competition (ibid, p. 189). At the same time they can cause a “*bandwagon effect*”, forcing excluding countries to step up their economic ties with the region and other countries.

Economic integration is an important aspect to consider when attempting identifying barriers to trade between markets. According to Lindberg (2007b), the classical and neo-classical integration theory is a systematic exposition of various forms of economic integration. Thus, depending on level of integration, business activities in the region and the way of doing business will be effected and take different forms. Consideration, and identification, of the different levels of integration between the EU and ASEAN can increase the understanding of the business environment in ASEAN, as perceived by European companies and about their possibilities of benefiting from the AFTA agreement, as well as the upcoming FTA between the EU and Singapore.

### **3.2 Geographical economics**

The new economic geography (NEG), that emerged in the beginning of the 1990s (see for example Krugman, 1991), provides an integrated and micro-founded approach to spatial economics. The theory emphasises on the role of clustering forces in generating an uneven distribution of economic activity and income across space, covering concepts such as imperfect competition, economies of scale and multiple equilibrium. Moreover, while the traditional approach to international trade theory have, until recently, ignored space and location, the new economic geography takes also distance and other geographical factors into account in the spatial economy (Lindberg, 2007b, p.45).

The conventional approach to trade flow analysis is based on the notion that countries trade in goods are produced from start to finish in solely one country, jurisdictions rather than geography, and where goods are characteristically assumed to be either traded freely, or to be completely non-tradable (Athukorala, 2010). Dicken (2007) argues about the important changes of “where” and the “how” of the material production, distribution, and consumption of goods and services (including, in particular, finance). In an increasingly globalised world,

old geographies of production, distribution, and consumption are continually being disrupted, whereas new are continuously being created (ibid, p.7).

Consequently, there has been a huge increase in both intra-industry and intra-firm trade, both of which are clear indicators of more functionally fragmented and geographically sophisticated production processes. Economies are seen as interconnected networks, hence, connections of activities linked through flows of both material and non-material phenomena into circuits and networks. Global production networks have become an important component of, especially, the economic landscape of East Asia (Athukorala, 2010).

However, there are also adverse effects of trade. While they create employment opportunities, incomes, and access to increasing variety of consumer products and services, they at the same time create unemployment, poverty, resource depletion, environmental pollution and cultural damage (Lindberg, 2007b). It has also been argued within economics over the different divisions of gains, why economic activity is so unequally distributed, and why these regularities occur (Marrewijk, 2002, Lindberg, 2007b).

To conclude, as Lindberg points out, the classical integration theory tends to focus on the overall economic benefits from economic integration and trade while new geographical economics includes transportation costs, the spatial distribution of economic activity, and factor mobility. These factors are relevant for this study as the implications of global production networks for economic integration in ASEAN, with emphasis on the behavior of bilateral trade flows between the EU and Singapore in the wake of the 2008 global economic crisis will be explored. In addition, it raises the overall discussion on regional economic integration in ASEAN, considering the highly contrasting levels of economic development among the countries, the high transportation costs faced by certain countries, and the large number of MNCs operating in the region (cf. Lindberg, 2007b). In conclusion, it also sheds light on the possible impact of EUSFTA on bilateral (EU-Singapore) and inter-regional (EU-ASEAN) trade, and the EU's role in the Southeast Asian region.

### **3.3 Foreign trade and FDI theory**

A large number of foreign trade theories have been developed over the years which explain why trade between nations takes place, elucidation of those trade patterns, and which effect it has on the participants involved. The Heckscher-Ohlin theory, also called the factor-proportions theory, emphasises the interplay between the supply and demand structures of the

economy. The supply structure determines the production level of goods and services in the country, while the demand structure determines the consumption level of goods and services (Marrewijk, 2002, p.116). The conclusion of the theory is that if a country is capital abundant, it will export manufactures (since the country's production is capital intensive). If a country is relatively labour-abundant, the country will export labour-intensive goods (ibid, p.115). Consequently, international trade flows represent the outcome of differences in resource endowments and factor proportions. Thus, by producing and exporting its comparatively advantaged product, a country will benefit from trade.

As argued by Lindberg, trade theory is traditionally seen as a macro phenomenon, in which trade is measured in aggregate numbers. Various approaches have been attempted by economists to explain the existence of FDI and its patterns. One of the oldest FDI theories that emerged in the early 1960s, capital market theory, is however explained on a macro level and suggest that the flows of FDI is based on exchange rate changes where FDI is used as a tool of exchange rate risk reduction. This contrasts with the new FDI theories where the unit of analysis is the company (on micro-level), or the economic development of a country. This approach is reflected by the contributions of Raymond Vernon, Terumoto Ozawa, Stephen Hymer and John Dunning (Dunning & Lundan, 2008).

Vernon's major contribution is the life cycle theory, which can be used to analyse the relationship of a product life cycle and possible FDI flows. The theory demonstrates a more dynamic comparative advantage, where FDI can mostly be seen in the phases of maturity and decline of a product. The theory suggests that early in a product's life-cycle all the parts and labour associated with that product come from the country which it was invented. After the product becomes adopted and used in the world markets, production will gradually move away from the point of origin (Vernon, 1966). Hence, the country that has the comparative advantage in the production of the product is shifted to low-cost locations in developing countries, if the product has become standardised (Dicken, 2007). The conclusions of this theory are however questionable, partly due to the fact that much of the world's international investment is reciprocal (Lindberg, 2007b).

Japanese theories of FDI were developed in the 1970s and its main contributor was Terumoto Ozawa, observing the relationship of FDI, competitiveness and economic development. He identified three main phases of development when analysing the patterns of FDI inflows and



outflows from a country. Later on, John Dunning modified this theory to a five stage theory of development. He defines the five stages as follows:

- *Stage 1:* The country is underdeveloped with a low incoming FDI, although foreign companies are beginning to explore the advantages of the country. Moreover, the country is characterised by a no, or almost none, outgoing FDI.
- *Stage 2:* In this stage, the growing incoming FDI do the advantages of the country, especially low labour costs. At the same time the standards of living are rising which is attracting more foreign companies.
- *Stage 3:* This is the phase of economic growth where there is still strong incoming FDI to the country, although their nature is changing due to, inter alia, the rising wages.
- *Stage 4:* Here, there is a strong outgoing FDI seeking comparative advantages abroad.
- *Stage 5:* At this stage, the investment decisions are based on the strategies of MNCs, where the flows of outgoing and incoming FDI come into equilibrium.

Hymer's pioneering study in 1960, emphasising on the firm at a micro-level approach, comes to the conclusion that FDI is not spread evenly among industries and that competitive conditions clearly affect FDI (Lindberg, 2007b). He starts from the assumption that domestic firms have an intrinsic advantage over foreign firms when it comes to serving a certain market (Dicken, 2007). Moreover, he stresses out the importance of firm specific advantages, such as superior technology for an investment to be profitable for a foreign company (Lindberg, 2007b). Hymer's contribution was immense but, like all theories, it has its limitations given its difficulties at explaining firms' subsequent development from an established transnational position (Dicken, 2007).

Another theoretical input with regards to FDI is Dunning's eclectic approach, the OLI-model. He highlights that three criteria must exist for a firm to be attracted to make FDI; *ownership advantages, location advantages and internalization advantages*. Firstly, some firms have a firm specific advantage if competing firms does not possess the same advantage, for example, human capital, technology, brand, reputation. Secondly, there must be location-specific advantages that make it more profitable for the firm to exploit its internalized assets in foreign, rather than domestic, locations. The location-specific factor is especially important in the context of transnational production – i.e., markets, production costs, resources and political conditions. Thirdly, internalization advantages, which are advantages by own

production rather than producing through a partnership arrangement such as licensing or joint venture (Dunning & Lundan, 2008).

As Lindberg argues, the traditional trade and FDI theories are partly relevant when applied on the East Asian context. The theories have a more Western drive and suggest that foreign trade precedes outward FDI. This contrasts to the development in East Asia where there seem to be an inward FDI launching first and promptly creating foreign trade. Hence, the export effect that the neo-classical theory suggests has not taken place. Moreover, the most important single global shift of recent times has been the emergence of East Asia, in particular China. FDI is the most capital intensive form of internalization activity. With this in mind, the foreign trade and FDI theories are relevant as they give a deeper understanding of the changes of production circuits and networks, configured at a multiplicity of geographical scales, from the local to the global.

### **3.4 The Free Trade Agreement negotiations between the EU and Singapore and other Asian strategic partners**

The EU trade policy has for a long time been characterised by a strict focus on the multilateral negotiations within the World Trade Organisation (WTO) (Lindberg & Alvstam, 2010). However, as the multilateral agreements within the WTO have shown lack of progress, bilateral free trade agreements have recently experienced resurgence in international trade diplomacy. The number of bilateral and regional FTAs has increased rapidly, especially during the last two decades. Furthermore, non EU countries, such as the US, have become increasingly active in signing bilateral FTAs and economic partnership agreements with the trading partners of the EU, inter alia ASEAN.

Against this background, the EU's economic policy strategy has changed. Although multilateralism and the Doha Development Agenda (DDA)<sup>7</sup> remain the top priority, the European Commission has engaged in bilateral negotiations with individual countries in certain key markets to increase market access and remove barriers to trade. This is most clearly reflected in the "Global Europe Strategy 2006", where the complementary role of bilateral FTAs is elucidated.<sup>8</sup> A key part of this strategy is to broaden external relations with

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<sup>7</sup> The DDA, or Doha Development Round, is the current trade-negotiation round of the WTO which commenced in November 2001. Its objective is to lower trade barriers around the world, which will help facilitate the increase of global trade.

<sup>8</sup> EC (2010) Global Europe Strategy 2006 Document. Available at: [http://trade.ec.europa.eu/doclib/docs/2006/october/tradoc\\_130376.pdf](http://trade.ec.europa.eu/doclib/docs/2006/october/tradoc_130376.pdf) [Accessed on 25 January 2011].

Asian countries giving priority to negotiations with Korea, India and ASEAN. Consequently, the EU commenced negotiations in 2006 regarding a region-to-region with the ASEAN-members. However due to a number of disagreements such as level of ambition, solving issues related to cultural differences, gaps in governance, transparency and negotiation style, and not least the lack of a common external trade policy; the negotiations came to a halt.<sup>9</sup> Additionally, the different levels of economic development among the ASEAN countries presents its own challenge, thus a regional agreement would not satisfy everybody.<sup>10</sup>

In order to overcome the hurdles, the EU ultimately changed its approach towards forming the regional agreement and embarked on bilateral trade talks with the member countries starting with Singapore. The city state's importance as a trading partner to the EU is not only reflected by its integral role in regional and global production networks, but the fact that Singapore stands for over 40 per cent of EU exports, as well as the origin of some 20 per cent of EU imports from ASEAN. This bilateral idea was not foreseen at the beginning of the process, but gradually evolved towards the end of the first year of negotiations. However, such FTAs could constitute "building blocks" that the EU and the ASEAN may wish to consolidate in due course into a region-to-region agreement (Lindberg & Alvstam 2009). Moreover, Singapore has concluded multiple FTA's over the last decade, signing FTA's with i.e. Japan, the US, China, and India, thus creating additional advantages for those countries that are included, whereas the disadvantages for those who are not, increase.

The first negotiating round took place in February 2010 in Singapore, and the second round in October the same year in Brussels. The EUSFTA is expected to go beyond lowering tariffs on goods to cover a broad range of areas, including trade in services, regulatory and other technical barriers to trade, competition policy and trade remedies. Especially, the investment and service chapters are important components that need to be adequately addressed in the negotiations. Further issues mentioned included limited banking licences for European banks.<sup>11</sup> The EUSFTA is expected to be concluded by late 2011.<sup>12</sup>

Negotiations with India were launched in June 2007, where the EU is one step ahead of the US. Once the FTA is finalised, these negotiations would result in an agreement covering more than one and a half billion consumers. Thus, the EU-India FTA has the potential of putting the

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<sup>9</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

<sup>10</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

<sup>11</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

<sup>12</sup> Personal interview with official at the Ministry of Trade and Industry, Singapore, June 9, 2010, (6).

EU in a privileged position (Ahnlid, Alvstam & Lindberg, 2011). Negotiations are on track but work remains to be done as there are important issues that need to be dealt adequately, such as how to get improvements on market access for goods and the inclusion of government procurement.<sup>13</sup> FTA negotiations with Korea have already been completed, where the Council approved the FTA and the agreement has been officially signed on 6 October 2010 in the margin of the EU-South Korea Summit in Brussels.<sup>14</sup> The final steps for an EU-South Korea FTA have been completed with the ratification of the agreement in the South Korean National Assembly and the European Parliament. The agreement is expected to go into effect on July 1, 2011.

