

East Asian Economic Integration and its Impact on Future Growth

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1. INTRODUCTION

EAST Asian economic integration appears on the brink of becoming *de jure*, not *de facto*. From the 1980s, East Asia developed high levels of intra-regional trade in response to market forces, not preferential trade agreements (PTAs). One reason was rising incomes in Japan and the newly industrialised economies (NIEs) of Hong Kong, Korea, Singapore and Taiwan, creating an incentive for these economies to relocate the labour-intensive stages of production to lower-wage countries in the rest of East Asia. Another reason was reductions in information and transport costs, which allowed this fragmentation of production to be managed logistically. A final incentive was the unilateral cuts in tariffs throughout the region, either generally or through duty drawbacks and duty-free export processing zones, which further reduced trade costs. Now over 50 per cent of East Asia's trade is with itself,¹ and Japan and the Asian NIEs account for a rising proportion of foreign direct investment in ASEAN and China.

This integration occurred largely without preferential trade agreements. The ASEAN Free Trade Agreement (AFTA) came into force in 1992, but this did not create much preferential trade. The preferential and non-preferential tariff rates were the same on about two-thirds of tariff lines. With successive rounds of unilateral liberalisation, the margins of preference on the remaining lines were small. Many producers did not find it worthwhile to retool to meet the 40 per cent

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¹ Calculated for Japan, the Asian NIEs (Hong Kong, Korea, Singapore and Taiwan), the remaining ASEAN economies (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Thailand, Vietnam) and China.

ASEAN content requirement, so less than five per cent of intra-regional trade takes place at the preferential rate (WTO, 2003). AFTA also involved ongoing negotiations on services and investment, but the commitments have been limited, often reflecting only a fraction of the status quo. The Asia-Pacific Economic Cooperation (APEC) agreement came into force in 1993, but it was designed to be non-preferential, and fully consistent with the most favoured nation principle.

Recently, however, a flurry of bilateral agreements have been signed or are under discussion, creating the legal basis for significant preferences within the region. Agreements that have been signed include Japan-Singapore in 2002, China-ASEAN in 2003, China-Hong Kong and China-Macau in 2004, and Japan-Malaysia in 2005. Agreements under official negotiation or consultation/study include Japan-Korea, Japan-Thailand, Japan-Philippines, Korea-Singapore, Japan-ASEAN, Japan-Indonesia, Japan-China-Korea, Korea-ASEAN and Singapore-Taiwan, among others. The reasons for these initiatives include a defensive response to the proliferation of preferential trade agreements elsewhere, a desire to enhance productivity and international competitiveness through exploitation of scale economies and dynamic efficiency, and the promotion of deeper integration and institution building at the regional level (Kawai, 2005). While many East Asian economies have also been signing bilateral agreements with partners outside the region, the China-ASEAN agreement in particular appears to have triggered a domino effect within the region, encouraging Japan and Korea to consider agreements with each other and with the ASEANs (Baldwin, 2006).

In a further response, the leaders of ASEAN+3 (China, Japan and Korea) announced in Vientiane in November 2004 that they would make efforts to create an 'East Asian Community', which would promote economic and financial cooperation, along with political and security cooperation, environmental cooperation, social and cultural cooperation, and institutional cooperation. As recommended by the East Asian Vision Group (2001), economic cooperation was to include the establishment of an East Asian Free Trade Area and the expansion of the Framework Agreement on an ASEAN Investment Area to all of East Asia. If the agreement followed the pattern of AFTA and the China-ASEAN agreement, it would include ongoing negotiations on services and investment, as well as commitments on goods trade. The first East Asian Summit was held in Kuala Lumpur in December 2005. Membership extended beyond ASEAN+3 to include India, Australia and New Zealand, a move seen as ensuring that ASEAN remained at the geographic centre of the emerging East Asian Community, and diluting China's influence. The leaders agreed to meet annually, although there were clear differences of opinion about objectives.

Rather than analysing the full range of geopolitical and other objectives of the proposed East Asian Community, the purpose of this paper is to challenge two of its presumptions on economic integration. These are, first, that economic integration among economies is a good way to promote economic growth and, second,

that preferential trade agreements (particularly ones that go beyond goods trade) are an effective way to promote economic integration. Both these presumptions are empirical questions. The paper examines, in a partial way, the empirical evidence in support of both presumptions. The results suggest caution. The partial evidence is that, in practice, even a broad-ranging PTA may do little to remove the important impediments to growth in the region. This suggests that it may be timely to rethink East Asian economic integration as a policy priority, or to at least review the way in which it might be pursued. And it suggests further careful analysis of the empirical evidence, to inform that policy review.

