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# PART 5:

## TRADE AND INVESTMENT



# Chapter 14

## The Challenges and Opportunities of Conformity in the Wider Asia-Pacific Context

### Tiny Steps on a Long Road

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#### 14.1 Introduction

In our increasingly globalised world, the way national economies connect has a major impact on how well each economy is able to grow. While this is important for all countries, it is even more important for smaller countries because they do not have the domestic scale of larger economies. To thrive, firms in smaller economies have to be more flexible in their dealings, governments more transparent, and both firms and government generally more resilient than firms and government in larger economies. Not only is New Zealand's economy "small" but it is further away from its key markets than its competitors are from theirs, and this distance creates further disadvantages.

Therefore, to improve economic performance New Zealand needs to use all of its distinctive advantages to create competitive edges to drive our growth. This applies equally to the suite of institutions that regulate the economy and to more tangible resources (such as potential exports of goods and services).<sup>1</sup> In Asia, our distant, but nevertheless, relevant neighbourhood,

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<sup>1</sup> Regulation as a competitive weapon is not a new concept, particularly when applying it to the "supply side" of the economy – meaning reducing the transactions costs of doing

further economic integration represents a huge challenge, possibly insurmountable, but one where the rewards are potentially large.

The scale of the challenge grows as the integration becomes more all-encompassing. It is even greater when the agreement goes “behind the border” to impose constraints on domestic institutions.<sup>2</sup> This effect on local regulatory powers is not always going to be unalloyed. There will be questions for participants to ask themselves.

The first is what is entailed in achieving a lasting agreement? There are a series of potential “participation constraints” to be addressed. These are aspects of the outcomes that thoughtful participant negotiators will seek to have satisfied before they sign up to any serious agreement.

*Political will* is very important; it makes the process happen, but it is not the only requirement for a trade agreement to be successful. There are many examples of such agreements that have been made, but that then became economically incoherent and failed; for example, such as delivering on Bogor Goal commitments under the APEC process.

*Economic forces* also have a major impact on the durability of any trade agreement. While these impacts are complex and short-term, inevitably a degree of self interest is apparent. Thus any agreement must deliver economic benefits to all member countries over the long run.

Key hurdles to be overcome are the differing *economic and administrative structures* within the region. While some, notably China and Vietnam, have made adjustments to allow competition within their economies, others, particularly smaller states, have very large government involvement in their economies which shapes their economic performance. Still other states have made slow progress in moving their domestic institutions toward internationally accepted models. Therefore the road by which these countries (and their specific institutions) are going to be brought together will determine the way those they team up with can interact with their economies.

This chapter examines the challenges and opportunities that further Asian (and possibly Pacific) integration present when such institutions are brought into the integration mix. This will be particularly important for small participants on the margins of the process – such as New Zealand. In examining these challenges and opportunities through a local lens our aim is look at the possible implications as a basis for considering how we might approach structuring negotiations, including specific details of coordinating further integration within the region.

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business domestically. What possibly has not been explored as fully is how to gain an export advantage from institutions that are embodied in goods and services, such as via food safety standards that guarantee origin and other production characteristics.

<sup>2</sup> See also Susy Frankel and Meredith Kolsky Lewis “Trade Agreements and Regulatory Autonomy: The Effect on National Interests” in this volume.

While there are a large number of bilateral and regional agreements already agreed or under discussion within the region, there is still uncertainty about whether a region-wide agreement will be signed. Most importantly, crucial and significant questions such as who will be in it and what might be the details of any particular agreement supporting freer trade, remain to be addressed.

The analytical approach here is to set up a stylised model of the “ideal” elements of the process, including the negotiating issues, to illustrate the underlying forces which shape the results (or lack thereof). By using this technique we can examine various aspects of further Asian integration to build up a wider (analytically structured) discussion. This is built around:

- demand side factors (or the areas over which we have only partial control) – who wants it? (that is, the attitudes of stakeholders given what is politically possible, economically durable, and whether or not the institutional arrangements are able to sustain any particular integration proposal).
- supply side factors (or areas over which we potentially have more control) – how might these wants be met? (that is, possible approaches).

We will examine each supply side approach in relation to unilateral adoption or recognition of another country’s regulation, or some international standard. In this way, we demonstrate the value that each approach might bring.

We will also be able to demonstrate how the demand and supply sides interact in each case and examine some of the high level implications for New Zealand – in particular, for the type of regulatory system we have, and how it is going to move in the new environment.

Specifically, this means the rest of this chapter will:

- examine why integration is being contemplated;
- briefly cover the spectrum of agreements already in play;
- establish a framework for examining the forces that drive the process of negotiation;
- discuss the importance of elements in the framework and how it might shape the details of any agreement; and
- draw some conclusions.

Our aim is to set out how a small open economy, seeking to be effective in the integration process sweeping Asia, should approach the regulatory effects that will inevitably be involved once the behind the border structures are included in the process.

## 14.2 Background

### 14.2.1 *Why further integration?*

In some ways, the political discourse over further integration has lagged behind the economic imperative that has driven further business integration within Asia. Interestingly, the push for further integration by business began with a political agreement.

The Plaza Accord of 1985<sup>3</sup> had the effect of devaluing the United States currency against the Japanese yen and European currencies. To remain competitive Japanese exporters began to gradually move production offshore. This has led to a sort of “de facto integration” as other countries, aided by technology advances, copied the Japanese approach.

Parallel to this process, other trade policy and economic events and trends also sharpened the focus of policy-makers. First, the negotiations associated with the GATT Uruguay Round of 1986–1994 and their conclusion in 1994. According to Soesatro,<sup>4</sup> this result brought about a realisation among Asian countries that if they were to secure export markets they would have to reciprocate and gradually open up their domestic markets. As these Asian economies partially removed trade barriers it boosted the profile of Asian nations as attractive places to invest. Secondly, the Asian financial crisis of the late 1990s demonstrated that transparency of domestic and trade policies were an important part of integrating with the world economy. The process of integration has changed the nature of sustained economic growth. No longer can economies expect to protect their home markets from foreign competition, while they take advantage of other more open markets. Thirdly, the rise of China and the associated threats (as competitor) and opportunities (as potential market) that have developed gradually over the last 30 years. Further integration and domestic reform can assist other nations to become more competitive and is a vital ingredient in supporting and sustaining economic growth rates within the Asian region.

The focus on economic growth through further economic integration is important because:

- with very few exceptions, economic growth is accompanied by improved literacy, reduced infant mortality and a better quality of life for citizens;
- increased interconnectivity between markets, driven by technology, has increased competitiveness which in turn fuels growth;<sup>5</sup> and

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<sup>3</sup> Plaza Accord (22 September 1985) was between the governments of France, West Germany, Japan, the United States and the United Kingdom.

<sup>4</sup> Hadi Soesatro “Deepening Economic Integration in East Asia: The ASEAN Economic Community and Beyond” (2007) Economic Research Institute for ASEAN and East Asia [www.eria.org/research/no1-2.html](http://www.eria.org/research/no1-2.html) (last accessed 7 August 2011).