Moreover, two major bilateral initiatives with Malaysia were launched on October 5 in 2010 and aimed at boosting bilateral trade and investment relations and creating a new strategic dimension for the EU-Malaysia political dimension and economic cooperation. The EU is going to have a second round of meetings with the Malaysian government in June 2011 to explore the feasibility of agreeing to an FTA. To conclude, by going the bilateral track, the ongoing negotiations between the EU and several East Asian countries can act as a stepping stone towards a more lucrative region-to-region agreement with ASEAN, rather than being a stumbling block and, thus, increase the inter-regional trade flows.

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<sup>13</sup> EC (2010) Trade document. 'Overview of FTA and other trade negotiations' [Online], available at: [http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc\\_118238.pdf](http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf) [Accessed on 24 May 2011].

<sup>14</sup> EC (2010) Press release in 6 October 2010, [Online], available at: <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/korea/> [Accessed on 24 May 2011].

## 4. Empirical Findings

*The aim of this chapter is to present empirical findings gained through primary and secondary data collection. To make it easier for the reader to get a clear overview of the paper this chapter will be divided into four different subsections.*

*In the first subsection (4.1), the bilateral trade flows between the EU and Singapore will be explored, with emphasis on the last decade (2000-2010). Moreover, in the wake of the economic crisis in 2008, the quarterly changes of the trade patterns of the 15 top traded commodity groups during the period 2007-2010 shall be analysed. By analysing the trade pattern of each commodity group, intriguing insights of which commodity groups have been affected the most by the recession can be explored. In the second subsection (4.2), the impact of the economic crisis on European business activities in ASEAN will be explored, as seen from the corporate level. Subsection 4.3 contains a comprehensive picture of the economic development in Southeast Asia, which begins with the corporate managers' views on the outlook for the region from an investment perspective. The following subsection (4.4) describes the business environment and the various issues that complicate companies' business activities in Southeast Asia, as perceived by European companies. Next, in subsection 4.5, European corporate expectations on the impact of the EU Singapore-FTA on local business activities in ASEAN are presented.*

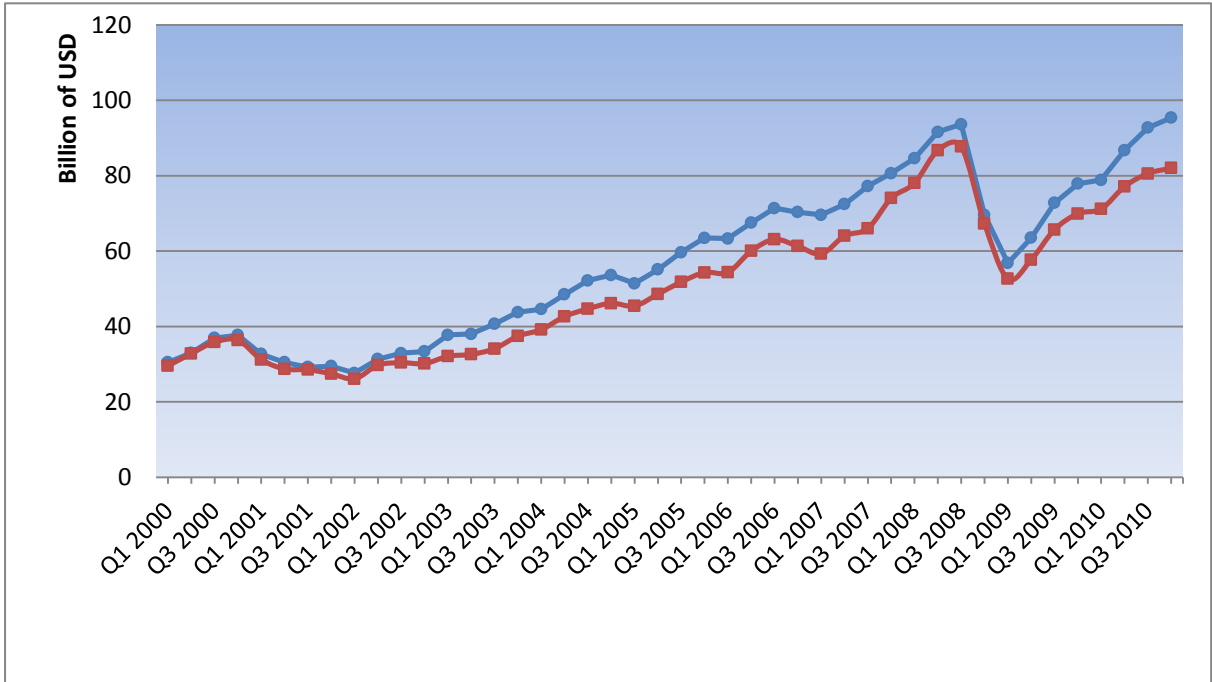
### 4.1 Bilateral trade

#### 4.1.1 Bilateral trade development between the EU and Singapore (2000-2010)

##### *Singapore's total foreign trade*

The development of Singapore's total foreign trade in absolute terms (see figure 4.1) is portrayed by rapid growth during 2002-2008, normally running a surplus in the overall trade balance. After experiencing rapid growth in both exports and imports during that period, Singapore was the first East Asian country to fall into a recession from the global economic crisis after July 2008. Consequently this resulted in a sharp decline of foreign trade. However, as the volumes started to grow again, Singapore became the second fastest growing economy in the world in 2010 with total foreign trade expanding remarkably, almost reaching pre-crisis levels. The rapid economic recovery has seen Singapore exporting itself out of recession as it did in the Asian economic crisis in 1997-98, with a spectacular V-shaped recovery.

**Figure 4.1: Singapore's total foreign trade, quarterly, 2000-2010 (absolute values, current prices)**

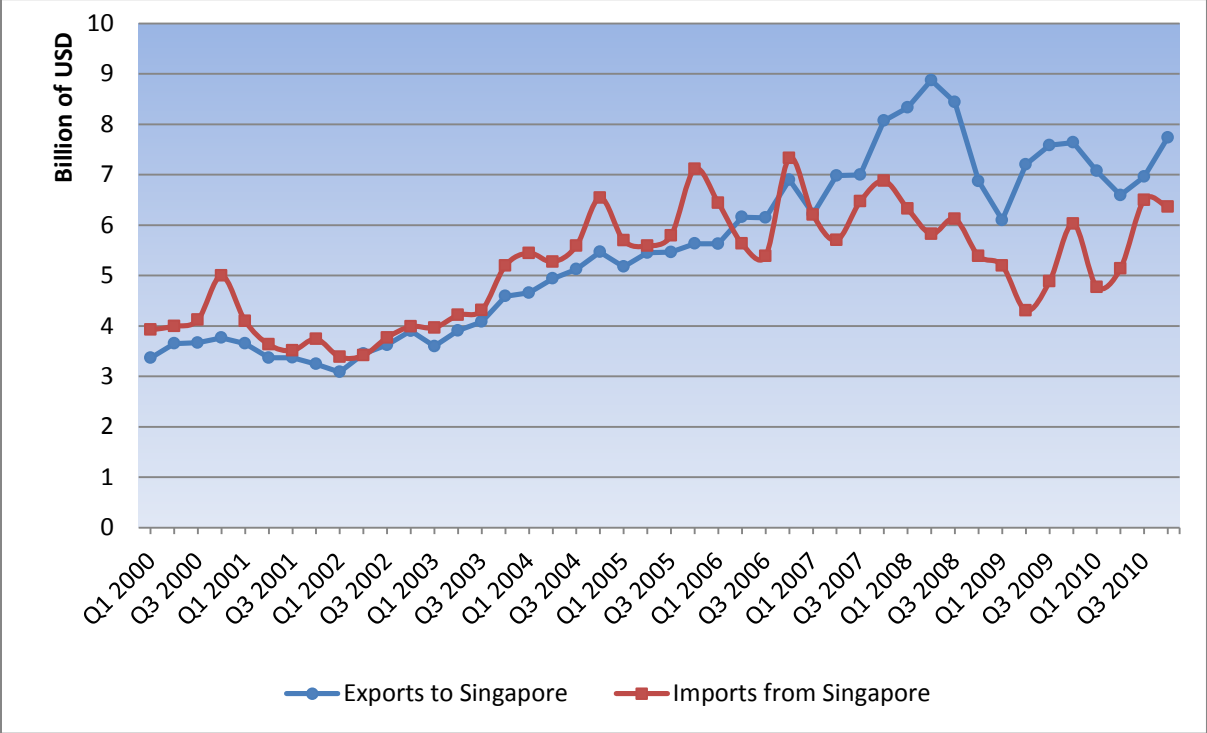


Source: IMF DOTS database, May 2, 2011

***Singapore’s trade relations with the EU***

It should be noted that there is a striking difference in the statistical reporting between Singapore and the EU, when comparing the quarterly Singaporean figures (see figure 4.2) with the EU statistics (see figure 4.3). The Singaporean figures are normally much higher. Similar results were also obtained in a study by Lindberg and Alvstam (2010) who emphasis the interregional trade between the EU and ASEAN. They found that the higher figures are presumably a result of the inclusion of transit trade. Furthermore, Singapore’s exports to the EU were time-lagged in relation to its imports in the downturn in 2008, that is, the imports dropped earlier than exports, and also started to recover earlier in 2009. Lindberg and Alvstam argue that one interpretation might be that Singapore was affected earlier than the EU by the global financial crisis, and commenced the recovery earlier (ibid).

**Figure 4.2: Singapore's trade with EU-27, quarterly, 2000-2010 (absolute values, current prices)**



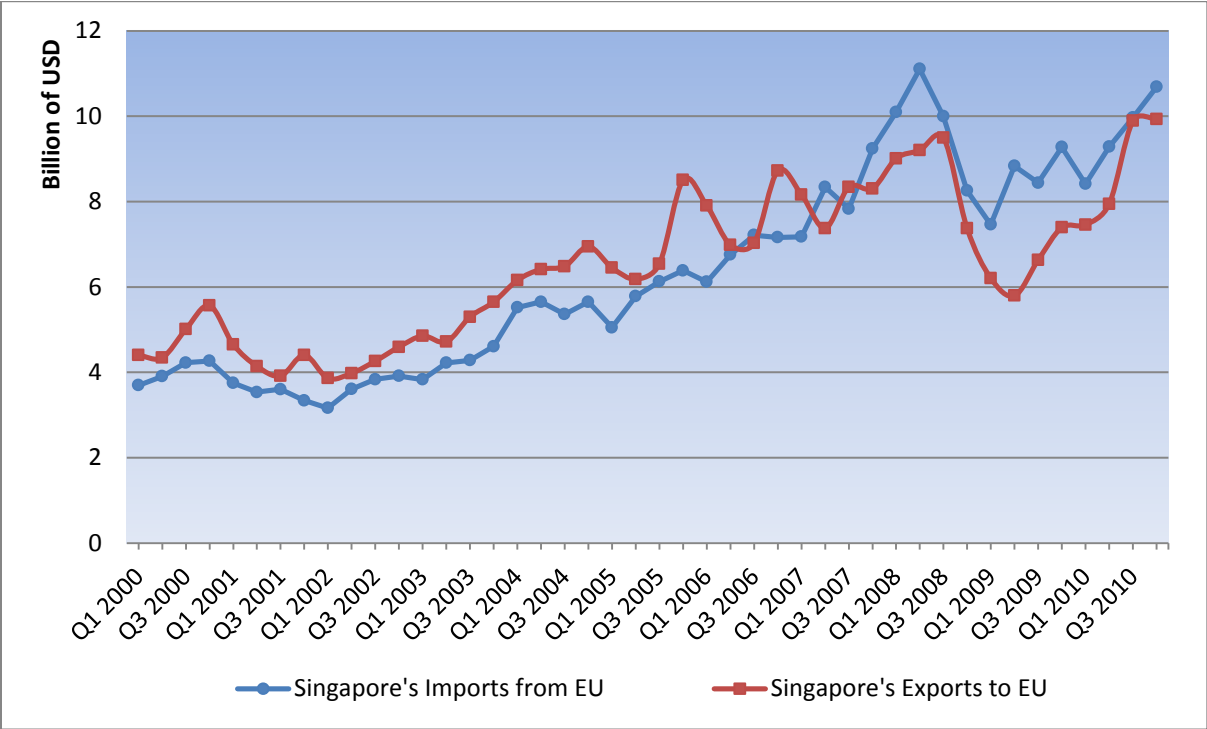
Source: IMF DOTS database, May 2, 2011

Over the last decade, the bilateral trade between the EU and Singapore has been characterised by a deficit, as seen from the EU perspective (see figure 4.3). However, the economic slowdown in the US, Japan and the EU, as well as the worldwide electronics slump, caused a fall of imports from Singapore to a lower level in 2001, which diminished the gap between imports and exports. Thereafter followed a period of steady growth, in both exports and imports, apart from 2003 when Singapore was affected by the SARS outbreak. The positive development of EU-imports from Singapore started to decrease in late 2006, although exports continued to soar steadily up to a peak during the second quarter of 2008.

