

## Insight

# Regional economic integration: more than one way to skin a cat

Recent angst about trade agreements challenging domestic regulatory power distracts from an undeniable truth: the international implications of domestic regulatory settings have never been more important for New Zealand businesses. Rather than fighting it, New Zealand policymakers and firms need to better understand how changes to domestic regulation that are taking place in an environment of closer regional cooperation can enhance productivity, growth and incomes.

### Policymakers and businesses must adapt to Asian way of economic integration

A recent ERIA report on economic integration in East Asia explains that integration has moved well beyond chiselling away at tariffs in formal negotiated agreements. The future in this part of the globe is likely to be guided by a different type of arrangement, or process of economic integration. This is one that recognises the patterns of modern trade among businesses, and the ways and preferences of who we increasingly trade with.

This *Insight* pulls out the key implications of the ERIA report from a New Zealand perspective. It concludes that regional economic integration:

- requires a deep understanding of how regional supply chains work
- aims to reduce transaction costs along all parts of a supply chain rather than just at the border when the finished good is shipped to the overseas customer
- suggests Kiwi firms have to build closer links with other producers instead of just end consumers
- means domestic regulatory decisions can have significant international implications and should be thought about more carefully in this way
- presents challenges to diplomats who prefer tightly negotiated and monitored agreements like the TPP over more cooperative and trust-based ASEAN-style arrangements
- can evolve in various ways and despite resourcing costs, New Zealand needs to be engaged in both the TPP and ASEAN-style processes.

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## Economic integration is about maximising regional welfare

The report emphasises the change in understanding which is required as our focus shifts from “trade” to “economic integration”.<sup>1</sup>

Tariffs remain important – ASEAN continues to devote effort towards simplifying the application of tariffs to individual trading partners as well as improving market access more generally. New Zealand is very aware of how tariffs on agricultural products still tend to be higher than average.

But economic integration is about securing as much consumer satisfaction as possible from all regional resources, and constraints on this are often through how domestic regulations are administered rather than tariffs.

## Integration is about making international supply chains run smoother

The most important recent change is the increasing use of international supply chains. Popular imagination is still dominated by the idea of exchanging different kinds of goods among complementary economies – agriculture and raw materials for manufactured goods.

But we learned more than 50 years ago about intra-industry trade. Consumer choice was expanded by exchange of goods *within* standard industrial categories – countries exchanged different types of manufactured goods which were often quite similar. We now see an especially rapid rise in trade in intermediate goods. Producers in different economies collaborate in producing inputs which are assembled in a hub for consumers who may be in several different economies. This has been most obvious in electronics and motor vehicles but is coming to dominate the food industry too.

## This requires a change in approach by domestic regulators

Economic diplomacy has been widening beyond tariffs for many years. As tariffs were reduced, non-tariff barriers became more important. Services were added to goods as a subject for negotiation, and over time government procurement codes and subsidies were added.

There has been some media attention recently to arguments that “trade” is suddenly coming to challenge domestic regulatory power, but the policy issue has always been about when sovereign interests are best served by international agreement rather than autarchy. The challenge now is not a constitutional one, but one of reorienting regulators of all kinds to have an understanding of international context rather than just continuing with their customary domestic preoccupations.

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<sup>1</sup> The report (referred to as a ‘joint statement’) on the nature of economic integration in East Asia was issued by the Economic Research Institute for ASEAN and East Asia (ERIA’s) Research Institutes Network (RIN), of which NZIER is New Zealand’s member.

ERIA, based in Jakarta, was promoted by the Government of Japan but is supported by all the governments which belonged to the East Asia Summit. The US and Russia have also recently acceded but have not yet joined ERIA. New Zealand gained considerable credit by being the first government to join Japan in providing funds for ERIA.

ERIA’s Research Institutes Network consists of one institute from each of the 10 members of ASEAN and the initial six further members of the East Asia Summit (i.e. excluding the US and Russia). NZIER is represented at the Network by Professor Gary Hawke, an Associate Senior Fellow of NZIER. Gary participated in drafting the statement and contributed a background paper to its preceding deliberations.

The RIN joint statement and background paper is available at <http://nzier.org.nz/publications/what-kind-of-economic-integration>. Supporting contributions and much relevant economic analysis can be found on the ERIA website, [www.eria.org](http://www.eria.org)

## **New Zealand firms need to collaborate with overseas producers to effectively participate in these supply chains**

The implications for conventional thinking in New Zealand are immense. We have always been a trading nation. We have traditionally seen this as producing a product in New Zealand, putting it in a box of some kind and transporting it to consumers overseas.