2. THEORETICAL CONSIDERATIONS

Economic theory suggests that, with some exceptions, competition can promote economic growth. Competition can exert powerful pressure on producers to find least-cost ways of serving consumer needs, and to innovate to better serve those needs. Theory also suggests that decentralised free markets can be an administratively efficient way of ensuring competition among actual and potential producers. There are well-known exceptions – the provision of public (non-rival) goods, and conditions of natural monopoly or asymmetric information are situations where competition in the market may not provide the best outcomes, at least not without some supporting regulation. However, in some cases (such as natural monopoly), competition *for* the market may provide discipline on costs, even though competition *in* the market would be inefficient. Two of the consequences of free entry and competition are that prices reflect production costs, and costs are as low as possible. The first condition ensures allocative efficiency, while the second ensures productive efficiency. Both types of efficiency contribute to higher levels of income.

As discussed by writers such as Lawrence (1996), the process of ‘deep’ economic integration is aimed at reducing the market segmenting effects of domestic (non-border) regulatory policies through coordination and cooperation. Market segmentation allows the prices of goods or services to be permanently higher in one market than in neighbouring countries. This violates the conditions for allocative efficiency and possibly also productive efficiency, and reduces income levels.

There are two types of regulatory impediments to competition that can lead to market segmentation. The first are restrictions that specifically discriminate against *foreign* suppliers – either against their entry, or against the nature and scope of their operations once they have entered the market. The second are restrictions that discriminate against *all* new suppliers, be they domestic or foreign – either by restricting their entry, or by restricting the nature or scope of their operations. The remainder of this paper focuses on situations where either or both of these

types of restrictions could be set at an inappropriate level (which could be ‘too little’ rather than ‘too much’), recognising that in some areas, there is a legitimate role for regulation to supplement market forces. Either type of restriction on competition can lead to prices for a particular good or service being higher than for a comparable product in a neighbouring country. But restrictions that discriminate against foreign suppliers would tend to lead to a smaller fraction of that market being served by foreign suppliers, all other things being equal.

Thus regulatory impediments to competition do not need to be *explicitly* discriminatory against foreigners in order to have the effect of raising the prices of goods or services above those in neighbouring countries. In principle, a process of ‘deep’ economic integration could target not just the inappropriate restrictions that explicitly discriminate against foreign suppliers, but also those that are not explicitly discriminatory but nevertheless raise prices above those in neighbouring countries. Such a wide-ranging reform process, if pursued on a non-preferential basis, would target all the inappropriate impediments to competition, and therefore likely have a significant impact on real incomes.

So a key question is whether economic integration initiatives are in practice this wide-ranging. If they turn out to be more selective, a further question is whether they target the restrictions that do the most damage.² Regulatory restrictions could raise prices for one of two reasons – because they raise the mark-up of prices over production costs, or because they raise production costs themselves. Economic theory suggests that restrictions that raise prices above costs involve a relatively large transfer from consumers to producers, but a relatively small net cost to the economy as a whole in terms of forgone income. By contrast, restrictions that raise real production costs involve a relatively large net cost to the economy as a whole. So if economic integration initiatives are both selective, and tend to target the restrictions that impose relatively low net economic costs, they are likely to be a distraction rather than a genuine route to greater prosperity.

3. WHAT DO ECONOMIC INTEGRATION AGREEMENTS DO?

Neither of the trade agreements in force in the 1990s did much to promote East Asian trade on a preferential basis. However, the China-ASEAN agreement includes phased tariff cuts that will eventually eliminate tariffs on almost all bilateral trade between China and the ASEANs. The East Asian Free Trade Area envisages deeper economic integration initiatives. But if these follow the pattern of other recent PTAs, they will tend to be selective in two important ways:

² The argument is similar to that made in Hoekman and Konan (1998).

- they will tend to be preferential, even in the provisions that go beyond goods trade; and
- they will tend to target only those provisions that explicitly discriminate against foreigners.

There are strong political economy explanations for both of these likely outcomes.