Similar to figure 4.2, there is a time-lag between EU-imports from Singapore, in relation to EU-exports. The time-lag between the decline of exports compared to imports resulted in growing EU bilateral trade surplus. While imports from Singapore peaked in the fourth quarter of 2006, exports to Singapore, as seen from the EUs perspective, peaked in the wake of the economic downturn in the second quarter of 2008. Thereafter followed a period of sharp decline of EU-exports to Singapore. However, growth in both exports and imports that commenced during the beginning of 2009 has brought imports from Singapore almost to an “all-time-high”, while exports from Singapore have not reached pre-crisis levels of 2006, in

terms of absolute values. Interestingly enough, EU-imports and exports reveal a negative pattern in relation to each other, ever since the wake of the crisis in 2008.

**Figure 4.3: EU trade with Singapore, quarterly, 2000-2010 (absolute values, current prices)**



Source: IMF DOTS database, May 2, 2011

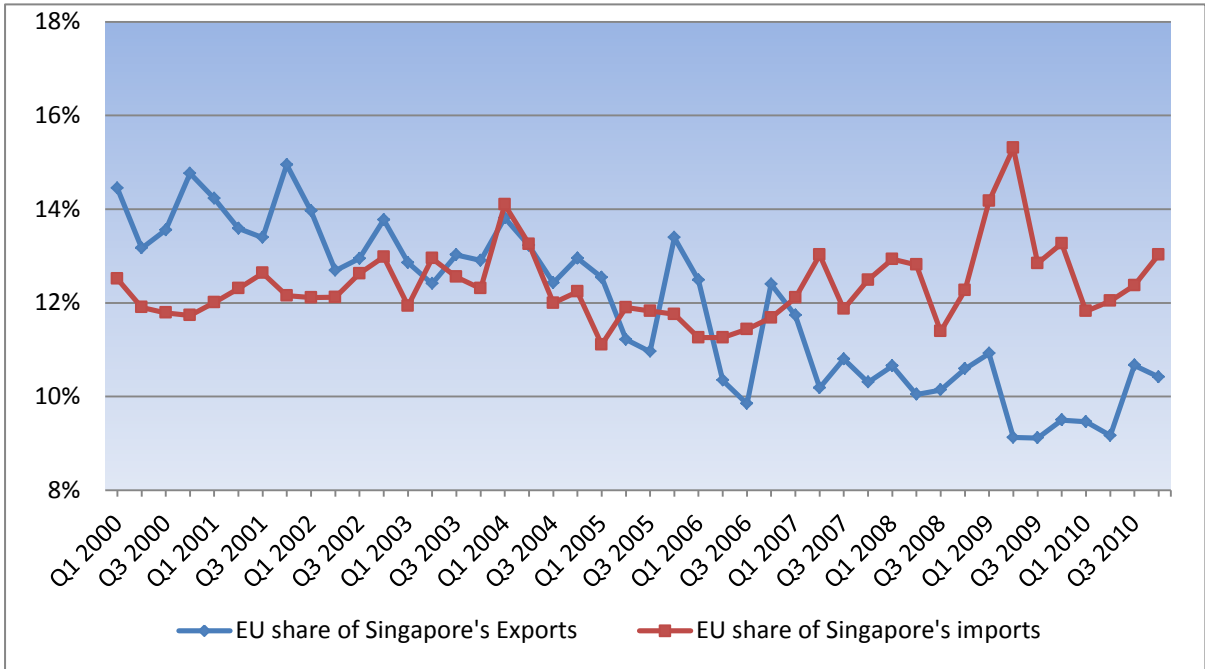
Figure 4.4 reveals more clearly that, despite the rapid growth in absolute values, the bilateral trade development between the EU and Singapore is far from positive in relative terms. On the contrary, Singapore’s long-term relative dependence on the EU as a final destination for its exports has declined during the 2000s. Hence, the significance of the EU as a trading partner to ASEAN, here measured by its share of global trade has decreased over the period 2001-2010. However, the EU share of Singapore’s total imports has been relatively stable throughout the period, apart from the rapid growth during 2009.

The decreasing significance of the EU, and the US, as a trading partner to ASEAN is even more apparent when comparing with other significant trading partners of Singapore. The Figure 4.5 reveals more clearly how Singapore’s total foreign trade with the EU and the US have decreased in relative terms. Meanwhile, foreign trade with China have increased rapidly during the whole examined period, whereas Japan displays the strongest drop, and Korean share of trade have remained stable during the period. This further indicates that the intra-



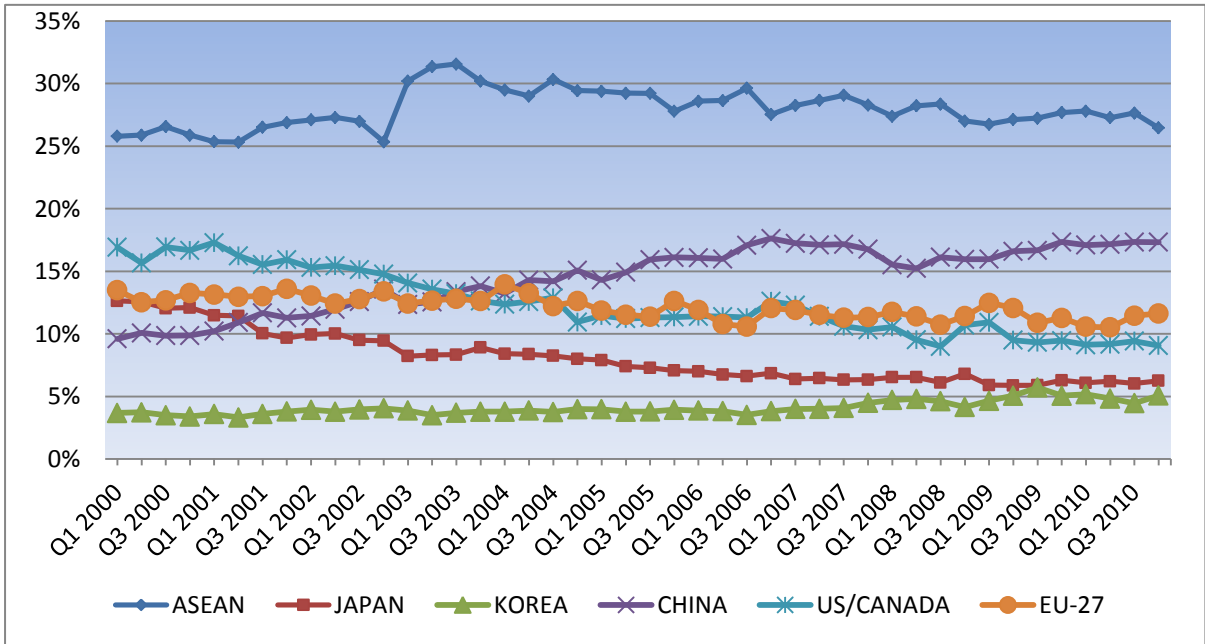
regional trade is increasing where Singapore has increased its economic relations with its neighbour countries, and particularly China, rather than the EU, the US or Japan. However, the development of intra-regional trade within ASEAN relative its total foreign trade have been fairly modest since 2003.

**Figure 4.4 EU-27 share of Singapore's trade (per cent, quarterly) 2000-2010**



Source: IMF DOTS database, May 2, 2011

**Figure 4.5 Singapore's total trade per selected partners (per cent, quarterly) 2000-2010**



Source: IMF DOTS database, May 2, 2011

#### 4.1.2 Trade development of the top traded commodities during economic downturn (1st quarter 2007– 4rd quarter 2010)

In what follows, trade statistics will initially be presented at a 1<sup>st</sup> SITC level to help determine a broad category of commodities that are relevant in the EU-Singapore trade. In order to further analyse the trade flows of commodities, data of selected commodities will be presented at a 2<sup>nd</sup> HS level. Trade patterns illustrate how the different commodities were affected by the recent economic and financial crisis to various degrees.

##### *Foreign trade by SITC classification, 1<sup>st</sup> level*

As shown in table 4.2, machinery and transport equipment, chemicals and miscellaneous manufactured articles are the dominant commodity sectors, which represent 83 percent of all bilateral trade flows between the EU and Singapore.

**Table 4.2 EU-27 trade with Singapore by various commodity groups (1<sup>st</sup> SITC level) 2007-2010**

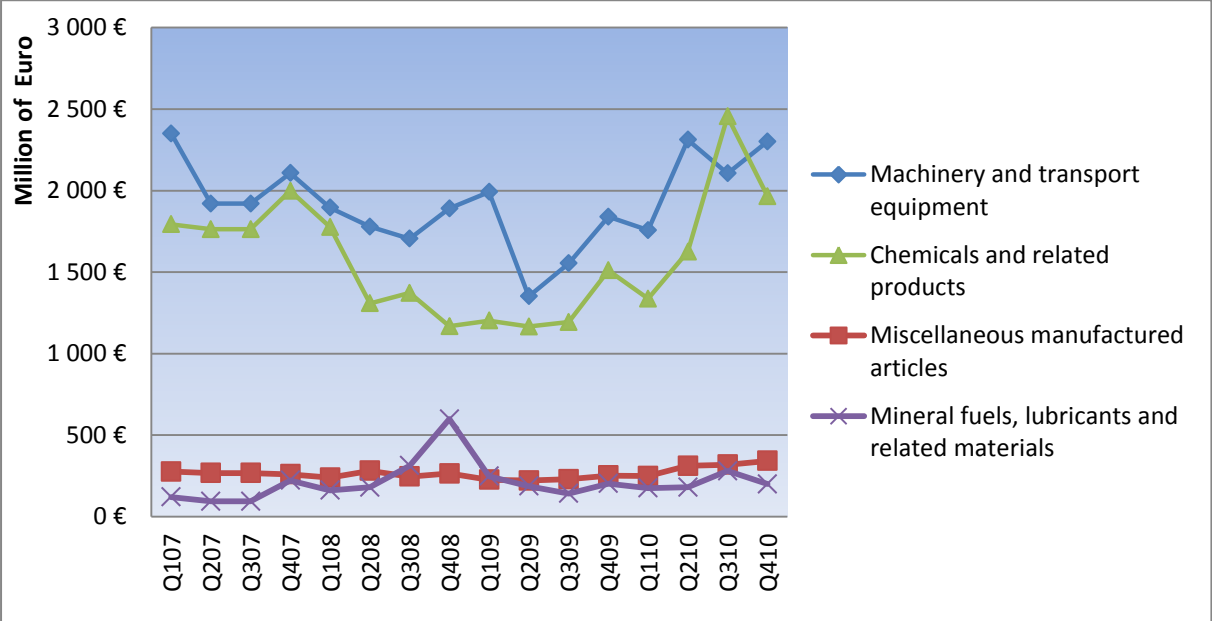
SITC	Product	Absolute values (in Million Euro)					Percentage of Total Trade				
		2007	2008	2009	2010	Total	2007	2008	2009	2010	Total
0	Food and Live animals	421,0	392,6	365,7	495,5	1 675,0	1,1%	1,0%	1,0%	1,2%	1,1%
1	Beverages and tobacco	738,8	816,8	692,3	925,5	3 173,5	1,9%	2,2%	2,0%	2,2%	2,1%
2	Crude materials, edible, except fuels	182,1	134,9	116,5	263,9	697,4	0,5%	0,4%	0,3%	0,6%	0,5%
3	Mineral fuels, lubricants and related materials	1 595,8	2 353,2	1 723,3	2 125,7	7 798,0	4,1%	6,2%	4,9%	5,0%	5,1%
4	Animal and vegetable oils, fats and waxes	17,4	21,2	29,3	40,7	108,6	0,0%	0,1%	0,1%	0,1%	0,1%
5	Chemicals and related products, N.E.S	9 853,2	8 178,7	7 605,0	10 708,8	36 345,8	25,5%	21,6%	21,7%	25,1%	23,6%
6	Manufactured goods classified chiefly by material	2 456,1	2 526,8	2 011,3	2 403,6	9 397,7	6,4%	6,7%	5,7%	5,6%	6,1%
7	Machinery and transport equipment	19 742,7	19 811,0	18 578,7	21 619,4	79 751,8	51,1%	52,3%	53,0%	50,7%	51,7%
8	Miscellaneous manufactured articles	2 921,7	2 876,3	2 709,0	3 349,2	11 856,2	7,6%	7,6%	7,7%	7,9%	7,7%
9	Commodities and transactions not classified elsewhere	484,8	636,2	466,4	384,4	1 971,8	1,3%	1,7%	1,3%	0,9%	1,3%
	<b>TOTAL TRADE</b>	<b>38 413,8</b>	<b>37 747,6</b>	<b>34 297,6</b>	<b>42 316,7</b>	<b>152 775,8</b>	<b>99,5%</b>	<b>99,7%</b>	<b>97,8%</b>	<b>99,2%</b>	<b>99,1%</b>

Source: Eurostat database, April 20, 2011

In the case of imports (see figure 4.6), the pattern clearly show the decreasing demand in machinery and transport equipment and chemicals during the economic crisis, that commenced since the beginning of the examined period, dropping to its lowest point in the

second quarter of 2009. Thereafter, both commodity sectors have grown dramatically in terms of absolute value, showing a high degree of volatility throughout the economic turmoil. Imports of miscellaneous manufactured articles and mineral fuels and related articles have been stable throughout the examined period.