<sup>5</sup> Daniel Kalderimis “Regulating Foreign Investment in New Zealand” in this volume (ch 16).

- it helps overcome the lack of transparency in domestic policies for those wanting to trade and invest.

According to Jones and Romer,<sup>6</sup> the scale of economic integration over the last 200 years has been dramatic. The freeing up of trade channels has brought about a near doubling of world trade as a share of world Gross Domestic Product (“GDP”) and further integration that has seen:

- Foreign Direct Investment (FDI) as a share of world GDP increase by a factor of 30 since 1965 from less than 0.1 per cent to nearly 2.8 per cent in 2006<sup>7</sup>
- the increase in the flow of ideas and people within and across borders. Jones and Romer<sup>8</sup> illustrate this by showing that in the early 1960s, 82 per cent of patents granted in the United States were granted to United States entities. This has now dropped to 50 per cent
- information flows have increased dramatically across borders, due to the rise of the internet.<sup>9</sup>

Integration has been vital to Asian growth – starting with Japanese post-war growth followed by the Republic of Korea and other Asian tigers, and now the emergence of China. These countries have approached integration in different ways with varying degrees of success. However, further integration and the type of agreement(s) and the way in which integration occurs is a long way from being decided, as the next section shows.

## 14.2.2 *Agreements in play – a sketch of the key elements*

One way of responding to the challenge of globalisation has been to develop bilateral and regional trade agreements to improve integration prospects.<sup>10</sup> This is particularly important since the current round of world trade talks (which has been, and always will be, the first best option)<sup>11</sup> has stalled.

<sup>6</sup> Charles I Jones and Paul M Romer “The New Kaldor Facts: Ideas, Institutions, Population and Human Capital” (2010) 2(1) *American Economic Journal: Macroeconomics* 224.

<sup>7</sup> Charles I Jones and Paul M Romer “The New Kaldor Facts: Ideas, Institutions, Population and Human Capital” (2010) 2(1) *American Economic Journal: Macroeconomics* 224 at 229.

<sup>8</sup> Charles I Jones and Paul M Romer “The New Kaldor Facts: Ideas, Institutions, Population and Human Capital” (2010) 2(1) *American Economic Journal: Macroeconomics* 224 at 229.

<sup>9</sup> Charles I Jones and Paul M Romer “The New Kaldor Facts: Ideas, Institutions, Population and Human Capital” (2010) 2(1) *American Economic Journal: Macroeconomics* 224 at 229.

<sup>10</sup> Susy Frankel and Megan Richardson “Trans-Tasman Intellectual Property Coordination” in this volume (ch 18).

<sup>11</sup> The greater the number of countries involved in a liberalisation process the greater the rewards and the less likely specific regions will suffer.

There has been a dramatic rise in the volume of regional trade agreements over time.<sup>12</sup> However, the sheer number of these agreements suggests it has been much easier to sign trade agreements than to reform domestic policy.<sup>13</sup> This further suggests that some of the agreements have not been of “high quality” because “good” trade agreements (at least implicitly) involve changing domestic economic structures (including regulatory structures) to make the most of the new set of joint opportunities the agreement opens up.<sup>14</sup>

Inevitably, for a major impact, this entails domestic reform. Specifically, what any agreement attempts to achieve is a seamless domestic and trade policy to provide consistency and improved economic efficiency that spurs further growth. This takes time since there are very strong economic, institutional and political forces that have a vested interest in the status quo.<sup>15</sup> The rushed approach to signing trade deals suggests that overcoming these domestic economic, institutional and political forces has not been properly addressed.

Two main types of arrangements have been observed:

- The European Union’s (EU) mainly bilateral arrangements with newly independent Eastern and Central European states – in some cases as a first step to joining the EU.
- The United States’ agreements with a number of smaller countries which take a “hub and spoke” form. These have reflected core United States protectionist policies, such as excluding (and so continuing to protect) agriculture and some sensitive industries and “liberalising” (in selected ways) services and intellectual property trade.

The volume of these agreements has meant that those in charge of trade policy around the world have been scrambling to ensure that they are not a victim of trade diversion in a defensive way.<sup>16</sup> There is a clear potential, particularly for small countries, to be harmed economically from being left out of any resulting shifts in trade patterns.

From a New Zealand perspective, regional trade agreement activity in the post-1990 period has been frenetic (see Figure 1). Agreements and potential

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<sup>12</sup> According to the World Trade Organization (WTO), 40 such arrangements were signed by 1990; this number had risen to 191 in 2000: “Regional Trade Agreements Database” (2011) World Trade Organisation [www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm) (last accessed 7 August 2011).

<sup>13</sup> Relevant Asia Pacific Free Trade Areas and Preferential Trade Areas are set out in Appendix A to this chapter.

<sup>14</sup> Susy Frankel and Meredith Kolsky Lewis “Trade Agreements and Regulatory Autonomy: The Effect on Consumer Interests” in this volume (ch 15).

<sup>15</sup> Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17).

<sup>16</sup> Trade diversion occurs when a trade agreement between two countries stops trade from a third country through higher trade barriers.



agreements are now continually being talked about in the popular press. Furthermore, the list of possible partners seems to grow as time goes on.

Amongst the various arrangements within the region (such as Australia New Zealand Closer Economic Relations Agreement ("CER"), Association of Southeast Asian Nations ("ASEAN"), Comprehensive Economic Partnership for East Asia ("CEPEA"), Trans-Pacific Partnership Agreement ("TPPA"), ASEAN + 1, ASEAN + CER, ASEAN + 3, ASEAN + 6, and Asia Pacific Economic Cooperation ("APEC")) there is a wide range of institutional arrangements with varying degrees of institutional quality.

In this respect, CER is the most comprehensive trade deal signed – it is the world's "best practice" since it allows New Zealand and Australia to offer reductions in tariffs and other trade barriers to third countries.<sup>17</sup>

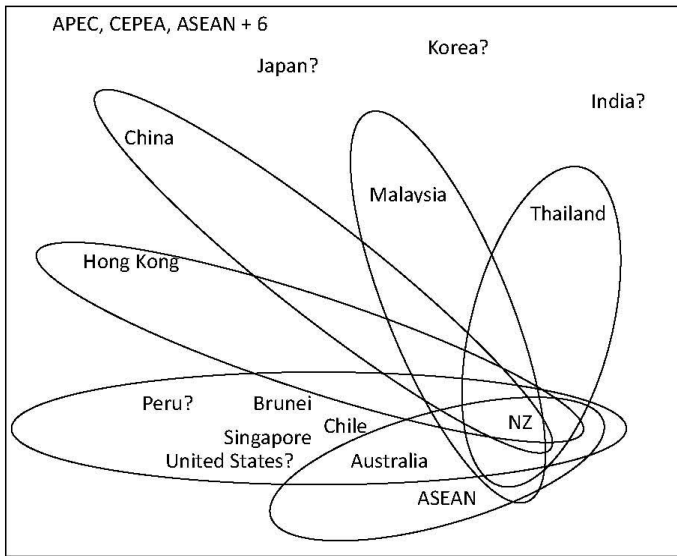
One major advantage both countries have is that their institutions are of high quality (both having imported their initial endowments of institutions almost whole from Britain in the 19th century). Therefore, since the agreement coverage was very wide (it includes not just tariff and non-tariff reductions but also relatively unrestricted movement of people), the structural impact has been substantial, particularly for the smaller nation: New Zealand. Prior to the CER agreement, New Zealand's trade with Australia was relatively small (in 1980 it was 13 per cent of total trade); now Australia is New Zealand's biggest export market (roughly 21 per cent in 2007). New Zealand is also the biggest market for Australian small to medium size businesses (SMEs).<sup>18</sup>

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<sup>17</sup> For a discussion of CER see Chris Nixon and John Yeabsley "Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of trans-Tasman Integration" (ch 17), and Susy Frankel and Megan Richardson "Trans-Tasman Intellectual Property Coordination" (ch 18) in this volume.

