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**East Asian Economic Integration and its  
Impact on Future Growth**

**Philippa Dee**

**AUSTRALIA–JAPAN RESEARCH CENTRE  
ASIA PACIFIC SCHOOL OF ECONOMICS & GOVERNMENT**



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# EAST ASIAN ECONOMIC INTEGRATION AND ITS IMPACT ON FUTURE GROWTH\*

Two propositions appear to be gaining wide currency, given the revealed preference for preferential trade agreements (PTAs) in the East Asian region and elsewhere. The first is that economic integration is a good way to promote economic growth. The second is that PTAs, particularly ones that go beyond goods trade, are an effective way to promote economic integration. Yet both propositions are empirical questions. In this paper, a partial evaluation of the evidence suggests caution is called for. Current PTAs appear to be doing little to remove the important impediments to growth in the region. Far greater income gains would come from comprehensive reform of non-discriminatory impediments to competition, as part of a thorough-going program of unilateral domestic regulatory reform. It may be time to rethink East Asian economic integration as a policy priority, or at least review the way in which it might be pursued.

There are two propositions that appear to be gaining wide currency, given the growing revealed preference for preferential trade agreements (PTAs) in the East Asian region and elsewhere.

*Proposition 1:* Economic integration among economies is a good way to promote economic growth.

*Proposition 2:* Preferential trade agreements, particularly ones that go beyond goods trade, are an effective way to promote economic integration.

Yet both these propositions are empirical questions.

The purpose of this paper is to examine, in a partial way, the empirical evidence in support of both propositions. The results suggest that caution is called for. The partial evidence is that, in practice, the current plethora of PTAs may be doing 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 at least to review the way in which it might be pursued. And it suggests further careful analysis of the empirical evidence to inform that policy review.

## Theoretical considerations

Economic theory suggests that the forces of competition can exert powerful pressure on producers to find the least-cost way of serving consumer needs, and to innovate in order to better serve those needs, thus promoting economic growth. And it suggests that decentralised free markets can be an administratively efficient way of ensuring competition among actual and potential producers.

Some exceptions to this are well-known – 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 will reflect production costs, and costs will be 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.

For the purposes of discussion, let us identify two types of regulatory impediments to competition. 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 of 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 the market being served by foreign suppliers, all other things being equal.

Thus restrictions on competition do not need to be *explicitly* discriminatory against foreigners in order to have the effect of raising the prices of goods or services to levels above those in neighbouring countries. But either type of restriction 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.

As a final piece of the jigsaw puzzle, economic theory suggests that restrictions that raise prices above average production 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.

Let us now try to put the jigsaw puzzle together. The arguments are similar to those made in Hoekman and Konan (1998).

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.

Thus, in principle, a process of 'deep' economic integration could target the inappropriate restrictions that explicitly discriminate against foreign suppliers, as well as 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 is therefore likely have a significant impact on real incomes.

So a key question is whether economic integration initiatives are in practice as wide-ranging as this. If they turn out to be more selective, a further question is whether they target the restrictions that tend to raise real resource costs, or whether they instead target the restrictions that raise prices above costs. If they 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.

### **What do economic integration agreements do?**

This section will argue that PTAs, the principal form of economic integration agreement in vogue at the moment, tend to be selective in two important ways:

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

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

The next section will document how, on the basis of partial empirical evidence, the measures typically targeted by PTAs tend to be those imposing low net economic costs. The final sections of this paper will estimate the implied opportunity cost of pursuing an economic integration agenda in East Asia, relative to two relevant alternatives – selective multilateral trade reform, and comprehensive unilateral regulatory reform.

It is well known that a key feature of PTAs is the preferential liberalisation of tariffs on goods trade. But it has also been recognised that so-called ‘new age’ PTAs contain provisions that go well beyond goods trade, and that in principle, many of these provisions (such as those governing intellectual property and competition policy) could be liberalised within a PTA on a non-preferential basis.

In practice, recent North–North PTAs have tended to do one of two things in the new age areas:

- to bind the status quo; and
- where concessions are made, to make them on a preferential basis, even when logic suggests they could sensibly be made non-preferentially.<sup>1</sup>

One very clear reason for this outcome is that many of these countries have strong ‘offensive’ interests in the Doha Round of multilateral trade negotiations. Rightly or wrongly, they are unlikely to give away negotiating coin by making defensive concessions on a multilateral basis within a PTA, prior to a Doha Round settlement.

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, b, 1999, 2001). But many of the East Asian economies also 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.

Finally, the commitments in ‘new age’ areas in recent South–South PTAs have tended to be limited, often reflecting only a fraction of the status quo. The commitments in the ASEAN Free Trade Area (AFTA) covering services and investment fall into this category. They imply little if any actual liberalisation.

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.<sup>2</sup>

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 (for example, 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 supra-national 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 discriminating explicitly 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. And as noted in the previous section, 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.

### **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 PTAs.

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 be generally applicable 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 that are listed as being potentially non-discriminatory are in fact applied on a discriminatory basis in some countries).