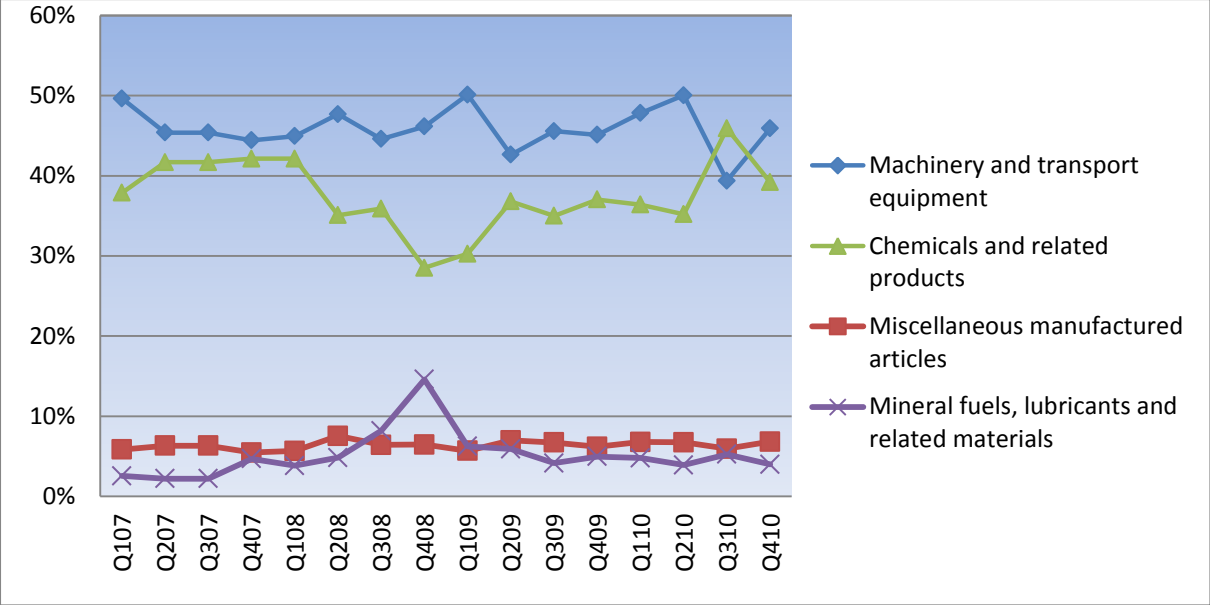
**Figure 4.6: EU-27 imports from Singapore, selected commodity groups, 1<sup>st</sup> SITC level, 2007-2010 (absolute values, current prices)**



Source: Eurostat database, April 20, 2011

Figure 4.7 shows the shares of the main EU-import commodity sectors from Singapore. While shares from respective commodity sectors have been relatively stable, the patterns of machinery and transport equipment and chemicals seem to be negatively related.

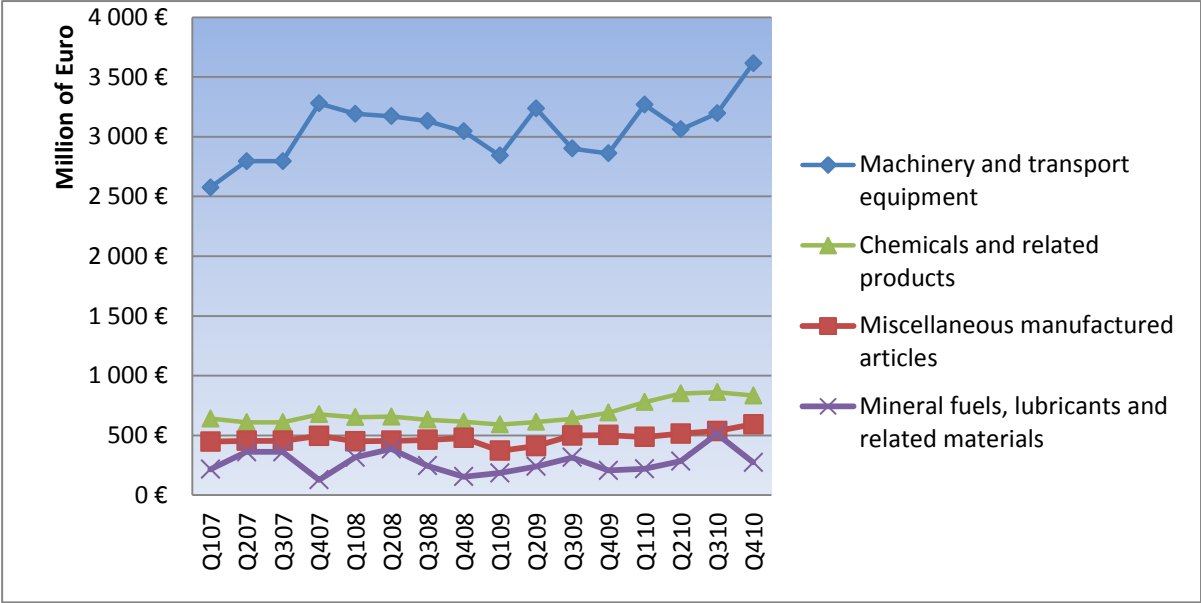
**Figure 4.7: Commodity share of EU-27 total imports from Singapore, selected commodity groups 2007-2010**



Source: Eurostat database, April 20, 2011

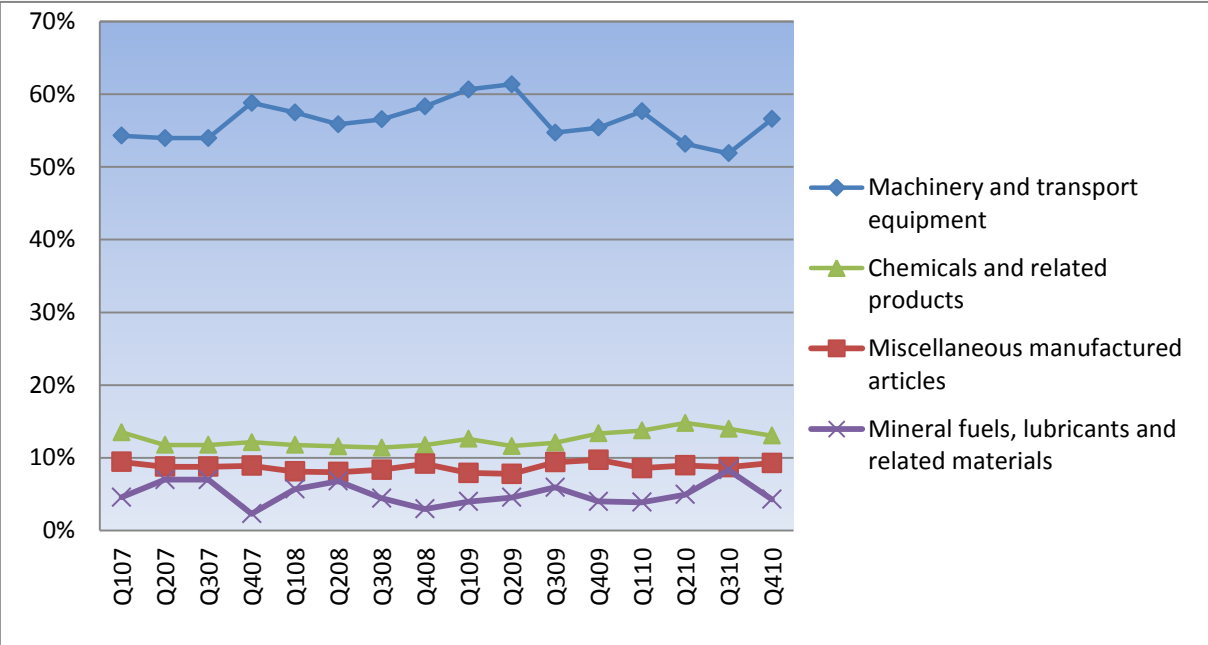
On the export side, the distribution of commodities looks very different (see figure 4.8). Here, the demand for European goods in Singapore has been consistent, even rising throughout most of the examined period, apart from mineral fuels, lubricants and related articles where the pattern of trade flows have been more inconsistent. Like EU-imports from Singapore, the pattern is similar on the export side, showing that the trade shares of the four largest commodity sectors have been fairly stable throughout 2007 to 2010 (see figure 4.9).

**Figure 4.8: EU-27 exports to Singapore, selected commodity groups 1<sup>st</sup> SITC level 2000 2010 (absolute values, current prices)**



Source: Eurostat database, April 22, 2011

**Figure 4.9: Commodity share of EU-27 exports to Singapore, selected commodity groups 2007-2010**



Source: Eurostat database, April 22, 2011

### Foreign trade by HS classification, 2<sup>nd</sup> level

It has been shown that the major part of the bilateral EU-Singaporean trade is found in SITC 7 and 5.<sup>15</sup> With the aim to further analyse individual commodity groups, the statistics have been aggregated to a two-digit HS level, since HS allows for a more detailed grouping. Emphasis is laid on the most important chapters. As shown in table 4.3, the largest share of EU trade with Singapore, in terms of total trade, was the differentiated commodities containing electrical components, machinery and appliances, accounting for 48 per cent of total bilateral trade, making it substantially larger than the other commodity groups. The absolute trade values are here presented in euro, instead of previously in dollar, for the reason that the trade statistics are provided by Eurostat. The examined 15 top traded commodities accounted for 89.10 per cent of total trade between the EU and Singapore.