<sup>18</sup> Daniel Kalderimis "Foreign Investment in New Zealand" in this volume (ch 16).

Figure 1: Regional trade agreements: The example of New Zealand



Source: Adapted from Lloyd and McLaren<sup>19</sup>

The components of the CER agreement include: free trade in goods (since 1990), free trade in services (since 1989), mutual recognition of goods and occupations (under the trans-Tasman Mutual Recognition Arrangement ("TTMRA")) and a free labour market. Also, there were extensive moves to remove technical barriers to trade.

The Asia Pacific Economic Cooperation ("APEC") nations have developed targets for trade facilitation through its Trade Facilitation Action Plan ("TFAP").<sup>20</sup> These targets are on-going and attempt to focus attention on border transaction costs. APEC has recognised that more fundamental changes are required before domestic institutions are able to cope with further liberalisation (specifically, the Leaders' Agenda to Implement Structural Reforms ("LAISR")). This initiative is designed to improve institutional quality within the APEC region. How this actually impacts on regulatory reform, competition policy, public sector management, economic and legal infrastructure, and corporate governance remains to be seen; however, it is one positive step in a long process that aims to improve the efficiency of trade within the APEC region.

<sup>19</sup> Peter J Lloyd and Donald McLaren "Gains and Losses from Regional Trading Agreements: A Survey" (2004) 80 Economic Record 445 at 460.

<sup>20</sup> APEC Committee on Trade and Investment "APEC Trade Facilitation Action Plan" (2002) Asia Pacific Economic Cooperation [www.apec.org/Groups/~media/Files/Groups/CTI/03\\_cti\\_tfactionplan.aspx](http://www.apec.org/Groups/~media/Files/Groups/CTI/03_cti_tfactionplan.aspx) (last accessed 7 August 2011).

APEC does not impose conditions on its members. In the area of standards,<sup>21</sup> it encourages greater alignment of APEC member economies' standards with international – normally WTO – standards. Crucially, some of the larger economies within the APEC region continue to develop independent standards for their own very large markets. This is likely to be a major trade issue as these emerging economies (China and India) flex their economic power in the same way the United States and the European Union have imposed their preferred trading regimes on the rest of the world since World War II.

While APEC has a well developed process, the shape of the ASEAN + agreements, Comprehensive Economic Partnership for East Asia (“CEPEA”) and Trans-Pacific Partnership Agreement (“TPPA”) are still being developed. Therefore, it is difficult to forecast how the various trade agreements will emerge and, more importantly, how the detail of any deeper integration agreements which include behind the border effects will impose themselves on our economy and the functioning of our institutions.<sup>22</sup>

### 14.2.3 *Challenges for New Zealand*

As stated above, further international integration offers a way of enhancing future economic prospects. But New Zealand has specific characteristics that affect both our aims in any integration process and its outcome, and our place in the underlying negotiations.

The specific characteristics that are relevant to the aims include:

- our existing economic structure and its potential development path;
- our preferred ways of doing business, and their institutional requirements; and
- our (domestic) expectations of our own institutions (including the degree of control we expect to have over their operations and effects).

On the other hand, our negotiating influence is limited.<sup>23</sup> New Zealand is:

- a small economy, with little to offer in terms of a market;
- not central to the way the core countries driving the negotiations see Asia; but
- tightly linked to Australia which is more central and a substantially bigger economy.

<sup>21</sup> Standards are important because they describe and define the process or final good which is to be regulated (or deregulated) in different jurisdictions. This allows a like with like comparison so that uniform rules (in the form of standards) can be applied in a transparent way across different jurisdictions.

<sup>22</sup> Susy Frankel and Megan Richardson “Trans-Tasman Intellectual Property Coordination” in this volume (ch 18).

<sup>23</sup> Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17).

Taken together these factors suggest that New Zealand faces significant challenges, and has limited leverage to wield. While this is not an unusual situation for New Zealand negotiators,<sup>24</sup> it is none the less demanding. Obviously each situation needs to be approached on its own terms; a maxim that is even more relevant for small players seeking to gain situational power where they can. But there are some general preparations that can be made.

These include developing an understanding of the strengths and weaknesses of possible integration methods that may be proposed. This permits our negotiators to make a careful assessment of the process as it progresses, and thus improves the chance of nudging it in a more favourable direction, where possible.

Different approaches to integration would imply different effects on the issues raised above and thus such an assessment would provide an introduction to the way in which wider, behind the border, institutional change might be achieved. The assessment would look toward the achievement of the aims discussed above. It would also draw on the experience New Zealand can assemble from its previous integration experience and what that meant for regulation and institutions.

## 14.3 The framework

At a high level, the organising framework used to analyse the possible approaches to further Asian integration is similar to that used in Nixon and Yeabsley,<sup>25</sup> which also examined a particular aspect of CER integration (therapeutics).

Here the approach is applied to potential Asian interactions and thus different arrangements that might be considered. This allows us to investigate the advantageous and disadvantageous outcomes from different methods of further integration and thereby gain insights into integration opportunities and vulnerabilities.

The design of this analysis has deliberately been kept simple. Therefore, we have abstracted from the full detail of the trade integration-policy issues in question. This analysis should contain just sufficient complexity and reality to allow us to consider the questions of interest, while illustrating the advantages and disadvantages of the strategies adopted for this trade policy episode.

Figure 2 sets out the high-level framework. It focuses on the interaction between the supply-led and demand-led processes, given the constraints-

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<sup>24</sup> See the historical examples discussed in Chris Nixon and John Yeabsley *New Zealand's Trade Policy Odyssey: Ottawa, via Marrakech and on* (New Zealand Institute of Economic Research, Wellington, 2002) at 41-53.

<sup>25</sup> See Chris Nixon and John Yeabsley "Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration" in this volume (ch 17).

opportunities.<sup>26</sup> The constraints and opportunities arise from bilateral trading arrangements, standards in force, international trading rules (WTO), and compatibility with other jurisdictions such as the European Union and United States.