'New age' PTAs tend to be preferential. They contain provisions that go well beyond goods trade and, in principle, many of these provisions (such as governing intellectual property and competition policy) could be liberalised on a non-preferential basis. But in practice, recent PTAs have tended to do one of two things in the new age areas – either bind the status quo, or make concessions on a preferential basis, even when logic suggests they could sensibly be made non-preferentially.³ One very clear reason for this outcome is that countries that have strong 'offensive' interests in the Doha Round of multilateral trade negotiations are unlikely to give away negotiating coin by making defensive concessions on a non-preferential basis within a PTA, prior to a Doha Round settlement.

There have been exceptions. Some recent North-South PTAs have required the Southern partner to undertake significant reforms on a non-preferential basis. For example, the recent PTA between the United States and Chile requires Chile to make significant changes to its customs administration and product standards. But Chile is one country with a recent history of significant unilateral trade reforms, despite its offensive interests in the Doha Round (particularly in agriculture). Other countries that have made significant non-preferential concessions in a PTA context are some of the transition economies, which have yet to claim a stake in the WTO and its multilateral negotiations (this point is also made by Ethier, 1998a, 1998b, 1999 and 2001). But many of the East Asian economies have at least some offensive interests in the Doha Round, and are likely to be constrained in the offers they make in a PTA context accordingly.

Thus, with some important exceptions, the substantive 'new age' provisions in recent PTAs have tended to be preferential. Partly as a corollary, recent PTAs have tended to target only those provisions that explicitly discriminate against foreigners. This is because, in many cases, the only provisions that can feasibly be liberalised on a preferential basis are those that discriminate against foreigners.⁴

³ For example, two of Australia's concessions in the Australia-United States Free Trade Agreement were the lifting of Foreign Investment Review Board screening on inward foreign direct investment in non-sensitive sectors, and a commitment to provisions similar to those in the WTO Agreement on Government Procurement. Both measures were made preferentially, even though the arguments advanced by the Australian Government would have applied *a fortiori* to non-preferential liberalisation.

⁴ The converse does not hold. Because some provisions do discriminate against foreigners, it does not mean that they can be liberalised on a preferential basis. For example, when countries liberalise restrictions on foreign ownership, it may be very difficult to ensure that the new foreign owners are only from selected partner countries.

But even without this feasibility constraint, there are economic and political economy forces that tend to limit concessions within PTAs to those that explicitly discriminate against foreigners. The central one is the loss of sovereignty that some (e.g. Robson, 1998) see as a necessary condition for economic integration to occur. This is not to say that East Asian economic integration need necessarily involve the establishment of formal supranational institutions – this is highly unlikely. But the threat to sovereignty is felt most strongly by countries when contemplating making reforms to non-discriminatory domestic regulatory regimes as part of a trade agreement. To some in the East Asian region, this may be viewed as too much of a threat to the ‘right to regulate’.

One particular negotiating modality can also contribute to PTAs that focus on provisions that explicitly discriminate against foreigners. This is the request-and-offer modality that is currently being used in the Doha negotiations on services, and is the means by which many PTAs are negotiated. Under this modality, countries are asked to contemplate, not just reforms that are in their own best interests, but reforms that are in their trading partners’ best interests. It will tend to be in a trading partner’s best interests to target only those provisions that explicitly discriminate against foreigners – in this way, the foreign market share is maximised. Foreign producers would generally have little interest in unleashing competition from promising domestic new entrants. They would rather join a cartel on a far more selective basis!

A final consideration is one of visibility. Regulatory regimes are always complex, and often not very transparent to insiders, let alone outsiders. The regulations that will tend to be visible to *potential* new entrants (the source of additional competitive pressures) are those that discriminate against foreigners.

4. DO PTAs TARGET THE IMPORTANT RESTRICTIONS?

Recent PTAs have tended to target regulatory restrictions on a preferential basis, and partly as a result to concentrate on those regulatory restrictions that discriminate explicitly against foreigners. Does this mean that PTAs are concentrating on the regulatory restrictions that matter most, in an economic sense?

Far too little empirical research has been done to come up with a definitive answer to this question. To do so would require a comprehensive study of:

- the ‘tax’ equivalents of all the regulatory restrictions that raise the mark-ups of prices above marginal costs;
- the ‘productivity’ equivalents of all the regulatory restrictions that raise real production costs;
- a comparison of the two in general equilibrium (since in partial equilibrium, tax and productivity equivalents cannot be compared directly);

- an assessment of which portions of these effects are likely to be achieved within a PTA.