Tables 2 to 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, Thailand), and Australia.<sup>3</sup> 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 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.

**Table 1** Indicative restrictions on competition, by sector

Sector	Restrictions that discriminate against foreign providers	Restrictions that may affect both domestic and foreign providers
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)
Distribution	Limits on foreign equity participation in local distribution outlets Restrictions on the temporary movement of people	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
Ports		Mandatory port services; Cargo handling restrictions; Organised crime
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
Telecom- munications	Prohibitions on call-back services Limits on foreign equity ownership	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
Air passenger transport		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
Electricity generation		Lack of structural separation of generation from transmission Lack of third party access for generators to transmission grid Lack of wholesale price pool

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

**Table 2 Direct price impacts of China's regulatory restrictions on trade and investment in services (per cent)**

Sector	Direct price impact			via costs
	via mark-ups on output	exports from	exports to	
International air passenger transport (domestic and foreign providers) <sup>a</sup>		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 <sup>b</sup>				2
– foreign providers <sup>b</sup>	10		10	
Telecommunications – domestic providers <sup>c</sup>	3			
– foreign providers <sup>c</sup>	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)**

Sector	Direct price impact			via costs
	via mark-ups on output	exports from	exports to	
International air passenger transport (domestic and foreign providers) <sup>a</sup>		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 <sup>b</sup>				4
– foreign providers <sup>b</sup>	11		11	
Telecommunications – domestic providers <sup>c</sup>	0.2			
– foreign providers <sup>c</sup>	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)**

Sector	Direct price impact			via costs
	output	via mark-ups on exports from	exports to	
International air passenger transport (domestic and foreign providers) <sup>a</sup>		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 <sup>b</sup>				2
– foreign providers <sup>b</sup>	11		11	
Telecommunications – domestic providers <sup>c</sup>	4			
– foreign providers <sup>c</sup>	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)**

Sector	Direct price impact			via costs
	output	via markups on exports from	exports to	
International air passenger transport (domestic and foreign providers) <sup>a</sup>		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 <sup>b</sup>				3
– foreign providers <sup>b</sup>	13		13	
Telecommunications – domestic providers <sup>c</sup>	3			
– foreign providers <sup>c</sup>	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)

Sector	Direct price impact			via costs
	output	via mark-ups on exports from	exports to	
International air passenger transport (domestic and foreign providers) <sup>a</sup>		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 <sup>b</sup>				4
– foreign providers <sup>b</sup>	9		9	
Telecommunications – domestic providers <sup>c</sup>	0.2			
– foreign providers <sup>c</sup>	0.2			

*Note:* 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.

### 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, Phamduc and Verikios (1999).



**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 multi-country 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).

**Table 7 Regional and sectoral aggregation for this version of the FTAP model**

Regional aggregation	Sectoral aggregation
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 (not elsewhere classified)
	Insurance
	Other business services
	Other services

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

The East Asian initiative examined in this section is a plurilateral PTA among all East Asian members.

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 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.<sup>4</sup> In keeping with recent PTAs, the air passenger transport sector is excluded from the PTA altogether (as it is from the GATS).

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.<sup>5</sup>

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 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.

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 on each component country. With a system of side payments, the 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 less than US \$2 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 coverage.

But 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 the region of over US \$30 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 those non-discriminatory restrictions that 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 regulatory reform of more than US \$100 billion per year to achieve a package that might generate less than US \$20 billion per year.

**Table 8 Reform scenarios and their effects on East Asian welfare**  
(Deviation from control in real income, measured in US\$ billion per year)

Sector	East Asian economic integration	Possible Doha round outcome	Comprehensive unilateral regulatory reform
Regulatory reform (services and investment)	National treatment in East Asia	National treatment in the world	Reform of all non-discriminatory regulation in East Asia
	1.7	7.4	107.3
Manufacturing tariffs	Elimination of tariffs against East Asian partners	25% reduction in tariffs globally	
	16.6	12.4	
Agricultural protection	No action	25% reduction in agricultural protection globally	
	0.0	12.8	
Total	18.3	32.6	107.3

*Source:* FTAP model projections.

## 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 program 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 be generally applicable? There is one important reason to think they would be. 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 included 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. 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 program. But this pre-supposes 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 any 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 where PTAs can usefully supplement a domestic regulatory reform program. But the main conclusion of this paper is that, because they tend to be preferential – even in their ‘new age’ provisions – they tend to focus reform efforts away from where the big gains are to be made.

The big gains would be achieved 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. The numbers are striking – gains of more than five times those that might be available through an East Asian PTA.

## Notes

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- 1 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 equally to non-preferential liberalisation.
- 2 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.
- 3 The surveys of actual restrictions and their tax or productivity equivalents were taken from McGuire and Schuele (2000), Kalirajan et al. (2000), Kalirajan (2000), Clark, Dollar and Micco (2001), 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.
- 4 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.
- 5 The measures for tariffs and agricultural protection used are those in version 5.4 of the GTAP model database.

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