**Table 4.3: Top 15 traded commodities between EU-27 and Singapore 2007-2010**

Within SITC	HS	Product	Absolute values (in Million Euro)					Percentage of Trade				
			2007	2008	2009	2010	Total	2007	2008	2009	2010	Total
7	84	Machinery and Electrical Appliances: Computer machinery	9 952,6 €	9 784,2 €	8 895,9 €	10 690,4 €	39 323,1 €	25,5%	25,6%	25,4%	25,0%	25,4%
7	85	Machinery and Electrical Appliances: Electrical equipment	8 358,3 €	7 858,6 €	5 137,8 €	6 672,9 €	28 027,7 €	21,4%	20,6%	14,7%	15,6%	18,1%
5	29	Chemicals: Organic chemicals	6 840,7 €	4 686,3 €	4 216,2 €	5 143,1 €	20 886,3 €	17,5%	12,3%	12,0%	12,0%	13,5%
8	90	Optical, precision & musical instruments:	1 905,4 €	1 818,8 €	1 758 €	2 049,5 €	7 531,7 €	4,9%	4,8%	5,0%	4,8%	4,9%
3	27	Mineral products: Lubricants/Fuels/Oil	1 411 €	2 403,6 €	1 723,3 €	2 184,3 €	7 722,1 €	3,6%	6,3%	4,9%	5,1%	5,0%
7	88	Vehicles: Aircraft, Spacecraft	620,2 €	1 268,8 €	1 915,4 €	1 676,6 €	5 481,1 €	1,6%	3,3%	5,5%	3,9%	3,5%
5	30	Chemicals: Pharmaceutical products	1 133,9 €	1 502,6 €	1 420,6 €	2 779,5 €	6 836,6 €	2,9%	3,9%	4,1%	6,5%	4,4%
5	39	Plastics	1 004,3 €	931 €	861,5 €	1 443,4 €	4 240,2 €	2,6%	2,4%	2,5%	3,4%	2,7%
7	89	Vehicles: Ships, Boats	330,9 €	350,8 €	1 861,9 €	1 457,1 €	4 000,6 €	0,8%	0,9%	5,3%	3,4%	2,6%
7	87	Vehicles: Cars, Trucks, Autos	811,6 €	847,6 €	811,7 €	1 124,2 €	3 595,1 €	2,1%	2,2%	2,3%	2,6%	2,3%
0+1	22	Prepared foodstuffs: Beverage	739,5 €	805,3 €	676,7 €	911,7 €	3 133,2 €	1,9%	2,1%	1,9%	2,1%	2,0%
6	73	Base metal and Metal articles: Articles of Iron or Steel	582,5 €	710,9 €	547,1 €	447,3 €	2 287,8 €	1,5%	1,9%	1,6%	1,0%	1,5%
5	33	Chemicals: Cosmetics	464,4 €	502,2 €	462,4 €	570,6 €	1 999,6 €	1,2%	1,3%	1,3%	1,3%	1,3%
5	38	Chemicals: Misc. Chemical Products	421,8 €	463,6 €	437,5 €	528,4 €	1 851,3 €	1,1%	1,2%	1,2%	1,2%	1,2%
6	82	Base metal and Metal articles: Tools	274,6 €	298 €	225,5 €	395,1 €	1 193,2 €	0,7%	0,8%	0,6%	0,9%	0,8%
		<b>TOTAL TRADE</b>	<b>34 851,6 €</b>	<b>34 232,2 €</b>	<b>30 951,5 €</b>	<b>38 074,1 €</b>	<b>138 109,3 €</b>	<b>89,3%</b>	<b>89,7%</b>	<b>88,3%</b>	<b>89,1%</b>	<b>89,1%</b>

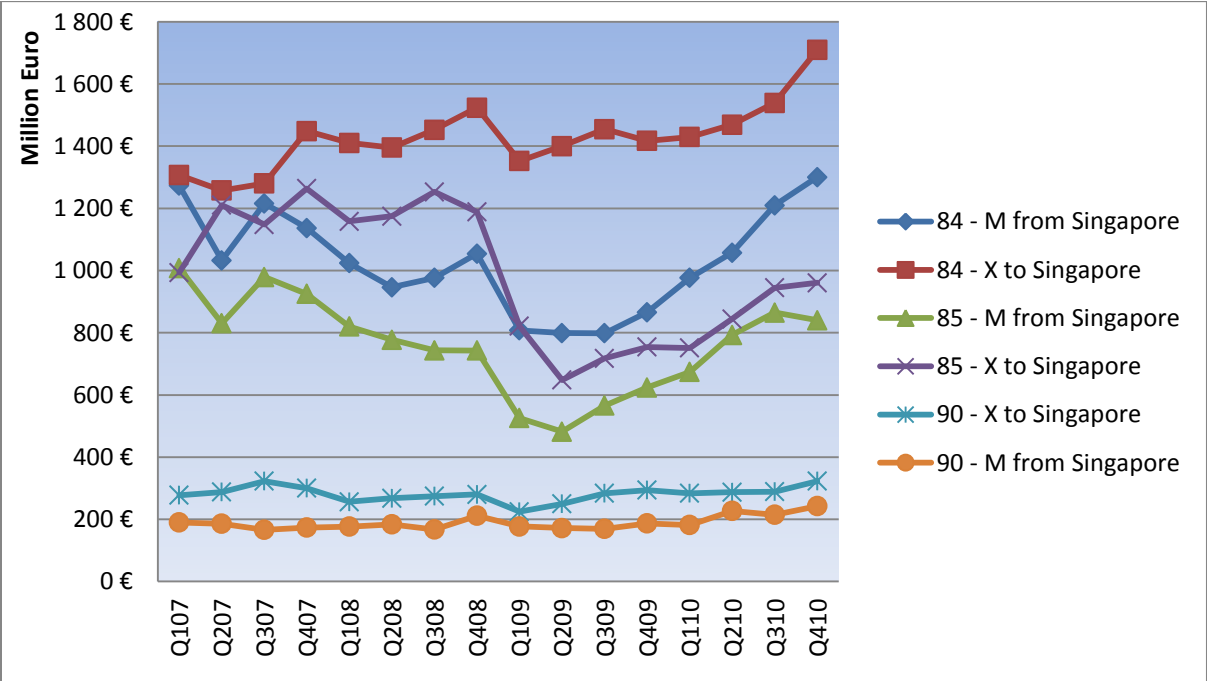
Source: Eurostat database, April 05, 2011

<sup>15</sup> HS chapters 84-89 can be found in SITC 7; HS 29-39 in SITC 5; HS 27 in SITC 3; HS 22 in SITC 0+1 and HS 82 in SITC 6

Interestingly enough, as shown in figure 4.10, exports of differentiated commodities from the EU to Singapore increased during 2007 and 2008 while imports plummeted during the same period. Albeit, there has been steady growth in both imports and exports in the differentiated commodity sector since the second quarter of 2009. Another major commodity in the same commodity group was optical/electrical instruments, accounting for almost 5 percent of total bilateral trade. The trade flows of optical/electrical instruments have been relatively stable, when compared to other differentiated commodities.

**Figure 4.10: EU Trade with Singapore, differentiated commodities 2007-2010 (absolute values, current prices)**

*HS*  
 84: *Electronic equipment*  
 85: *Nuclear reactors, boilers, machinery, etc.*  
 90: *Optical, precision and musical instruments*



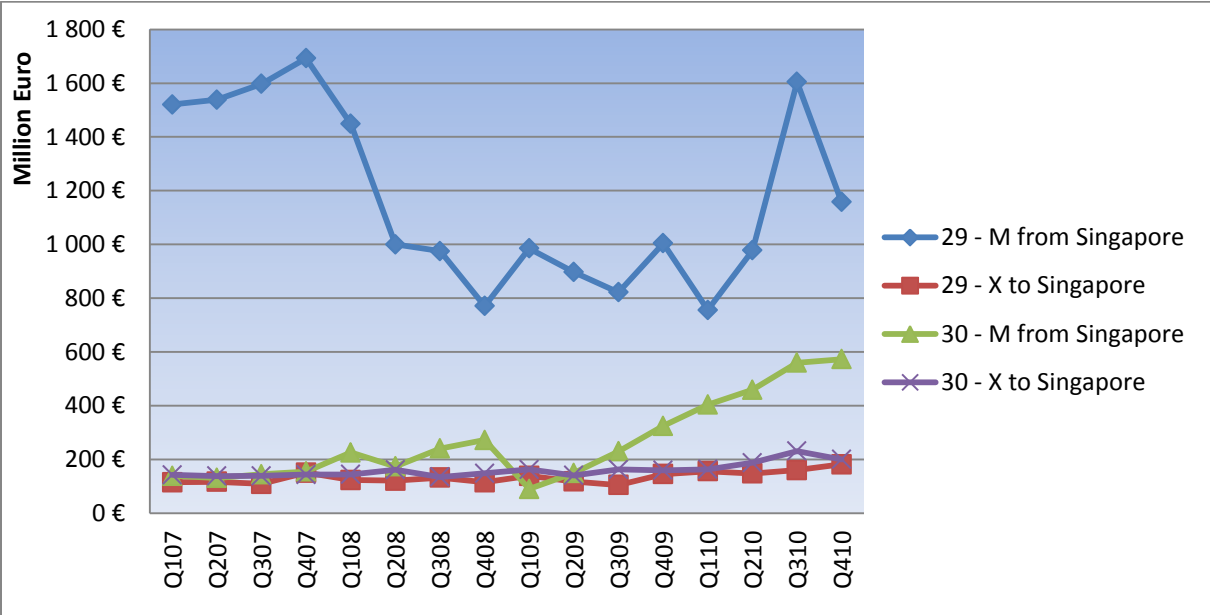
Source: Eurostat database, April 22, 2011

The second largest share of bilateral trade during the years examined was products of the chemical or allied industries, i.e. organic chemicals, pharmaceutical products and cosmetics, having shares of bilateral trade of approximately 20.4 per cent. As shown in figure 4.11, the organic chemical sector is characterised by a large EU trade deficit, which has increased during 2010. Exports of organic chemicals to Singapore, in particular, contributed to 13.5 per cent of total bilateral trade. EU-imports of organic chemicals peaked in late 2007. Thereafter, a period of sharp decline of imports followed, mostly during 2008. However, the rapid growth

of organic chemical imports from Singapore, which commenced during the first quarter of 2010, brought exports back to pre-crisis levels of 2006. Trade development of pharmaceutical products and cosmetics shows a similar trade pattern. Trade volumes of EU imports of pharmaceutical products have grown remarkably during all quarters of 2009 and 2010.

**Figure 4.11: EU Trade with Singapore, chemical sector, 2007-2010 (absolute values, current prices)**

HS:  
 29: Organic chemicals  
 30: Pharmaceutical products

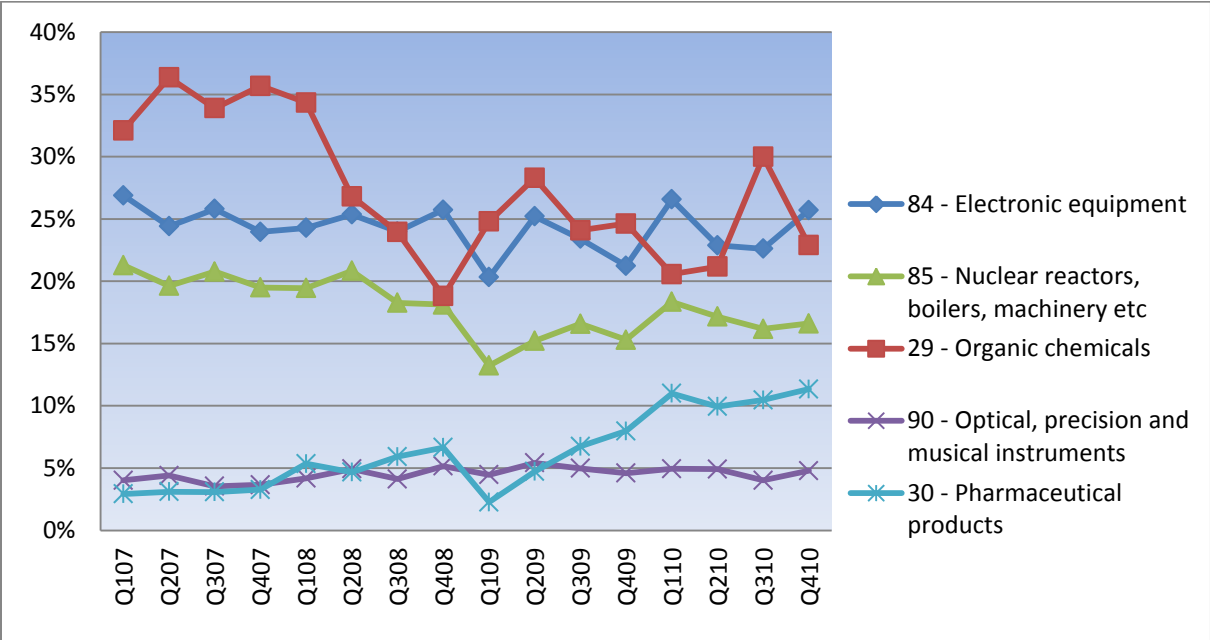


Source: Eurostat database, April 22, 2011

While figures 4.10 and 4.11 reveal the trade pattern in terms of absolute values for selected commodities, figures 4.12 and 4.13 reflect certain trends by presenting the average share of these commodities. In the case of imports from Singapore (see figure 4.12), the pattern depicts that organic chemicals' share of EU-Singaporean trade have decreased gradually since the second quarter of 2007, and becoming less important as EU-exports market for Singapore. When viewed in the bilateral EU-Singaporean trade context, organic chemicals are nonetheless an important commodity, accounting for 42.2 per cent of total EU-imports from Singapore. Electronic equipment and optical, precision and musical instruments shares of bilateral trade have remained the same during the examined period. Meanwhile, shares of the rest of the other commodities, most notably pharmaceutical products, are on the rise. On the export side (see figure 4.13), nuclear reactors, boilers and machinery, there is a downward trend in exports and in imports. Albeit, the major commodities share of EU-exports to Singapore have remained relatively the same.