While this exercise cannot be done comprehensively, it can be done in the East Asian region for the regulations affecting trade and investment in some selected services sectors – banking, distribution, ports, professions, telecommunications, air passenger transport and electricity generation. Admittedly, this is only a very small portion of the measures covered by PTAs. Other key areas that have been targeted, particularly in the context of deeper economic integration, are standards and competition policy. But the analysis has to start somewhere. The concluding section will discuss whether the findings of this paper are likely to generalise to other regulatory areas.

Table 1 summarises some of the key regulatory restrictions typically found to affect trade and investment in these seven services sectors. As the table shows, many of the relevant restrictions on competition do not necessarily discriminate against foreign providers (although some listed as being potentially non-discriminatory are in fact applied on a discriminatory basis in some countries).

Tables 2–6 provide estimates of the tax or productivity equivalents of the restrictions actually found in five parts of the East Asian region – China, Japan, Korea, the ASEAN-5 (Indonesia, Malaysia, Philippines, Singapore and Thailand) and Australia.⁵ Tax equivalents are shown in the tables as price impacts affecting mark-ups, while productivity equivalents are shown as price impacts affecting costs.

The tables indicate that although there are some significant restrictions in the East Asian region that discriminate explicitly against foreigners, especially in banking, telecommunications and the professions, they tend to be of the sort to increase mark-ups of prices over costs. Indeed, the restrictions that are prevalent in these sectors are regulatory barriers to entry that tend to create rents for incumbent service providers. The net economy-wide gains from eliminating these types of barriers would tend to be smaller than the net gains from eliminating regulatory restrictions that raise costs. But because they are discriminatory, and hence amenable to liberalisation on a preferential basis, they are the sorts of barriers that tend to be targeted in PTAs.

By contrast, regulatory impediments that raise real resource costs are also prevalent in the region, in sectors such as distribution and electricity generation, but these impediments tend to affect both domestic and foreign providers. So while they impose relatively high net economic costs, they tend not to be targeted

⁵ The surveys of actual restrictions and estimates of their tax or productivity equivalents were taken from McGuire and Schuele (2000), Kalirajan et al. (2000), Kalirajan (2000), Clark et al. (2004), Nguyen-Hong (2000), Warren (2000) and Doove et al. (2001). Updated estimates for Malaysia were taken from Dee (2004a), for Thailand from Dee (2004b), and for Japan and Australia from Dee (2005a). A preliminary survey for China was undertaken especially for this study.

TABLE 1
Indicative Restrictions on Competition, by Sector

<i>Sector</i>	<i>Restrictions That Discriminate Against Foreign Providers</i>	<i>Restrictions That May Affect Both Domestic and Foreign Providers</i>
Banking	Limits on foreign equity participation in local banks Requirements that foreign participation be via joint venture Restrictions on the temporary movement of people	Restrictions on the number of new bank licences Restrictions on raising of funds by banks Restrictions on lending Prohibitions on other lines of business (e.g. insurance, securities) Restrictions on number of bank outlets (including ATMs) Restrictions on the acquisition of commercial land Restrictions on the establishment of large-scale stores Screening tests, needs tests, performance requirements and other factors affecting investment Local government requirements (e.g. zoning, environmental, employment, operating hours) Restrictions on number of wholesale licences Limits on promotional activities Lack of protection of intellectual property rights Presence of statutory monopolies Licensing requirements on management Mandatory port services Cargo-handling restrictions Organised crime
Distribution	Limits on foreign equity participation in local distribution outlets Restrictions on the temporary movement of people	
Ports		

Professions	Prohibitions on, or requirements for, joint venture Limits on investment and ownership by foreign investors Nationality, citizenship, residency or local presence requirements Quotas or needs tests on foreign entry Restrictions on the temporary movement of people	Restrictions on juridical form Limits on investment and ownership by non-professional investors Licensing and accreditation requirements on individual professionals Activities reserved by law to the profession Limits on multidisciplinary practices Limits on advertising, marketing and solicitation Restrictions on fee setting Licensing requirements on management Prohibitions on leased lines or private networks Prohibitions on third-party resale Prohibitions on the connection of leased lines and private networks to the public switched telecommunications network Limits on number of operators in fixed or mobile market Government ownership of incumbent Limits on the number of airlines flying a particular route Limits on capacity Limits on fare setting Limits on use of non-scheduled (charter) services Lack of structural separation of generation from transmission Lack of third-party access for generators to transmission grid Lack of wholesale price pool
Telecommunications	Prohibitions on call-back services Limits on foreign equity ownership	
Air passenger transport		
Electricity generation		

Sources: McGuire and Schuele (2000), Kalirajan (2000), Clark et al. (2004), Nguyen-Hong (2000), Warren (2000) and Doove et al. (2001).