In most freely operating markets the demand side factors are the dominant element.<sup>27</sup> This is because those close to the market have a better understanding of what will satisfy the market; and from the market flows the revenue. This process has also been heavily assisted by new technology that allows those close to the market to monitor sales trends, to keep a tight rein on inventory and use the ability to source product from different parts of the world relatively easily. Importantly, producers of regulatory design solutions do not always appreciate the speed that markets move, or the subtlety of what is required since they are either biased towards their particular regulatory design solution or have not fully understood the market and the way it works.

The motivation for further integration is coming from businesses, politicians and policy-makers who have various motivations.<sup>28</sup> The challenge for parties negotiating any particular agreement is to align those motivations in a coherent way that leads to a durable agreement given the details of the supply side issues (elements of the regulatory design).

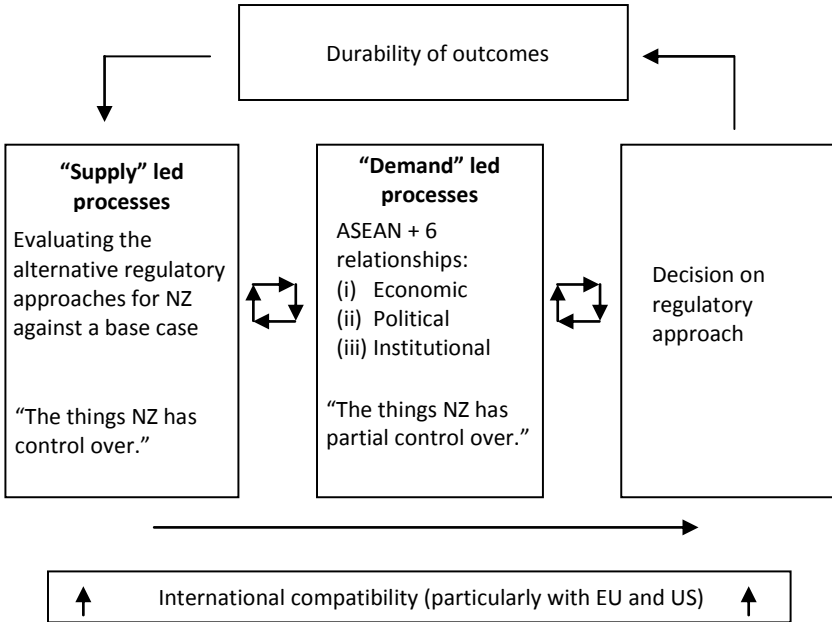
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<sup>26</sup> Often the demand-led processes are partly or mostly beyond New Zealand's control, while the supply-led process are typically New Zealand's responsibility.

<sup>27</sup> Robert D Buzzel and Bradley T Gale *The PIMS Principles: Linking Strategy to Performance* (Free Press, New York, 1987).

<sup>28</sup> Masashiro Kawai and Ganeshan Wignaraja "ADB Economics Working Paper Series: Asian FTAs - Trends, Prospects and Challenges" (2010) Asian Development Bank [beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges](http://beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges) (last accessed 7 August 2011).

Figure 2: Approach to further integration within ASEAN + 6 countries



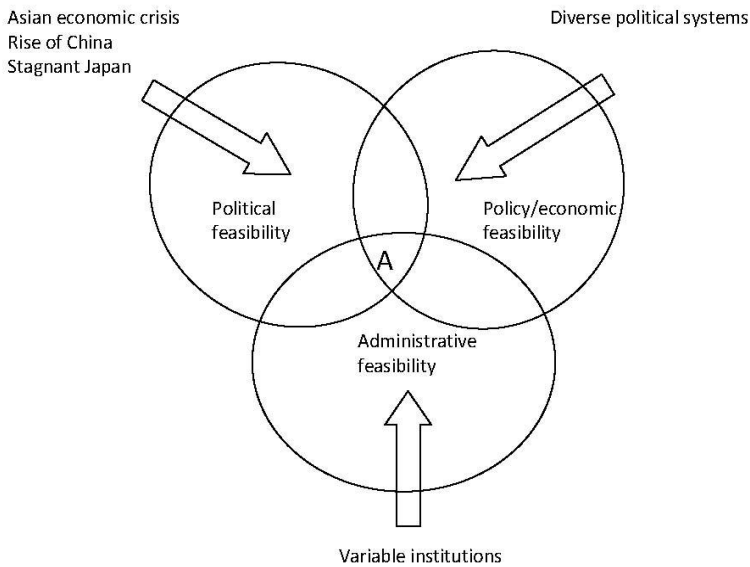
## 14.4 Regional relationships – demand-led processes

Key to understanding the likely efficiency and effectiveness of any particular trade agreement in the Asian region is how well the details of the economic, political and institutional relationships reinforce each other to create a durable integration process.<sup>29</sup> Figure 3 sets out the political, economic/policy, and administrative issues that need to be considered in any negotiation for closer integration.

<sup>29</sup>

See Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17), for more discussion of this model.

Figure 3: Factors to be considered for further integration in the Asian region



Source: Adapted from Lax and Sebenius<sup>30</sup>

At point A, all three processes overlap and so there are no barriers to progress. The three potential constraint areas can be considered. The *political feasibility* relates to the background issues that drive political thinking in each country, such as a country's overriding concerns. These may be more to do with security than economic growth. (For example, Thailand is more concerned with maintaining its border with Myanmar than its trading relationship.) The relationships developed between different countries over time, the impact these relationships have on trade agreements, and the degree of domestic understanding of regional issues are also important. The *policy/economic feasibility* includes the demonstration effect of open markets and how competitors are responding relative to domestic firms and government. The *administrative or institutional feasibility* is concerned with how the arrangement works out in practice, and over time. What are the real impediments to the integration process? The more endemic corruption is within an economy, the more likely it is that institutions will be less predictable in their decision making, reducing transparency and the ability of the economy to grow.

These matters of substance all play a part in the durability of economic integration. Therefore, for success to occur all three need to be examined in detail and aligned, since it is the details of these matters of substance that will

<sup>30</sup>

David A Lax and James K Sebenius *The Manager as Negotiator: Bargaining for Cooperation and Competitive Gain* (Free Press, New York, 1986) at 266.

decide the fate of any particular potential agreement. We can examine each in slightly more detail.

### **14.4.1 Political**

A number of clear political trends are assisting the economic integration process. The demonstration effect of a relatively free trading Chinese economy, a stagnant Japan which seems unwilling to reform its domestic economy (including trade), and the Asian economic crisis which showed that transparency in economic management was very important, have all pushed Asian political sentiment towards further economic integration. Having said that, overcoming the political impediments to integration will require time because vested interests are unlikely to give up their privileged position lightly.

#### *(a) Political relationships*

The single most important hurdle to integration is domestic political resistance since political will is the oil that greases the integration wheels. Therefore, while the pattern of economic activity can show the glittering possibilities of further integration, Asian nations will require the political will to overcome the challenges and sustain the integration process. Politicians will need to assess the trade offs required before committing to a particular course of action.