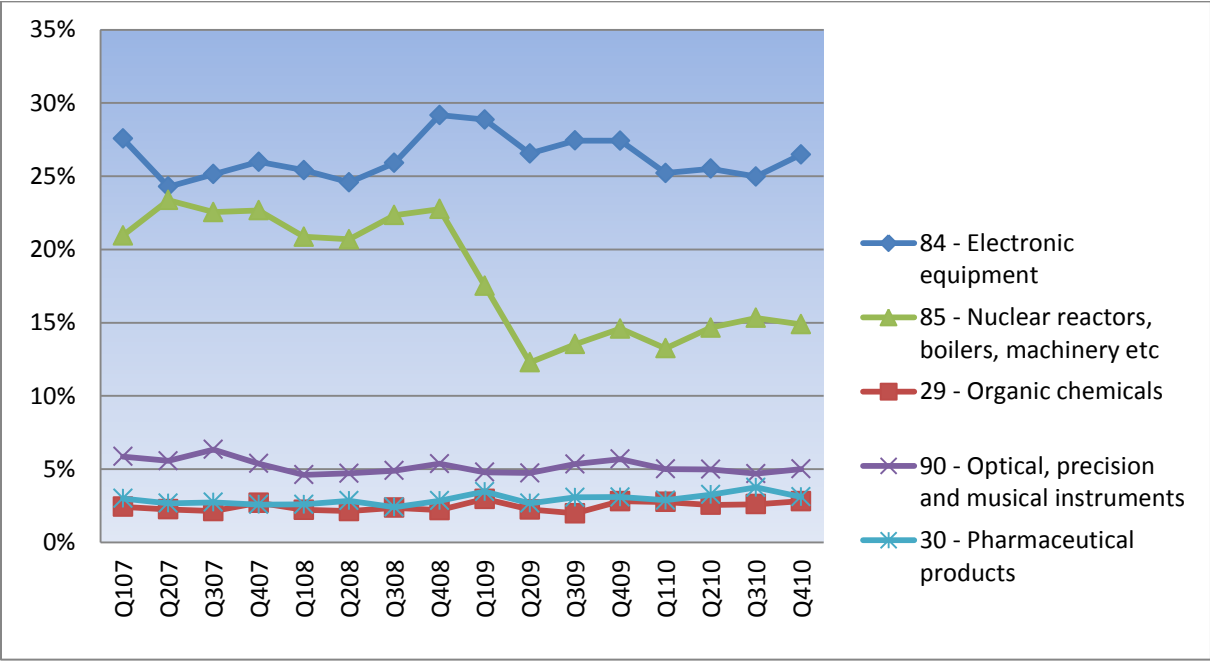


**Figure 4.12: Commodity share of EU-27 imports from Singapore, selected commodities (2<sup>nd</sup> HS level) 2007-2010**



Source: Eurostat database, April 22, 2011

**Figure 4.13: Commodity share of EU-27 exports to Singapore, selected commodities (2<sup>nd</sup> HS level) 2007-2010**



Source: Eurostat database, April 22, 2011

## **4.2 The impact of the financial crisis on European business activities in ASEAN**

The financial crisis that commenced in late 2008 has affected European companies' business activities in ASEAN to varying degrees, depending on industry sector. Several corporate managers perceived that the financial crisis have affected their companies' business activities in ASEAN only to a limited extent (Interview 1, 3). Interviewee 1 perceived that there was no big drop in demand in the electronic equipment sector. Furthermore, interviewee 1 stated that their company had learnt their lesson after being severely damaged by the Asian crisis that struck in 1997. When the financial crisis began in 2008, the company was well prepared, financed, acted quickly and managed to turn into profit. Moreover, it is being perceived that the demand for chemical products have increased since the beginning of 2008 (Interview 3).

*“Business has never been better in the chemical sector.”* (Interview 3)

However, the economic turmoil is assessed to have had an underlying negative effect on other companies' business activities in the region, in which revenue is perceived have been cut drastically for several companies (Interview 2, 4, 5). Interviewee 2 stated that the company's revenue had been cut by as much as 30 per cent. However, the company still managed to turn into profit in 2008 and in 2009. The investment climate in Southeast Asia is perceived to have changed to a great extent in the pulp and paper industry. In evolving markets, like ASEAN, the pulp and paper industry's growth rate have more or less followed the countries' GDP growth rate, unlike the US or the EU where the pulp and paper industry does not necessarily follow the same pattern (Interview 2).

Furthermore, the logistics and heavy machinery sector, more specifically manufacturers of carbide cutting tools and associated equipment, have been affected by the financial crisis to a large extent (Interview 4, 5). Interviewee 3 stated that there was a sharp decline in revenue and demand for logistics services during 2008, highlighting Singapore's importance to global production networks and vulnerability to external economic shocks (Interview 4). Albeit, the machinery sector is still perceived as evolving in Southeast Asia, mainly due to the substantial drop in business during the crisis for machinery equipment, especially capital-intensive goods. While companies have been affected by the crisis to various degrees, several companies still managed to turn into profit in 2008 and 2009 (1, 2, 3).

### 4.3 The outlook for ASEAN - from an investment perspective

The ASEAN-region is the fifth largest export market of the EU, whereas the EU is the second largest trading partner for most countries in ASEAN after the US. Furthermore, while the ASEAN member states themselves are not large enough in scale, the AFTA agreement makes ASEAN the most populated internal market in the world with over 540 million inhabitants. Therefore, ASEAN was identified by the European Commission in Global Europe strategy as an ideal FTA partner because it combines high barriers to many EU exports with huge market potential.<sup>16</sup>

*“The Southeast Asian region has a lot of growth potential and a bright future ahead; there are big opportunities for doing some good business in Southeast Asia”.* (Interview 5)

The economic recovery in Southeast Asia appears to be even stronger than envisaged, with medium-term growth prospects returning to pre-crisis levels.<sup>17</sup> The GDP is expected to average a growth rate of 5.5 per cent in 2011, and will average 6 per cent annually across the ASEAN-6 countries (Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam) over the 2011-2015 period, according to the International Monetary Fund (IMF). In comparison the US is projected to grow by 2.5 per cent in 2011, and the euro zone by 3 per cent. As the strong economic development has been highlighted by all interviewed corporate managers, ASEAN is perceived to be an attractive investment target. Interviewee 1 pointed out the variances in domestic market demand within ASEAN. The regional markets within the region appear to balance each other out over time. When demand declines in one country it is compensated with a higher demand in Vietnam, Malaysia or in another country in ASEAN. As noted in previous chapter (see figure 4.1: Singapore’s total foreign trade), the vulnerability of the Singaporean economy to global economic shocks have been acknowledged by several corporate managers, indicating that Singapore is more exposed to economic shocks than the other ASEAN member states (Interview 2, 3, 5).

*“We used to do a lot of business from Europe by exporting equipment and then sell to this part of the world but the European goods are more expensive and all the MNCs now produce in Asia instead.”* (Interview 2)

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<sup>16</sup> Cf. EC (2010) External trade: EU-trade relations with ASEAN’. Available at: [http://trade.ec.europa.eu/doclib/docs/2008/may/tradoc\\_138792.pdf](http://trade.ec.europa.eu/doclib/docs/2008/may/tradoc_138792.pdf), [Accessed on 28 May 2011].

<sup>17</sup> Speech by the Senior Director of the Office of Regional Economic Integration at the ADB Srinivasa Madhur in January 29, 2010, Singapore, at the conference: ‘Managing the economic crisis in Southeast Asia’.

Several corporate managers perceived that increasing production costs and living standards in China have made Vietnam and Indonesia as an applicable alternative to companies, especially in low production and labour intense industries as the textile and shoe industry (Interview 1). Interviewee 2 mentioned that previously there was a more clear growth pattern for the different markets around the world. If there was a boom in Europe there was rapid growth in Southeast Asia as well.

At the same time, in the early 90's, the discussion rose about the decoupling theory (Interview 1, 2). The theory based on the assumption that the Southeast Asian region had become increasingly independent of the Western economies. This was during a time when Europe had an economic crisis during 1992-95, while the Southeast Asian economies experienced tremendous growth. The emerging market decoupling theory was shown to be premature as Asia experienced an economic crisis in the late 90's. Several interviewees highlighted that Southeast Asia still has not fully recovered from the Asian crisis (Interview 1, 2, 4). Prior to the Asian crisis the ASEAN-countries experienced the same tremendous growth rate as contemporary China. One can draw parallels to the current situation in which China is growing, the US economy continues to struggle and doubts remain over the sustainability of the euro zone.

## **4.4 Challenges European companies face when doing business in Southeast Asia**

### **4.4.1 Tariffs and quotas**

Tariffs and non-tariff barriers fixed by the ASEAN countries' governments have restricted European companies' business activities in Southeast Asia to varying degrees. Seeing as Singapore's average tariff rate was zero per cent in 2009, none of the interviewed corporate managers perceived tariffs as a barrier to trade in Singapore. However, importers of beer from EU countries are forced to pay an import duty, which domestic producers are exempted from. This implies a significant disadvantage in competition with local beer producers.<sup>18</sup>

Although there are only a few barriers to trade in Singapore, all interviewed corporate managers stated that they were affected by tariff duties in other ASEAN countries to a limited extent. Hence, seeing as Interviewee 3 stated that the tariff duties have had a big impact on the company's exporting activities to Europe.

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<sup>18</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

Tariff duties and customs procedures are still an issue, most notably in Indonesia whose government is active in protecting local interest with excessive tariff duties (Interview 1, 2, 3). Tariffs as a barrier to trade seem to be less significant in Thailand and in Vietnam (Interview 1, 2). With the implementation of the AFTA agreement, the tariff duties have been reduced when trading within the ASEAN region (Interview 2). Furthermore, as the tariff duties have been reduced to a low level, it has also raised the competition within ASEAN. None of the interviewed corporate managers perceived any quotas as a barrier to trade. However, there is a quota on qualifying full bank licences and wholesale licenses, which imply a limitation to market access in Singapore for European banks.<sup>19</sup>

#### **4.4.2 Non-tariff barriers**

Non-tariff barriers, however, are perceived to have a more extensive impact on European business activities in ASEAN. The complexity of red tapes, in terms of logistics and transport, and poor communication between the various ministries, raises difficulties for European companies' to operate in Southeast Asia (Interview 1, 2, 3, 4). The level of bureaucracy is perceived to be high according to all corporate managers. Especially dealing with custom and port authorities are characterised by administrative regulations and requirements that lack transparency. All public authorities in Indonesia publish their regulation in Indonesian which makes it difficult for foreign companies to get information on regulations, restrictions and requirements concerning their business (Interview 5). As regulations are sometimes very complex, interviewee 1 stated that it is not uncommon that officials from customs or tax authorities do not know their own regulations. Some countries in Southeast Asia are perceived to have a poorly developed legislation system, most notably Indonesia, thus corruption is widespread (Interview 1, 2, 3, 4) and opposes a major obstacle to trade (Interview 3, 5).

*“Corruption and protectionism are there to protect local interest. Therefore, we are quite limited when doing business in Vietnam as we are expected to provide an envelope with money basically as a commission for the buyers.”* (Interview 1)

Corruption is assessed to have an underlying effect on European companies' inclination to commit investments into several countries in ASEAN, particularly in Vietnam and Indonesia. Several interviewees highlighted the commonness of under-the-table money and the fact that competitors often use bribes. The expectation on companies to pay a commission fee, just to

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<sup>19</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

enter the market, has limited their business activities in the Southeast Asian region (Interview 1, 3).

Protectionism of local industries is even more apparent in Indonesia; a foreign direct investment company can only take the form of a 100 % foreign owned company with limited liability or established as a limited liability company through joint venture with Indonesian partners. Interviewee 1 stated that the previous mentioned regulation was the major reason why their company opted for local production in Singapore, Malaysia and Thailand instead.

*“Another big obstacle to trade in Indonesia is the troublesome, too employee friendly, labour law.”* (Interview 2)

The strong labour legislations in Malaysia, Indonesia and especially Vietnam imply massive obligations for European companies. These laws may eventually result in unpredictable costs as lay-off regulations are restrictive, even in case of misbehaviour shown by employees. The termination compensation imposes unpredictable risks for employers in case of dismissal of staff (Interview 2). Additionally, interviewee 2 mentioned that regulations on employee protection are so strict it inhibits companies just to enter the markets even if these countries are characterized by a low labour cost structure. Lack of enforcement of Intellectual Property Rights Protection has been another stumbling block for European companies to commit investments into several countries in ASEAN (Interview 1, 2, 4, 5). The various issues that complicate business ASEAN, which have been acknowledged by the interviewees, depict the difficulties of concluding a region-to-region FTA with ASEAN.