TABLE 2
Direct Price Impacts of China's Regulatory Restrictions on
Trade and Investment in Services (Per cent)

<i>Sector</i>	<i>Direct Price Impact</i>		
	<i>via Markups on</i>		<i>via Costs</i>
	<i>Output</i>	<i>Exps. from</i>	<i>Exps. to</i>
International air passenger transport (domestic and foreign providers) ^a		7	7
Banking – domestic providers	5		
– foreign providers	36		
Distribution services – domestic providers			9
– foreign providers			8
Electricity supply – domestic and foreign providers			9
Maritime – domestic and foreign providers			5
Professional services – domestic providers ^b			2
– foreign providers ^b	10		10
Telecommunications – domestic providers ^c	3		
– foreign providers ^c	21		

Notes:

^a In the absence of definitive research, the 50/50 split between price and cost impacts is arbitrary.

^b Simple average of estimates for legal, accounting, architecture and engineering services.

^c A simple average of price impacts for fixed line and cellular services.

Source: Author's calculations.

TABLE 3
Direct Price Impacts of Japan's Regulatory Restrictions on
Trade and Investment in Services (Per cent)

<i>Sector</i>	<i>Direct Price Impact</i>		
	<i>via Markups on</i>		<i>via Costs</i>
	<i>Output</i>	<i>Exps. from</i>	<i>Exps. to</i>
International air passenger transport (domestic and foreign providers) ^a		9	9
Banking – domestic providers	0		
– foreign providers	0		
Distribution services – domestic providers			2
– foreign providers			1
Electricity supply – domestic and foreign providers			10
Maritime – domestic and foreign providers			0
Professional services – domestic providers ^b			4
– foreign providers ^b	11		11
Telecommunications – domestic providers ^c	0.2		
– foreign providers ^c	0.2		

Notes:

^a In the absence of definitive research, the 50/50 split between price and cost impacts is arbitrary.

^b Simple average of estimates for legal, accounting, architecture and engineering services.

^c A simple average of price impacts for fixed line and cellular services.

Source: Author's calculations.

TABLE 4
Direct Price Impacts of Korea's Regulatory Restrictions on
Trade and Investment in Services (Per cent)

<i>Sector</i>	<i>Direct Price Impact</i>		
	<i>via Markups on</i>		<i>via Costs</i>
	<i>Output</i>	<i>Exps. from</i>	<i>Exps. to</i>
International air passenger transport (domestic and foreign providers) ^a		10	10
Banking – domestic providers	10		
– foreign providers	22		
Distribution services – domestic providers			15
– foreign providers			6
Electricity supply – domestic and foreign providers			15
Maritime – domestic and foreign providers			3
Professional services – domestic providers ^b			2
– foreign providers ^b	11	11	
Telecommunications – domestic providers ^c	4		
– foreign providers ^c	10		

Notes:

^a In the absence of definitive research, the 50/50 split between price and cost impacts is arbitrary.

^b Simple average of estimates for legal, accounting, architecture and engineering services.

^c A simple average of price impacts for fixed line and cellular services.

Source: Author's calculations.

TABLE 5
Direct Price Impacts of ASEAN's Regulatory Restrictions on
Trade and Investment in Services (Per cent)

<i>Sector</i>	<i>Direct Price Impact</i>		
	<i>via Markups on</i>		<i>via Costs</i>
	<i>Output</i>	<i>Exps. from</i>	<i>Exps. to</i>
International air passenger transport (domestic and foreign providers) ^a		9.5	9.5
Banking – domestic providers	6		
– foreign providers	24		
Distribution services – domestic providers			2
– foreign providers			5
Electricity supply – domestic and foreign providers			17
Maritime – domestic and foreign providers			4
Professional services – domestic providers ^b			3
– foreign providers ^b	13	13	
Telecommunications – domestic providers ^c	3		
– foreign providers ^c	19		

Notes:

^a In the absence of definitive research, the 50/50 split between price and cost impacts is arbitrary.