Without the political imperative, in the short run, there is no integration. The most celebrated case of this is former French President de Gaulle twice saying “non” to British accession into the European Economic Community (“EEC”) for no other reason than he did not want Britain in the EEC. This held up British accession until de Gaulle left office (Nixon and Yeabsley 2002).

The political actors therefore have the most immediate impact on the process of any particular negotiation since they set the tone; the likelihood that both sides want to cooperate affects the aspirations of the parties, and circumscribes what is able to be achieved in any particular negotiation.

#### *(b) Different stages of development*

The different economic speeds at which some members are travelling will also cause political resistance. Asia incorporates nearly the full spectrum of developed and developing nations with differing priorities and differing views on the preferred route to economic development and government’s role in it. There are a variety of political positions on further integration. While there are ways to overcome this problem, and better align views, it will require patience. The key is to understand and address the real fears associated with



integration, and to resist short-term political fixes that dampen the potential gains of freer trade over the long run.<sup>31</sup>

The political appetite for further integration will depend on leadership within individual Asian countries. This will be determined by the likely assessment of benefits (short, medium, and long term) and the costs of integration (mainly in the short term). In some cases, the adjustment costs will cause politicians to balk at further integration. How they approach these hurdles will determine the strength and speed of the integration process.

### (c) Which FTA?

Many free trade agreements (“FTAs”) are in play.<sup>32</sup> In part this reflects the political rivalry within the region. For example:

- China prefers an East Asian Free Trade Agreement among ASEAN + 3 (ASEAN members plus PRC, Japan, South Korea) countries
- Japan has been more interested in CEPEA<sup>33</sup> and ASEAN + 6 (ASEAN members plus PRC, Japan, Korea, India, Australia and New Zealand)
- the issue remains of the role the United States will take in any integration.

In this respect, it is not obvious that any region-wide agreement can be formed at all.<sup>34</sup>

This has implications for the rules of the integration process (standard-setting, competition policy, intellectual property, institution building etc). The larger the grouping of Asian nations involved in the integration process, the more likely that international standards will be adopted. This will also assist in delivering the benefits of integration.

### (d) Ensuring voice and accountability

In the presence of weaker institutions, the politics of further integration can become somewhat fraught, since the gains can potentially be much less than were anticipated and also can be captured by politically astute domestic players (rather than economically astute players). This can have a major impact on the politics of the decision as various interests within the economy compete for the resulting economic gains.

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<sup>31</sup> This includes the use of longer timelines before full integration occurs, different speeds of protection reduction, and help and advice on understanding how rules can be effectively implemented.

<sup>32</sup> See discussion above.

<sup>33</sup> Comprehensive Economic Partnership for East Asia.

<sup>34</sup> Masashiro Kawai and Ganeshan Wignaraja “ADB Economics Working Paper Series: Asian FTAs – Trends, Prospects and Challenges” (2010) Asian Development Bank [beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges](http://beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges) (last accessed 7 August 2011) at 20–23.

Any efficient trading system aims to encourage participants to react to transparent and clear economic incentives. Therefore, the mechanics of the trading process and standards that govern trade must be seen to be set in a transparent manner and those that transgress these laws need to be held accountable. While this is relatively straightforward in theory, ensuring that countries police trade rules in a transparent manner depends mainly on the strength of the institutions that enforce the rules. Where institutions are variable in voice, accountability will also be variable.

The development of high quality institutions within the Asian region is likely to be a slow process, taking years if not decades to achieve. The only way a trading system can build up this type of structure is by rewarding good behaviour and penalising bad. If the rules are applied unevenly across a regional trading area on a continuing basis the benefits are likely to be less from an integration process than policy-makers would have hoped.

#### *(e) Loss of political control*

One of the main trade-offs required is to assess how much political control will be lost for improved economic performance. Key vested interest groups within countries are likely to oppose such moves because of fears of the erosion of their rights and privileges. Further integration will also challenge the mindset of various government agencies who eye neighbouring countries as competitors. These mindsets will have to change over time before the benefits of complete integration to the region are fully realised.

#### *(f) Dynamic nature of the process*

Understanding these issues and realising the trade policy approaches are likely to change and that there is little a country like New Zealand can do to set the policy agenda requires trade policy flexibility. New Zealand has little ability to take the substantive high ground and somehow persuade, browbeat or otherwise obtain concessions from larger, more powerful nations.<sup>35</sup>

In this dynamic situation, one of New Zealand's key negotiating weapons is flexibility and the ability to remain nimble through the negotiation process. This will be particularly important in the "shifting sands" of Asian politics.

In these processes, New Zealand needs to be useful to the process by floating ideas that suggest novel ways of getting around seemingly intractable issues.

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<sup>35</sup>

Chris Nixon and John Yeabsley "Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration" in this volume (ch 17).

### 14.4.2 *Economic/policy feasibility*

The core requirement of any integration agreement is that there will be a net surplus generated. In other words, the fundamental question is whether there will be a bigger national income. This is a generic economic precondition because otherwise individuals will be suffering income falls to achieve the integration, and their interests will be better served by the status quo. Moreover, any increase in national income from what it would otherwise have been is potentially a pool from which to create incentives for “losing groups” via redistribution. The winners are able to compensate the losers.

Below we look at some of the other factors that impact on the economic coherence of further integration.

#### *(a) Size of the prize*

There have been a number of attempts to model the various possible trade agreements associated with closer Asian integration. Kawai and Wignaraja<sup>36</sup> compare economic impacts of CEPEA with an East Asia Free Trade Agreement (“EFTA”) showing that CEPEA yields greater benefits to participants and fewer losses to non-participants. They also cite Lee, Owen and van der Mensbrugghe<sup>37</sup> who show similar results. The final CEPEA Report<sup>38</sup> which includes NZIER modelling shows not only greater benefits from the wider agreement but that virtually every country would be better off if agriculture is included in CEPEA. See Table 1 for a summary of results.

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<sup>36</sup> Masashiro Kawai and Ganeshan Wignaraja “ADB Economics Working Paper Series: Asian FTAs – Trends, Prospects and Challenges” (2010) Asian Development Bank [beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges](http://beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges) (last accessed 7 August 2011) at 24.

<sup>37</sup> Hiro Lee, Robert Owen and Dominique van der Mensbrugghe “Regional Integration in Asia and its Effects on the EU and North America” (2009) 20 *Journal of Asian Economics* 240.

<sup>38</sup> Risaburo Nezu (Chair) “Track Two Study Group on Comprehensive Economic Partnership in East Asia” (2008) at 35. A copy of the report is available online at [www.thaifta.com/thaifta/Portals/0/cepea\\_report.pdf](http://www.thaifta.com/thaifta/Portals/0/cepea_report.pdf) (last accessed 10 August 2011).

Table 1: Computable General Equilibrium (CGE) modelling estimates of the “size of the integration prize”

	<b>Kawai and Wignaraja (2009)</b>	<b>Lee, Owen and van Mensbrughe (2009)</b>	<b>CEPEA (2009)</b>
Integration of the region: income (US\$) billion	260	201	
East Asia only (US\$) billion		177	
ASEAN + 3 (tariff elimination only)			GDP impacts range between -0.17% and 1.86%
Full liberalisation in the ASEAN + 6 region			GDP impacts range between -0.18% and 11.04% <sup>1</sup>

Note: (1) Only one region, Taiwan, suffered a slight drop in GDP growth and all other countries gain in the region.