A similar pilot study was made by Lindberg in 2007 regarding barriers to trade in ASEAN and the possible benefits of an EU-ASEAN FTA.<sup>20</sup> She found that the majority of the interviewed companies face at least some kind of barrier to trade in the region. Albeit, that these companies had learnt to deal with them. However, new company establishments in the region may pose greater challenges. Moreover, while the companies could not really see the true benefits of an EU-ASEAN FTA the results of the study point to the need for raising the level of awareness about the potential usefulness of FTAs.

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<sup>20</sup> Cf. Lindberg, L. (2007a). ‘A Status Report on the ASEAN & EU-ASEAN Economic Integration in 2007 - including a pilot study on the interests of the Swedish business sector in Singapore.’ April, 2007. Available at: <http://gup.ub.gu.se/gup/record/index.xsql?pubid=65939>

## 4.5 Expectations on the EU-Singapore FTA

In early 2010, the EU launched FTA negotiations with Singapore; the aim is to go beyond lowering tariffs on goods to cover a broad range of areas, including trade in services, regulatory and other technical barriers to trade, intellectual property rights and competition policy.<sup>21</sup>

*“There are so many FTAs in place nowadays; therefore it is important the EUSFTA is realized to level the playing field for European companies”.* (Interview 2)

As regulations generally do not impose actual barriers to trade, in the sense that they entirely inhibit certain business, there are certain restrictions that impose difficulties to European companies<sup>22</sup>. Interviewee 2 indicated that European companies don't compete on the same terms and conditions as American and Japanese companies given the preferential treatment American and Japanese companies attain from the already implemented FTAs Singapore has signed with US and Japan.

*“The agreement will further strengthen the excellent economic relations between Singapore and the EU”.*<sup>23</sup> (Interview 6)

All corporate managers stated that they had a rather positive perception of the upcoming EU-Singapore FTA, albeit with a dissimilarity on the extent to which the agreement would have an effect on their business activities in Singapore and the rest of ASEAN region. Regarding tariff rates, none of the interviewees expected that the FTA would affect their business in Singapore considering that the weighted average tariff rate was 0 percent in 2009. However, interviewee 3 stated that dismantling tariff rates for the chemical sector in the EU could have a direct impact on the company's exports to the EU.

Interviewee 1 perceived that the upcoming agreement could give better preferential access to EU markets for manufacturing companies in Singapore, especially in sensitive industry sectors, who export their goods to the EU. Dismantling tariff rates in other Southeast Asian countries could result in a more direct effect on companies' business activities in the region (Interview 3, 4, 5). It is being perceived that an FTA with the EU would also provide benefits for Singapore such as tariff concessions for eligible goods, mostly in the electronics sector

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<sup>21</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

<sup>22</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

<sup>23</sup> Personal interview with official at the Ministry of Trade and Industry, Singapore, June 9, 2010, (6).

and chemical sector. Other potential benefits are improved market access for committed sectors, removed quantitative restrictions for committed sectors, and mutual recognition of standards and qualifications.<sup>24</sup>

Interviewee 2 indicated that, even though intra-Asian trade is growing rapidly, the upcoming FTA will help smoothen and increase European share of trade in Southeast Asia as there will still be a demand on European goods. By concluding the EUSFTA, European companies operating in Southeast Asia will become more competitive only to a certain extent. It is perceived that companies will still have to keep services and products competitive while lowering their production costs. Furthermore, several interviewed corporate managers acknowledged the difficulties in the EUs efforts to conclude a multilateral agreement with ASEAN (Interview 1, 2, 3).

*“It would be too difficult concluding a regional agreement including Myanmar, considering the political situation and the US sanctions.” (Interview 2)*

The city state is the EU's 15th largest trading partner and largest trading partner among ASEAN states. Conversely, the EU is Singapore's largest trading partner and foreign investor, and second largest trading partner. Thus, the EUSFTA forms a high level of interest to Singapore as well. Singapore and the EU enjoy close economic relations that, it is hoped, will be boosted further by the EUSFTA.<sup>25</sup>

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<sup>24</sup> Personal interview with official at the Ministry of Trade and Industry, Singapore, June 9, 2010, (6).

<sup>25</sup> Personal interview with official at the Ministry of Trade and Industry, Singapore, June 9, 2010, (6).



## 5. Analysis

*This chapter aims at synthesizing the four previous ones in a summarizing analysis consisting of two main sections. The first part, subsection 5.1, revisits the theoretical framework and highlights what theories have been found to be the most relevant. The second part, section 5.2 attempts to answer the three research questions.*

### 5.1 The theoretical framework revisited

One of the objectives of this study has been to examine the bilateral trade flows between the EU and Singapore, in times of the recent economic turmoil. Theories originating within economics such as the classical/neoclassical integration theory, geographical economics, foreign trade and FDI theories have been applied in order to critically examine and describe the patterns of trade. These theories deal primarily with the conception behind trade creation, trade diversion, and regional integration in general. Therefore, a central issue concerns whether they are applicable and sufficient in the Southeast Asian context, and the implementation of new FTAs, i.e. the EUSFTA, in the prevailing schemes.

It was found that the traditional theories are all relevant, albeit to various degrees, as they contribute with different perspectives. The classical/neoclassical integration theory suggests that reducing barriers to trade contribute increased welfare. Hence, that there is a positive correlation between the different stages of economic integration and increases in trade flows. Therefore, by concluding the EUSFTA, the EU-Singaporean trade flows will increase. This scenario has been acknowledged by several corporate managers and representatives from both parties. However, one may argue over the theory's ability to capture this process in ASEAN, as the classical integration theory is deeply rooted in the European context (Lindberg, 2007b).

The AFTA agreement is at the second stage of Balassa's customs union concept, with plans to advance to an economic community in 2015, without transforming into a customs union in between. While the aim of the ASEAN economic community is free flow of goods, services, capital and labour, the latter three categories are very unlikely to be fully liberalised by then. There are several issues that need to be dealt with, such as the highly different levels of economic development among the ASEAN countries, ranging from the highly developed Singapore to protectionist Myanmar/Burma, cultural differences, gaps in governance, and the fact that ASEAN does not have a common foreign trade policy. It is widely believed that if

these issues are not achieved the ASEAN economic community 2015 will just remain a political dream and not a possible scenario, at least not in the near future.

The disadvantage of geographical economics is its failure at testing the theory in a more empirical context, considering that trade flows does not pay attention to the geographical origin or destination, but represent trade statistics derived from border-crossing. This categorisation proved useful in chapter four, when analysing Singapore's foreign trade relations. Here, the geographical closeness seems to be important, seeing that Singapore's external trade has increased with its neighbouring countries (cf. figure 4.5). This further indicates the major impact of intra-trade flows. As global supply chains and production networks are globalised, the ability to invest freely in emerging markets becomes even more important. Hence, a linkage between interconnectivity in global production networks and the logic of intra-firm trade in transnational corporations can be drawn.

Foreign trade and FDI theory have been difficult to apply on the Southeast Asian region, seeing that inward FDI has been the precursor of foreign trade in Southeast Asia, unlike in the EU where the pattern have been the opposite. Nevertheless, the foreign trade and investment theories have been useful to understand the patterns and economic benefits of foreign trade in general. Moreover, the MNCs role in world trade should not be neglected.

## **5.2 Bilateral trade**

The central question for this analysis of the patterns described in chapter 4.1 is how the bilateral trade flows between the EU and Singapore has developed over the last decade, and which commodities have been affected the most by the recession that started in the beginning of 2007.

The large fluctuations of Singapore's foreign trade confirms how changes in the global economy have affected Singapore's volume of trade more than anywhere in the world and the city state's exposure to external shocks. Albeit, the country's openness to trade have enabled the country to export itself out of the recession and benefiting the most from a recovery.

It has been shown that bilateral trade between the EU and Singapore has, despite rapid growth in absolute values during the past decade, not developed at the same pace as intra-regional trade in Southeast Asia (see Singapore's external trade relations in figure 4.5). While intra-regional trade within ASEAN relative its total foreign trade has been fairly modest, the general expansion of foreign trade in Southeast Asia and the contribution by the ASEAN

member countries in the accelerating process of globalisation and integration has been extremely successful (Lindberg & Alvstam, 2009). The striking differences between EU imports and exports from Singapore indicate that Singapore exports are increasingly destined for markets in other parts of the world, particularly to China, who has been an increasingly important trading partner to Singapore, and other countries in East Asia. As have been argued by Ahnlid, Alvstam and Lindberg (2011); the EU is slowly but steadily losing shares in world trade, particularly in relation to Asian partners.

The bilateral trade surplus, as seen from the EU perspective, has remained ever since the beginning of 2007. Considering that Singapore is the EU's main trading partner in ASEAN, by being the destination for over 40 per cent of EU exports to ASEAN, as well as the origin of more than 20 per cent of EU imports from ASEAN, it is not assumptive to say that EU's role as an important trading partner to ASEAN is decreasing. This has been confirmed by several interviewed corporate managers, giving a similar picture of the development. Interviewee 2 indicated that the share of European trade has decreased in Southeast Asia because the intra-Asian trade is growing at a higher pace. The intra-Asian trade is perceived to have outgrown European share of trade in Southeast Asia, or at least will in the near future. Having said that it is quite feasible to say that a "decoupling" is actually taking place and that Southeast Asia has become a self-contained economic entity.

*"The absolute purchasing power is after all much higher in the Western economies than in Southeast Asia. ASEAN are not islands that are unconnected to the rest of the world".*  
(Interview 1)

However, while the relative growth rate is higher in Southeast Asia, the absolute volumes are much higher in the US and in Europe. In an age of globalization, emerging markets like Southeast Asia are a part of the world, thus a potentially new economic slowdown in the US is likely to be felt globally. Moreover, the continuing rise of China and its role in regional production networks is central to the decoupling hypothesis. As was shown in figure 4.5, China's share of Singapore's total trade have increased remarkably over the last decade from 10 per cent to over 17 percent, making China a major economic player in Southeast Asia. Thus, the decoupling fallacy can be seen in the global context rather with a shift from the previously Asian dependence on the Europe and North America towards a more balanced and increased dependence within Asia, with China as a dominant economic power.

### **5.3 The financial crisis impact on top traded commodities and on European companies business activities**

The more detailed investigation of the commodities' trade patterns reveals that the financial crisis that commenced in early 2007 has affected the commodities to various degrees, depending on industry sector. While the demand for differentiated commodities, containing machinery and electrical appliances, has experienced a sharp decline during the recession the demand for chemical products has interestingly enough increased rapidly. These observations have to a certain extent been confirmed by several corporate managers when comparing the trade statistics, where the rising demand for electronic equipment (as shown in figure 4.10) and chemical products has also been singled out by interviewee 1 respective interviewee 3. However, the recession is assessed to have had an underlying negative effect on other companies' business activities in the region, i.e. companies in the pulp and paper industry, logistics and heavy machinery sectors have been affected by the financial crisis to a large extent, affecting companies' revenue and demand for their products and services (Interview 2, 4, 5).

### **5.4 The business environment in Southeast Asia as perceived by European companies**

Seeing as Singapore is one of the most business friendly countries in the world, none of the interviewed corporate managers perceived any barriers to trade in the city state. Therefore, the EU-Singapore FTA is expected to have a rather limited effect on the companies' business activities in Singapore. Albeit it perceived important that the agreement is concluded as soon as possible, despite the fact that none of the interviewed corporate managers perceived any difficulties doing business in Singapore, discrimination, nor preferential treatment, to local and foreign companies. There are issues that need to be adequately addressed in the EUSFTA. Elimination of tariffs for eligible exports, improved market access for committed sectors (i.e. the banking sector) removal of quantitative restrictions, and easing conditions for committed service sectors are key elements for improving the business climate further.

Even though the tariff rates have been reduced and customs procedures are slowly improving in ASEAN, dismantling the non-tariff barriers has been a slow progress (Interview 1, 2). Analysing the impact of the AFTA agreement on non-tariff barriers to trade, all interviewed corporate managers stated that there has been a somewhat gradual improvement since the implementation of AFTA. As stated earlier, the high level of bureaucracy and the strong

governmental influence on trade regulations are still an issue in several ASEAN countries. Albeit, the openness of Singapore have increased other ASEAN countries' willingness to further open up their local markets. Moreover, all interviewed corporate managers stated that they had chosen Singapore as a hub from which to serve the ASEAN-region.