^b Simple average of estimates for legal, accounting, architecture and engineering services.

^c A simple average of price impacts for fixed line and cellular services.

Source: Author's calculations.

TABLE 6
Direct Price Impacts of Australia's Regulatory Restrictions on
Trade and Investment in Services (Per cent)

<i>Sector</i>	<i>Direct Price Impact</i>		
	<i>via Markups on</i>		<i>via Costs</i>
	<i>Output</i>	<i>Exps. from</i>	<i>Exps. to</i>
International air passenger transport (domestic and foreign providers) ^a		7.5	7.5
Banking – domestic providers	0		
– foreign providers	4		
Distribution services – domestic providers			0
– foreign providers			0
Electricity supply – domestic and foreign providers			0
Maritime – domestic and foreign providers			0
Professional services – domestic providers ^b			4
– foreign providers ^b	9	9	
Telecommunications – domestic providers ^c	0.2		
– foreign providers ^c	0.2		

Notes:

^a In the absence of definitive research, the 50/50 split between price and cost impacts is arbitrary.

^b Simple average of estimates for legal, accounting, architecture and engineering services.

^c A simple average of price impacts for fixed line and cellular services.

Source: Author's calculations.

in PTAs, because they tend to be difficult to liberalise on a preferential basis. Strictly speaking, however, the different sorts of barriers cannot be compared by looking at their tax or productivity equivalents alone. Their effects need to be examined in general equilibrium. That is the task of the next section.

5. ASSESSING EAST ASIAN ECONOMIC INTEGRATION

If East Asian economic integration initiatives followed the pattern of recent PTAs, they would tend to involve the preferential liberalisation of those regulatory impediments that explicitly discriminated against foreign providers. In this section, a computable general equilibrium model is used to assess the net welfare effects of an indicative East Asian economic integration initiative. The model is described briefly in Box 1, and the regional and sectoral aggregation used for the current exercise is shown in Table 7. The model is fully documented in Hanslow et al. (1999).

The East Asian initiative examined in this section is a plurilateral PTA among the East Asian members identified in the model (all regions except the rest of the world). In the first instance, it is assumed that each PTA member grants the other members full national treatment in the application of regulations in those services

BOX 1

The FTAP Model – GTAP with Foreign Direct Investment

- The FTAP model is a computable general equilibrium model incorporating services delivered via FDI. It was developed by Dee and Hanslow (2001). It differs in turn from GTAP (Hertel, 1997), the ‘plain vanilla’ model from which it was derived, in three important respects.
- First, because trade negotiations now cover services delivered via commercial presence, the modelling framework includes foreign direct investment as a mode of services trade delivery, and covers separately the production and trading activity of foreign multinationals. In other words, GTAP, the conventional multi-country model, is split out by ownership as well as location.
- Second, by virtue of foreign ownership, at least some of the profits of foreign multinationals will be repatriated back to the home country. Thus the profit streams in the conventional multicountry model have to be reallocated from the host to the home country, after provision is made for them to be taxed in either the home or host country. This reallocation leads to a distinction between GDP – the income *generated* in a region – and GNP – the income *received by residents* of a region. The latter forms the basis of (although is not identical to) the welfare measure in FTAP.
- Finally, not all profits of foreign multinationals need be repatriated to the home country. Some may be reinvested in the host country. To account for this phenomenon, and to allow for the effect that regulatory reform may have on both domestic and foreign direct investment more generally, the model makes provision for savings and capital accumulation. This is particularly important, since some regulatory barriers are aimed directly at limiting foreign equity participation. It is therefore important to capture how regulatory reform will affect not just foreign ownership *shares*, but also the *total amount* of productivity capacity available to an economy.
- The FTAP model also differs from GTAP in other respects. In particular, it allows for firm-level product differentiation. This is also important, since services tend to be highly specialised, being tailored to the needs of individual customers.

Source: Based on Dee and Hanslow (2001).

sectors for which quantitative estimates are available. This means that under the PTA, foreign services providers from PTA partner countries are treated no less favourably than domestic providers in these sectors. In most instances, this means that the tax or productivity equivalents of the regulations affecting foreign providers (shown in Tables 2 to 6) are reduced so as to be the same as those affecting domestic providers.⁶ In keeping with recent PTAs, the air passenger transport sector is excluded from the PTA altogether (as it is from the GATS).