The leading edge of thought was focused on identifying *consumers* more closely and making what we put in boxes something with greater appeal to them. But the emergence of complex supply chains has changed much of that.

The international economy now requires collaboration with *producers* elsewhere, sometimes without any knowledge of who the final consumers will be, let alone with any intimate direct connection with them.

## **The TPP is not the only game in town to achieve economic integration**

New Zealand is participating in two efforts to promote economic integration in our part of the world. The Trans-Pacific Partnership (TPP) attracts a good deal of media commentary, albeit with only a little intelligent analysis. The second effort is centred on ASEAN and its Regional Comprehensive Economic Partnership (RCEP) process.

RCEP has grown out of the ASEAN commitment to building an ASEAN Economic Community by 2015. The objective is to ensure that the Community relates appropriately to its regional and global context.

RCEP reflects a desire to establish modern economic interdependence among ASEAN and its regional partners, including New Zealand. The East Asia Summit brings those regional partners together.

## **TPP and RCEP take overlapping but different approaches to integration...**

Both TPP and RCEP grapple with the changed international economy. While TPP generates a lot of rhetoric about being a “21st century agreement”, Asian processes (of which RCEP is one) have given more attention to issues like infrastructural development and narrowing development gaps (among economies and within economies).

But above all, RCEP has adopted an approach of “learning together” in response to new challenges, such as supply chains. This is a different approach to that of the TPP: smoother supply chains are much less likely to be accommodated in an approach which is characterised by imposing the current practices of developed economies on a bigger array of participants.

## **...which presents challenges for diplomats and politicians, including New Zealand’s**

Orthodox diplomats prize negotiated agreements, a signed statement which includes agreed processes for monitoring and enforcement. But integration depends on genuine commitment to agreed objectives and continued processes for honest reporting of progress and peer review. Nobody could look at the recent experience in Europe and continue to believe that signed commitments necessarily signal genuine commitment.

Asian processes have avoided supranational surveillance – colonialism remains a living memory – and have emphasised continued interaction rather than completed agreements. The place of formal negotiations at the top of the hierarchy is challenged by frequent meetings of leaders, ministers and officials which develop consensus. ERIA has been employed not to provide supranational authority but to rejuvenate the notion of “concerted unilateralism”.

Technicians agree more readily than strategists, let alone politicians; change is difficult; and agreement is easier among friends. Economic integration requires cooperation among political leaders and it can therefore never be entirely segregated from other areas of diplomacy, including controversial ones. This means that economic integration cannot ignore areas of tension between majors players such as the United States and China, but has sufficient autonomy for progress to be possible even while tensions persist.

### So which should New Zealand choose? TPP, RCEP or both?

Reducing issues to a contest between China and the United States is cheap journalism. The big issues are about learning: the biggest threat to international security is the economic illiteracy of the United States Congress.

This is not because its members are more ignorant than parliamentarians elsewhere but because they are more influential. We all have to learn to function in a world where no country or small group of countries can impose its own rules as international rules, and where the evolution of international rules and institutions cannot proceed without Chinese participation.

TPP cannot succeed as a vehicle for long-run regional economic integration if China is not eventually a member. The most crucial provisions of TPP, therefore, will be those which govern the admission of new members, including recognition that China will not simply accede to a ready-made institution.

The ASEAN processes start from a better understanding of the modern international economy. China is an important player in these processes. But many key participants are deeply resistant to change. New Zealand should build on its acceptability in ASEAN, and should use its influence to encourage the United States to participate without seeking to dominate.

New Zealand politicians and policymakers rightly judge that the two processes are not incompatible, and can be pursued simultaneously albeit at the cost of more diplomatic effort. Our greatest challenge is to avoid too ready resort to familiar friends and ideas at the cost of contemporary understanding.

New Zealand firms should emphasise opportunities, recognising that some frustration is inevitable – Asia is not going to do things our way.

This Insight was written by Gary Hawke, Associate Senior Fellow at NZIER, July 2012  
For further information please contact Gary on [garyh@nzier.org.nz](mailto:garyh@nzier.org.nz) or 027 563 5794

NZIER | (04) 472 1880 | [econ@nzier.org.nz](mailto:econ@nzier.org.nz) | PO Box 3479 Wellington