Source: Kawai and Wignaraja;<sup>39</sup> Lee, Owen and Mensbrughe;<sup>40</sup> CEPEA<sup>41</sup>

The results show that the wider the agreement is, the bigger the (substantial) benefits. The expectations of the Kawai and Wignaraja<sup>42</sup> work suggest a rather traditional approach to FTA development, which is distilled into one package. However, it is more likely that a network of “compatible agreements” will develop with overlapping membership. The agreements will deal with a range of issues including tariff reductions, removal of beyond the border restrictions on services trade, trade facilitation, capacity building, customs cooperation, competition policy, intellectual property rights, treatment of foreign companies, mutual recognition agreements, and possibly movement of natural persons (and there may be others).

<sup>39</sup> Masashiro Kawai and Ganeshan Wignaraja “ADB Economics Working Paper Series: Asian FTAs – Trends, Prospects and Challenges” (2010) Asian Development Bank [beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges](http://beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges) (last accessed 7 August 2011) at 22.

<sup>40</sup> Hiro Lee, Robert Owen and Dominique van der Mensbrughe “Regional Integration in Asia and its Effects on the EU and North America” (Osaka School of International Public Policy discussion paper, 08E012, 2008) at Table 4.

<sup>41</sup> Risaburo Nezu (Chair) “Track Two Study Group on Comprehensive Economic Partnership in East Asia” (2008) at 35.

<sup>42</sup> Masashiro Kawai and Ganeshan Wignaraja “ADB Economics Working Paper Series: Asian FTAs – Trends, Prospects and Challenges” (2010) Asian Development Bank [beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges](http://beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges) (last accessed 7 August 2011).

The focus will not be on agreeing to an FTA which removes tariffs on goods and some barriers to investment and services trade but on the gradual integration of the economies of the Asia-Pacific region. We expect the agreement to grow and mature over time as participants see the benefits.

In this context, we see no issue with countries developing an overlapping network of agreements. Examples might include New Zealand engaging in the TPPA with as many parties as possible, as well as participating in efforts to set up the CEPEA.

### *(b) Unbundling the economic impacts*

Trade agreements not only have market implications but also non market effects, all of which have an impact on the efficiency of the economic integration process. Therefore, it is important to consider both market and non market processes when contemplating further integration. Figure 4 sets out the approach to total economic value associated with integration.

Use values are more easily appraised relative to other forms of economic value because they can be measured in the market. Normally this can be shown in terms of increased/decreased business and other economic activity in the market after regulation is put in place.<sup>43</sup>

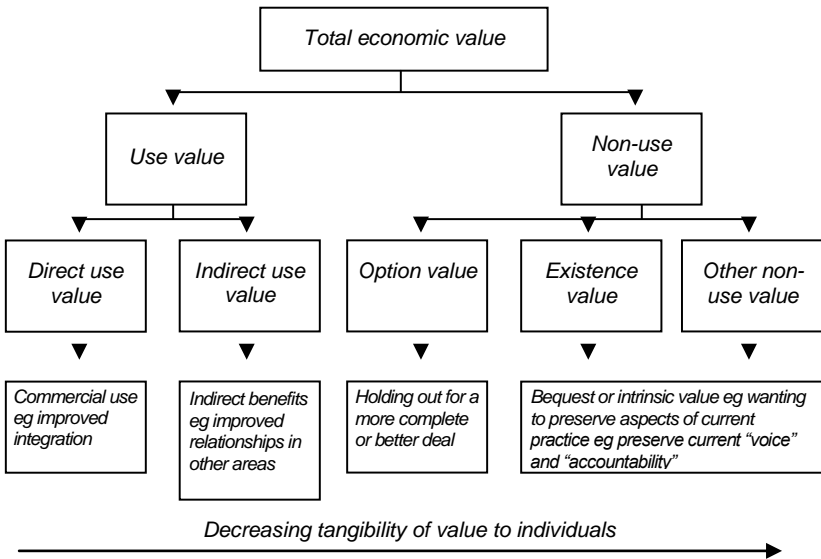
Non use values are more difficult to pin down since gauging the impact of successful economic integration on other areas of the relationship, such as the political relationship, can be difficult. However, successful approaches to economic integration can spill over and do have an impact on other areas.<sup>44</sup>

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<sup>43</sup> Although setting out the counterfactual – what would have happened otherwise – is problematic.

<sup>44</sup> Daniel Kalderimis “Foreign Investment in New Zealand” in this volume (ch 16).

Figure 4: Unbundling the components of economic value



Source: Adapted from Serageldin<sup>45</sup>

A non-use value can also be an option value, that is, holding out for a better structured trade deal or a more apt set of regulations is also a potential approach that should be considered. This is possibly more important when considering how we integrate with Asia, since a badly structured trade deal could set the process of integration back further and build in inefficiencies that are difficult to get rid of. Included in this approach is also understanding the price of that option, in terms of economic opportunities forgone and spillover impacts to other parts of the relationship.

More intangible are the existence of and bequest values associated with trade agreements. The real question is how much of these values are eroded in the process of more tightly integrating Asian-Pacific economies – are they things that matter to each player or on the periphery each players' concern?

It would also be a mistake just to take into account market-related transactions in estimating the costs and benefits of "tighter" integration, since the full economic costs/benefits stem more from the spillover impacts of regulations, that is, the dynamic efficiency gains as firms realise the potential of new regulations or the lack of domestic accountability for the actions of firms under the new regulations.

<sup>45</sup>

Ismail Serageldin *Very Special Places: The Architecture and Economics of Intervening in Historic Cities* (The World Bank, Washington DC, 1999).

### (c) Structure of agreements

Closer economic integration will be a difficult and somewhat arduous task for regional policy-makers, despite the clear economic, social, and developmental benefits, since institutional and entrenched vested interests and political obstacles loom large. In this respect, further integration gets to the heart of the economic issues facing nations.

Governments find it increasingly difficult to control who reaps the economic rewards within a nation. The economic rewards are determined by economic factors rather than political factors. Government also, to some extent, has to withdraw from economic activity. Where once it might have been a major economic player it has to restrict itself to certain “industries” and allow for competition. Its new role as an impartial referee in economic matters, where it once might have favoured various sectors within society, is a difficult job that requires the building up of institutions that set the rules of the game over a long period of time.

The role of impartial referee requires less opaqueness and more economic transparency than has otherwise been the case.

Furthermore, the full benefits from further integration are likely to take many years to accrue since economic growth is somewhat dependent on the strength of the institutions in each country. Currently, the strength of the institutions within the ASEAN + 6 nations is variable, in terms of their existence, and otherwise.<sup>46</sup>

While the barriers to successful integration are large, a pathway can be developed to overcome these hurdles. A necessary first step is to ensure that the strategy to develop further integration in the Asian region is *comprehensive, ambitious and realistic*.<sup>47</sup>

Being comprehensive and ambitious is important because we can set out the full extent of what economic integration potentially means for the region. By full integration, we mean going beyond tariff and non tariff reductions on merchandise trade to the task of building or strengthening institutions behind the border to support the economic development and integration in the region.