⁶ In two instances (distribution and the professions), full national treatment implies tax or productivity equivalents that are lower than otherwise, but still not equal to those affecting domestic producers, because the underlying econometric analysis in Kalirajan (2000) and Nguyen-Hong (2000) suggested that the same regulations have different effects on domestic and foreign service providers.

TABLE 7
Regional and Sectoral Aggregation for this Version of the FTAP Model

<i>Regional Aggregation</i>	<i>Sectoral Aggregation</i>
China	Paddy rice
Japan	Other crops
Korea	Livestock
ASEAN-5	Other primary (forestry, fishing, mining)
Australia	Processed rice
Rest of the world	Meat products
	Vegetable products
	Textiles, clothing, footwear
	Wood products
	Chemicals
	Metals
	Transport equipment
	Other manufacturing
	Electricity
	Gas and water
	Construction
	Trade
	Other transport
	Water transport
	Air transport
	Communications
	Financial services n.e.c.
	Insurance
	Other business services
	Other services

Source: Aggregation based on version 5.4 of the GTAP database.

Of course, any East Asian economic integration initiative would also include provisions affecting merchandise trade. Hence, it has been assumed that a plurilateral PTA among all East Asian members would also succeed in eliminating tariffs on manufactured goods from other PTA members. But taking the recent agreement concluded between Japan and Singapore as a guide, it is assumed that an East Asian economic integration initiative would not succeed in making any inroads on protection affecting agriculture in the region. It is assumed that this would more likely be achieved as part of the Doha Round of multilateral trade negotiations.⁷

To put such an East Asian economic integration initiative in further perspective, it can be compared with what a successful Doha Round could be expected to

⁷ The measures of tariffs and agricultural protection used are those in version 5.4 of the GTAP model database.

achieve. On the one hand, the Doha Round could include agriculture. On the other, it is unlikely to lead to the complete elimination of protection on merchandise trade. Hence it is assumed that a Doha Round might achieve full national treatment in regulatory regimes for all regions (including the rest of the world), but only a 25 per cent reduction in tariffs and in agricultural protection.

Finally, both the East Asian economic integration initiative and the indicative Doha Round scenario are compared with a third scenario – comprehensive unilateral regulatory reform in each East Asian region. This involves the full reform of all non-discriminatory regulations affecting both domestic and foreign providers in each East Asian region. In most instances, this means that the tax or productivity equivalents of the regulations affecting domestic providers (shown in Tables 2 to 6) are reduced to zero, while the tax or productivity equivalents of the regulations affecting foreign providers are reduced by the same absolute amount. With only non-discriminatory regulations being reformed, any additional margin of discrimination against foreign providers is retained.

To keep the comparison simple, Table 8 reports the consequences of each scenario for economic welfare of the East Asian region – the simple sum of welfare effects for each model regional except the rest of the world. With a system of side payments, the East Asian region could achieve any desired distribution of these total gains among individual member countries.

The results suggest first that if ‘deep’ economic integration initiatives were limited to reform of regulations that explicitly discriminated against foreigners, and the reforms were undertaken on a preferential basis, they would add only trivially to the gains from preferential liberalisation of tariffs on merchandise trade. This conclusion is subject to the proviso that the scope of regulatory reform envisaged in this exercise is only partial. But the relative orders of magnitude – gains of US\$1.7 billion per year from regulatory reform, compared with gains of US\$16.6 billion from tariff reform – suggest that the result would be relatively robust to wider sectoral coverage of regulatory reform.

Even such limited regulatory reform would be more worthwhile if it were undertaken on a global basis, a possible outcome of the Doha Round. Despite growing economic interdependence within the region, the rest of the world remains an important source of foreign direct investment for East Asia. So the region would gain from removing regulatory barriers to that investment. The region would also gain indirectly from the income growth in the rest of the world that would be encouraged by matching regulatory reform there. As a result of these two factors, the income gains to the East Asian region would be more than four times greater (at US\$7.4 billion per year) than from regulatory reform of comparable scope within an East Asian economic integration initiative.