The 1997-1998 financial crisis prompted ASEAN to accelerate regional financial co-operation. Several interviewees further described how the economic integration in ASEAN have somewhat had an indirect positive impact on companies' business activities in the region. The various FTAs signed, most notably the AFTA agreement, have slightly improved the business environment (Interview 1, 2, 3).

*“Regardless, doing business in ASEAN is not that difficult”.* (Interview 5)

Despite the various issues that complicate European business activities, which have been presented in the previous chapter, the business climate is perceived as positive, mainly for the potential benefits when investing in the region, and the fact that they had learnt to cope with the issues when doing business. The EUSFTA would seek to create additional trade and investment opportunities.

## **5.5 The EUSFTA negotiations**

The EU is the largest trading bloc worldwide. Hence, in order to maintain its position in international trade the EU stands to gain from improving the global trading environment. Globalisation driven by growing trade and capital flows, deepening financial markets and falling transportation costs has created unprecedented economic growth, particularly in Southeast Asia, China and India. A combination of great market potential and further economic growth development presents great opportunities for European corporations. In a world marked by rapid globalisation and increasing competition, the EU needs to ensure that European corporations can compete successfully.

Moreover, a trend among many East Asian countries is engaging in BTAs and RTAs, with Singapore in the front seat. Singapore has been extremely active on the bilateral front over the last decade, signing FTAs with Japan, the US, Australia, India, and more recently China (concluded in late 2008). The multitude of bilateral FTAs create unequal preconditions for European companies and puts companies from Singapore's FTA partners at a different level

of playing field.<sup>26</sup> The utilisation of these FTAs has been relatively high, hence that they have had a positive effect on the business environment, and the trade flows with respective partners have increased.<sup>27</sup>

In a time when the multilateral route seems to be close, by engaging with Singapore, the bilateral negotiations are also an important step towards a better interconnectedness of Europe and ASEAN.<sup>28</sup> Furthermore, the agreement needs to send a strong political message to the other Southeast Asian countries to step up their economic engagement with the EU, especially after negotiations concerning an EU-ASEAN trade pact fizzled out.<sup>29</sup>

The transit issue in ASEAN, e.g. establishing the country of origin when classifying a commodity or service at the entry of the EU, will be one of the major challenges in the Bilateral Trade Agreement (BTA) negotiations between the EU and Singapore. While trying to negotiate a far-reaching FTA with Singapore, there is a need to take other negotiating parties into consideration. All ASEAN members' concerns and issues will have to be addressed, although they will negotiate as a single unit.<sup>30</sup> The EUSFTA can serve as a good example of how the EU and ASEAN can further deepen its economic relations. While, concluding the EUSFTA remains a challenge, representatives from the EU-delegation and the Ministry of Trade and Industry of Singapore acknowledged that the FTA negotiations have been a fast process so far.

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<sup>26</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

<sup>27</sup> Personal interview with official at the International Enterprise Singapore, Singapore, June 10, 2010, (8).

<sup>28</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

<sup>29</sup> Personal interview with official at the Ministry of Trade and Industry, Singapore, June 9, 2010, (6).

<sup>30</sup> Personal interview with official at the EU delegation, Singapore, June 11, 2010, (7).

## **6. Conclusions**

### **6.1 Concluding remarks**

Bilateral trade between the EU and Singapore has, despite rapid growth in absolute values during the past decade, not developed at the same pace as intra-regional trade in Southeast Asia. This thesis has revealed that the decoupling fallacy should not be seen as Southeast Asian interdependence from the Western Economies but rather as shift towards a more balanced and increased dependence within Asia, with China as a dominant economic power.

Trade patterns also reveal that the financial crisis that commenced in 2008 has affected commodities to various degrees, depending on industry sector. The recession is perceived to have affected European companies' business activities in Southeast Asia to various degrees. While assessing the EUSFTA positively, European companies expect a rather limited impact on their business activities in the region. However, the EUSFTA's importance should not be neglected. Ever since the Doha round collapsed, it has triggered a "spaghetti bowl" of bilateral FTA's; whereas Singapore has concluded 15 FTA's over the last decade. With each new agreement the additional advantages for those countries that are included, diminish whereas the disadvantages for those who are not, increase. Thus, the question is not "What advantages can EU business get from an EUSFTA?", but "What disadvantages can EU business suffer for not having an EUSFTA?"

An EUSFTA would level the playing field for European companies, eliminate trade barriers and local discriminations, and consequently lead to a more investor-friendly ASEAN. Considering that ASEAN with its AFTA agreement is the world's largest market with almost 600 million in population, the EU stands to gain from improving its economic relations with ASEAN. Thus, it is crucial to give high priority to the ongoing FTA negotiations and to consider the opportunities of initiating negotiations with other major economic partners. An FTA with Singapore may serve as a pathfinder and template for future bilateral agreements with other ASEAN members, which could finally lead to a more lucrative region-to-region agreement with ASEAN.

### **6.2 Academic implications**

There are many alternatives when it comes to further research on analysing the trade development of foreign trade. First of all, this study has analysed and described the bilateral trade development between the EU and Singapore over the last decade, with emphasis on

analysing patterns of the top traded commodities at the second HS level during an economic downturn. Thus an attempt at disaggregating the commodities further should be of great interest. Furthermore, this research implies opportunities for future research on the development of inter-regional trade versus intra-regional trade with regards to the impact of new bilateral and multilateral FTAs.

One of the research questions that partly has remained open in this thesis was the proposed impact a future EUSFTA may have on business activities in ASEAN. It should therefore be of great interest to explore the benefits of the EU-Singapore FTA once the agreement is ratified and entered into force. Moreover, one may argue whether bilateral free trade agreements should be seen as a ‘stepping-stone’ or a stumbling block in the context of trade creation and economic welfare. Thus, further empirical observations that give support to any standpoint should be welcomed.

### **6.3 Managerial implications**

An important component of this study has been considering the elaborated findings and acknowledging the challenges European companies face when doing business in Southeast Asia. This thesis should provide managers with insights into the Southeast Asian business environment and the economic outlook for the region. Thus, this study should, hopefully, contribute to identifying potential challenges and assessing business opportunities that may arise in Southeast Asia for companies.



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4. Corporate manager at a major Swedish company in the logistics sector, Singapore, June 8, 2010.
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6. Official at the Ministry of Trade and Industry, Singapore, June 9, 2010.
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## **Appendix 1: Interview questions for representatives' of the European business community in Singapore**

*How did the intra trade between the EU and ASEAN develop over the past decade, and to what extent has the general decline in trade between the EU and Singapore, respectively, caused by the recent economic turmoil, affected their intra trade flows?*

*What are the possibilities for using the EU-Singapore as a stepping stone towards a regional agreement with the rest of ASEAN?*

*How will the EU-Singapore FTA affect the bilateral trade flows?*

*How has the failure to conclude a regional agreement with ASEAN affected European countries?*

*Do European companies compete on the same terms and conditions as local and American companies?*

*How has the previous FTA:s impacted the business environment?*

*How has the investment climate changed?*

*How has the regional integration and the FTA agreements affected the company itself and its operations?*

*How have tariffs changed and what has been the impact on the company?*

*How have customs practices and procedures changed and what has been the impact on the company?*

*What makes South East Asia/ASEAN region an attractive investment target?*

*What makes Singapore an attractive regional hub?*

*Is there any strategic reasons?*

- Geographic*
- Political stability*
- Business climate, such as personnel, wages, know-how*

*What kinds of investment barriers exist?*

*What needs to improve in Singapore to ease trade even more?*

*How will the trade between the EU and Singapore be affected by the upcoming bilateral agreement between the two parties?*

*- Different types of FTAs within ASEAN?*

*How do European companies see Singapore as a regional hub in the light of the upcoming FTA between the EU and Singapore?*

*How do you find your company operates from Singapore to the rest of South East Asia and vice versa?*

## **Appendix 2: Interview questions to officials from the EU delegation, the Ministry of Trade and Industry in Singapore, and the International Enterprise Singapore**

*What are the possibilities for using the EU-Singapore as a stepping stone towards a regional agreement with the rest of ASEAN?*

*How will the EU-Singapore FTA affect the intra trade flows?*

*How has the failure to conclude a regional agreement with ASEAN affected European companies?*

*Do European companies compete on the same terms and conditions as local and American companies?*

*How has the previous FTA:s impacted the business environment?*

*How will trade between the EU and Singapore be affected by the upcoming bilateral free trade agreement between the two parties?*

- *Different types of FTAs within ASEAN?*
- *Different types of FTAs between Singapore and other countries?*

*What kinds of investment barriers exist?*

*What needs to improve in Singapore to ease trade even more?*



### Appendix 3: HS Classification key, chapter-section

	<i>Section</i>	<i>Chapter</i>
	<i>Resource-based commodities</i>	<i>Resource-based commodities</i>
01-05	Live Animals	01 Live Animals 02 Meat & Edible Meat Offal 03 Fish 04 Dairy Produce 05 Other Animal Products
06-14	Vegetable Products	06 Live Trees 07 Edible Vegetables 08 Edible Fruit & Nuts 09 Coffee, Tea, Spices 10 Cereals 11 Malt & Wheat Gluten 12 Seeds 13 Lac, Gums & Resins 14 Other Vegetable Products
15	Fats and Oils	15 Fats & Oils
16-24	Prepared Foodstuffs	16 Preparations Meat/Fish 17 Sugars 18 Cocoa 19 Prep. Cereals/Flour/Milk 20 Prep. Vegetables/Fruit/Nuts 21 Misc. Edible Products 22 Beverages 23 Waste from Food Industry 24 Tobacco
25-27	Mineral Products	25 Salt/Sulphur/Lime/Cement 26 Ores 27 Lubricants/Fuels/Oil
44-46	Wood and Wood articles	44 Wood 45 Cork 46 Straw
	<i>Labour-intensive commodities</i>	<i>Labour-intensive commodities</i>
41-43	Hides and Leather	41 Raw Hides & Skins 42 Articles of Leather 43 Fur skins

	<i>Section</i>	<i>Chapter</i>
50-63	Textiles and apparel	50 Silk 51 Wool 52 Cotton 53 Paper Yarn 54 Man-made Filaments 55 Man-made Staple Fibres 56 Wadding 57 Carpets 58 Special Woven Fabrics 59 Laminated Textile Fabrics 60 Knitted Fabrics 61 Apparel, Knitted 62 Apparel, not Knitted 63 Other Textile Articles
64-67	Footwear	64 Footwear 65 Headgears 66 Umbrellas, Walking Sticks 67 Prepared Feathers
71	Gems	71 Jewelry
93	Arms	93 Arms & Ammunition
94-96	Miscellaneous Manufactured articles	94 Furniture 95 Toys 96 Misc. Manufactured Articles
99	Other	99 Other
	<i>Scale-intensive commodities</i>	<i>Scale-intensive commodities</i>
28-38	Chemicals	28 Inorganic Chemicals 29 Organic Chemicals 30 Pharmaceutical Products 31 Fertilizers 32 Tanning/Dyeing Extracts/Ink 33 Cosmetics 34 Soap, Waxes, Pastes 35 Glues 36 Explosives 37 Photographic Goods 38 Misc. Chemical Products
39-40	Plastics	39 Plastics 40 Rubber
47-49	Pulp and paper	47 Wood Pulp 48 Paper & Paper Board 49 Books, Newspapers
68-70	Stone/Cement/Ceramics	68 Stone/Plaster/Cement 69 Ceramic Products 70 Glass and Glassware

	<i>Section</i>	<i>Chapter</i>
72-83	Base metal and Metal articles	72 Iron and Steel 73 Articles of Iron or Steel 74 Copper 75 Nickel 76 Aluminium 78 Lead 79 Zinc 80 Tin 81 Other Base Metals 82 Tools 83 Miscellaneous Base Metals 86-89 Vehicles 86 Railway 87 Cars, Trucks, Autos 88 Aircraft, Spacecraft 89 Ships, Boats
	<i>Differentiated commodities</i>	<i>Differentiated commodities</i>
84-85	Machinery and Electrical Appliances	84 Electronic equipment 85 Nuclear reactors, boilers, machinery
90-92	Optical, precision & musical instruments	90 Optical/Medical Instruments 91 Clocks 92 Musical Instruments
97-98	Antiques and works of art	97 Works of Art 98 Postal Packages & Special Transactions