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<sup>46</sup> See, for instance, the discussion in Johannah Branson “Competition Policy in ASEAN: Case Studies” (2008) 374 Asia Pacific Economic Paper at 60. Available at [www.eaber.org/intranet/documents/102/1709/AJRC\\_Branson\\_2008.pdf](http://www.eaber.org/intranet/documents/102/1709/AJRC_Branson_2008.pdf) (last accessed 7 August 2011).

<sup>47</sup> Hadi Soesatro “Deepening Economic Integration in East Asia: The ASEAN Economic Community and Beyond” (2007) Economic Research Institute for ASEAN and East Asia [www.eria.org/research/no1-2.html](http://www.eria.org/research/no1-2.html) (last accessed 7 August 2011) at 214; “New Zealand Trade Consortium working paper no 47: Building the Pillars of a Regional Economic Partnership” (2009) New Zealand Institute of Economic Research [nzier.live.egressive.com/system/files/sites/nzier.live.egressive.com/files/NZTC%2047.pdf](http://nzier.live.egressive.com/system/files/sites/nzier.live.egressive.com/files/NZTC%2047.pdf) (last accessed 7 August 2011).

By being realistic, we mean finding mechanisms that are built into any agreement that provide optimal approaches to the integration hurdles faced. While this might be more difficult in the short run, experience from other trade negotiations suggests that political “quick” fixes, partial agreements, and badly structured agreements can lead to long-term distortions that take on a life of their own with the support of vested interests.<sup>48</sup> These “temporary” fixes can take decades to address and are very difficult to rectify – getting the structure of economic integration right at the beginning of the process is a key strategic goal.

Another important issue is that all – or nearly all – sides must get something out of the integration process.

What we know about liberalisation processes is that the larger the number of countries involved the more likely that the size of the integration prize will be higher and the less likely that there will be many losers in the process. So, a part of being ambitious and realistic is to ensure that as many countries participate in the integration process as possible.

#### *(d) Details can be important: the “noodle bowl” example*

The economics of seemingly positive moves to greater integration can be offset to the extent of producing possibly negative results via seemingly technical details. This is not a trivial issue, and needs to be reviewed in an appropriate time-scale, to ensure the participation requirement is satisfied.

An example is the choice of provisions governing rules of origin (“RoO”). In the dramatic surge of FTAs over the past 20 years a crucial “detail” has been the RoO included. Because they can rule certain goods in and out of such PTAs, the price of having one can be to (comparatively) restrict imports from third countries through design of the RoO applied.<sup>49</sup>

RoOs have become more important because:

- lower tariffs in FTAs has brought other trade policy instruments to the fore;
- many PTAs now require RoOs;
- RoOs are seen as a technical issue, therefore less attention is placed on them;
- the ease in which firms can influence RoOs; and
- global integration increases trade in intermediate goods, where RoOs are focused.

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<sup>48</sup> See, for example, Chris Nixon and John Yeabsley *New Zealand’s Trade Policy Odyssey: Ottawa, via Marrakech and on* (New Zealand Institute of Economic Research, Wellington, 2002) at 127.

<sup>49</sup> Two types of RoO exist – one is non-preferential RoO (to clarify whether a good qualifies for a reduction in customs duties) and the other is preferential RoO which prevents third parties from taking advantage of a FTA in which they are not involved.



Researchers are highly critical of the use of overlapping FTAs. Led by Bhagwati,<sup>50</sup> they point to systematic problems associated with giving preferences to selected FTA members behind high tariff walls (trade diversion) and the use of restrictive trade rules, particularly RoO. Others, most notably Bergsten<sup>51</sup> believe that the PTA process leads to a process of competitive liberalisation.

The degree of RoO restrictiveness, and thus its economic impact, depends on a number of factors: market size, market structure, how the RoO is determined and implemented in the importing country, and the cost of compliance associated with RoOs.

Looked at over a longer time period, RoO restrictiveness tends to decrease if regime-wide rules are in place. Estevadeordal and Suominen<sup>52</sup> suggest that this is because firms tend to overcome the negative aspects of product-specific rules by learning how to take advantage of the more permissive regime-wide rules. They also note elsewhere<sup>53</sup> that European ("PANEURO" system) and North American (under NAFTA) RoOs are more restrictive than Asian RoOs. (However, this situation is becoming more complicated as intercontinental PTAs are signed or proposed).

This "learning" effect suggested by Estevadeordal and Suominen<sup>54</sup> and the high costs of implementing RoOs may be why Petri<sup>55</sup> has argued that characterising ASEAN FTAs as a "noodle bowl" of overlapping and intertwined agreements that reduce the value of economic outcomes may be misleading. It is suggested these should be viewed as a trade agreement matrix ("TRAM").

<sup>50</sup> Jagdish Bhagwati "US Trade Policy: The Infatuation with Free Trade Agreements" in Jagdish Bhagwati and Anne O Krueger (eds) *The Dangerous Drift to Preferential Trade Agreements* (AEI Press, Washington, 1995).

<sup>51</sup> C Fred Bergsten "Asia Pacific Economic Cooperation Working Paper nos 96–15: Competitive Liberalization and Global Free Trade – A Vision for the Early 21st Century" (1996) *Asia Pacific Economic Cooperation*.

<sup>52</sup> Kati Suominen and Antoni Estevadeordal *Gatekeepers of Global Commerce – Rules of Origin and International Economic Integration* (Inter-American Development Bank, Washington DC, 2008) at ch 5.

<sup>53</sup> Kati Suominen and Antoni Estevadeordal "Rules of Origin: A World Map and Trade Effects" (paper prepared for the World Bank Seventh Annual Conference on Global Economic Analysis, Washington DC, June 2004). The paper is also available online at: [siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/288464-1119888387789/Mapping&MeasuringRulesOfOrigin\\_aroundTheWorld\\_AntoniEstevadeordal&KatiSuominen.pdf](http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/288464-1119888387789/Mapping&MeasuringRulesOfOrigin_aroundTheWorld_AntoniEstevadeordal&KatiSuominen.pdf) (last accessed 8 August 2011).

<sup>54</sup> Kati Suominen and Antoni Estevadeordal *Gatekeepers of Global Commerce – Rules of Origin and International Economic Integration* (Inter-American Development Bank, Washington DC, 2008). The paper is also available online at: [idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1773236](http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1773236) (last accessed 8 August 2011).

<sup>55</sup> Peter A Petri "East-West Center no 86: Multitrack Integration in East Asian Trade – Noodle Bowl or Matrix?" (2008) East-West Center [www.eastwestcenter.org/fileadmin/stored/pdfs/api086.pdf](http://www.eastwestcenter.org/fileadmin/stored/pdfs/api086.pdf) (last accessed 8 August 2011) at 1.