The East Asian region would also benefit significantly from the slow but widespread reform of merchandise trade that might accompany a Doha Round settlement. Partly as a result, a full Doha settlement could deliver income gains to

TABLE 8
 Reform Scenarios and Their Effects on East Asian Welfare
 (Deviation from control in real income, measured in US\$ billion per year)

<i>Sector</i>	<i>East Asian Economic Integration</i>	<i>Possible Doha Round Outcome</i>	<i>Comprehensive Unilateral Regulatory Reform</i>
Regulatory reform (services and investment)	National treatment in East Asia 1.7	National treatment in the world 7.4	Reform of all non-discriminatory regulation in East Asia 107.3
Manufacturing tariffs	Elimination of tariffs against East Asian partners 16.6	25 per cent reduction in tariffs globally 12.4	
Agricultural protection	No action	25 per cent reduction in agricultural protection globally 12.8	
Total	0.0 18.3	32.6	107.3

Source: FTAP model projections.

the region of US\$32.6 billion per year, almost double those achievable from an East Asian economic integration initiative.

But the most telling result in Table 8 is the projected gains from comprehensive unilateral regulatory reform in the East Asian region. Even if the scope of such reform were limited to the same services sectors as included in the East Asian economic integration initiative, its more comprehensive coverage, targeting non-discriminatory restrictions which tend to add to real resource costs, would yield gains of more than five times an entire integration initiative. This is the true opportunity cost of using a PTA route to achieve economic integration – forgoing gains from unilateral regulatory reform of more than US\$100 billion per year, to achieve a PTA package that might generate less than US\$20 billion per year.

6. CONCLUSIONS

Countries can attempt to ‘walk and chew gum’ at the same time. The question is whether they would want to. For reform-weary governments, PTAs are the best excuse they have had in years to avoid doing the things that really matter. For reform-ready governments with limited regulatory reform capacity, PTAs are a distraction from the main game. If the empirical analysis of this paper can be generalised, it suggests that by far the greatest real income gains to the East Asian region would come from comprehensive reform of the non-discriminatory impediments to competition, as part of a thorough-going programme of unilateral domestic regulatory reform.

The empirical analysis has been based on available studies of impediments to competition in selected services sectors. New age PTAs cover more than this. So are the results of this paper likely to generalise? There is one important reason to think so. The art of good competition policy (broadly defined) is to put regulations in place to protect competition, *not* to protect particular competitors. When PTAs are preferential, they are protecting particular competitors – a country’s trading partners. They are thus the antithesis of good competition policy.

There are measures that are often taken in PTAs that are not preferential. Much of these fall under the rubric of enforcement – enforcement of intellectual property protection, enforcement of quarantine regulations, enforcement of technical standards, enforcement of customs regulations through good customs administration. And often PTAs involve promises of technical assistance to help with these enforcement issues. In these respects, PTAs can be a useful complement to a domestic regulatory reform programme. But this presupposes that the measures that are being enforced are in a country’s best interests. For some of the provisions ensuring intellectual property protection, for example, this is not always clear (Dee, 2005b).

Proponents of 'deep' economic integration often stress the benefits of using PTAs to achieve harmonisation of standards or mutual recognition of qualifications and accreditation requirements. This discussion is often in the context of North-North agreements between partners of similar size and economic income, where much of the trade between them is intra-industry trade, or even intra-firm trade among the affiliates of multinationals engaging in horizontal FDI. When trade is two-way, there is a need for recognition to be mutual. When trade patterns are governed more by considerations of comparative advantage, and when trade is one-way, it is less clear why the adoption of accreditation requirements requires coordination across governments. For example, Singapore is a net importer of medical skills, and its professional medical bodies have developed their own lists of acceptable qualifications, completely outside of a PTA framework. While it is clear that shared standards reduce trade costs (Moenius, 1999), countries can achieve this by unilaterally adopting recognised international standards.

In short, there may be a few limited areas in which an East Asian PTA could usefully supplement a domestic regulatory reform programme. But the main conclusion of this paper is that, because it would likely be preferential, even in its new age provisions, it would tend to focus reform efforts away from where the big gains are to be made.

The big gains are from reforming the non-discriminatory restrictions on competition that affect both foreigners and domestic new entrants equally. This is best done domestically, where the debate can be held about how any losses to incumbents can be managed politically. The East Asian economies could provide important moral support, and even 'benchmark competition' to each other in these domestic initiatives. For example, they could agree to publish comparable measures of sectoral economic performance such as prices, service availability or total factor productivity, to help clarify government objectives and responsibilities, to identify areas of substandard performance, and to generate incentives to address substandard performance through domestic reform measures. The numbers are striking – gains of more than five times those that might be available through an East Asian PTA.

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