The erosion of exclusivity and the high cost of compliance may lead to pressure building for a multilateral approach to the problem, that lowers the overall transaction costs and complexity and thus improves all economic benefits.

In fact, the negative impact of RoO has been relatively limited in the Asian region.<sup>56</sup> Kawai and Wignaraja suggest that the impacts are much larger on big firms than smaller firms.<sup>57</sup>

### **14.4.3 Institutional feasibility**

While some within the Asian region have very high-quality institutions, across the region the standard is mixed. The quality of institutions is one of the serious barriers to maximising integration efforts.

Institutions will only improve if economic benefits within the region reinforce institutional development. This will demonstrate to political actors that there is an overriding need to support the rules associated with economic activity.

Any trade agreement must be supported by high-quality institutions for it to be durable. This means that thought must be given to:

- assisting countries with embryonic institutions by providing resources (including expertise) to develop national institutions; and
- focusing institutional development where there is greatest potential for returns to be made. This potentially has the impact of demonstrating how benefits from reform can assist economic development.

The difficulty of this process should not be underestimated, as an analysis of Asian taxi market regulation shows.<sup>58</sup> ASEAN + 6 taxi markets are highly regulated and in many places and corruption is rife. Any progress on institutional development is likely to be slow; however, the rewards to improvement are large.

## **14.5 Possible approaches – supply side**

To understand what structures might be appropriate to integrate efficiently we must first understand the nature of the trade policy marketplace within the Asia-Pacific region. Below we examine the trade policy bets that are evolving in the trade policy marketplace, and the types of mechanism that

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<sup>56</sup> See Trinh Le and Chris Nixon “Distance Matters” (forthcoming NZIER working paper).

<sup>57</sup> Masashiro Kawai and Ganeshan Wignaraja “ADB Economics Working Paper Series: Asian FTAs – Trends, Prospects and Challenges” (2010) Asian Development Bank [beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges](http://beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges) (last accessed 7 August 2011) at ch III.

<sup>58</sup> Chris Nixon “Taxi!” (forthcoming NZIER working paper).

could be applied (tool-kit) to assist the integration process in the Asia-Pacific region.

### 14.5.1 Trade policy bets in play

One way of examining how the integration process might affect New Zealand is to examine the “likely scenarios” that might emerge.

Work by Kawai and Wignaraja<sup>59</sup> discusses a possible pathway for further regional integration:

- acceleration of an ASEAN Economic Community (“AEC”) by 2015
- completion of all ASEAN + 1 FTAs
- a Chinese, Japanese, and Korean (CJK) FTA, via a trilateral FTA or three bilateral FTAs
- formation of an EAFTA among the ASEAN + 3 countries through mechanisms<sup>60</sup> to connect the ASEAN + 1 FTAs and CJK FTA
- a Comprehensive Economic Partnership for East Asia (CEPEA) by adding India, Australia, and New Zealand
- connecting East Asia and the United States through a free trade area, and the EU through a free trade area.

Since Kawai and Wignaraja wrote their paper, the first two points have been achieved. ASEAN has agreed on the ASEAN Economic Community by 2015, although this must be seen as the start of this process rather than the finishing point – it would be very optimistic to think that all the components of the agreement would be in place by 2015.

Furthermore, a complete set of ASEAN + 1 with all East Asian Summit members – Australia, China, India, Republic of Korea, Japan and New Zealand – has been signed. While they vary in quality and coverage; all are in place.

Creation of an FTA between China, Japan and Korea is more problematic. Difficulties of major substance exist between the parties, and there are issues because of military interactions during the 20th century. Matters with potential to cause problems include:

- China insists upon being recognised as a market economy. The Japanese will want to treat it as a non-market economy so that it can use safeguard measures against any rapid rise in imports from China. Japan also argues that China has yet to demonstrate satisfactory progress in implementing WTO entry commitments, including the treatment of Japanese firms in

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<sup>59</sup> Masashiro Kawai and Ganeshan Wignaraja “ADB Economics Working Paper Series: Asian FTAs – Trends, Prospects and Challenges” (2010) Asian Development Bank [beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges](http://beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges) (last accessed 7 August 2011) at 29.

<sup>60</sup> Using simplification, cumulation and harmonisation of RoOs.

China, clarity of regulations and rules over firms and the protection of intellectual property rights.

- The Republic of Korea is concerned about China's agricultural competitiveness and also about becoming too dependent on Chinese imports.
- Japan and the Republic of Korea also have concerns about each other's imports. Japan's primary concern is the competitiveness of the Republic's agriculture and fisheries sectors. Korean concerns include the competitiveness of Japan's manufacturing, the size of the tariff reductions it would have to make, and the risks freer trade might bring to its bilateral trade balance with Japan.

Three party discussions are difficult and the bilateral relations between these countries are loaded with potential sources of tension. This suggests that it may be easier for the three countries to use an ASEAN forum such as EAFTA or CEPEA to progress agreements which effectively involve trade liberalisation and facilitation between them.

Kawai and Wignaraja believe that EAFTA should proceed prior to CEPEA because:<sup>61</sup>

- ASEAN + 3 has three fewer players than ASEAN + 6.
- India is likely to be a "slow" participant and has a lot of domestic deregulation to do before it will be able to participate.

It was also thought that participants in the CEPEA Track II Study Group had developed a view that EAFTA liberalisation was more important than CEPEA liberalisation. We are unsure where this view was formed and as already noted, fewer parties do not necessarily mean easier negotiations when it comes to trade.<sup>62</sup>

There are many difficulties to overcome. As the experience of the Doha Round of negotiations underlines however, countries are slowly beginning to understand that if they want to be important economies and lift the bulk of citizens out of poverty they have to be responsible players. This is a very potent incentive for those that have traditionally been laggards when it comes to liberalisation.

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<sup>61</sup> Masashiro Kawai and Ganeshan Wignaraja "ADB Economics Working Paper Series: Asian FTAs – Trends, Prospects and Challenges" (2010) Asian Development Bank [beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges](http://beta.adb.org/publications/asian-ftas-trends-prospects-and-challenges) (last accessed 7 August 2011) at ch IV.

<sup>62</sup> See Chris Nixon and John Yeabsley *New Zealand's Trade Policy Odyssey: Ottawa, via Marrakech and on* (New Zealand Institute of Economic Research, Wellington, 2002) at 217. The order in which the CEPEA Report discusses topics is liberalisation, cooperation (but not specifically technical cooperation), facilitation of trade and investment and institutions. The Study Group was clear, however, that it did not suggest any priority or order in which arrangements should proceed. What was envisaged was that governments would make progress across the range of issues at the same time.

## 14.5.2 Mechanisms to assist integration

The previous section sets out the likely path of integration. This can be taken as a broad indication of the structure of challenges within which New Zealand negotiators will have to work. What is there to work with?

Petrie,<sup>63</sup> Goddard,<sup>64</sup> ANZSOG,<sup>65</sup> and Nixon and Yeabsley<sup>66</sup> collectively discuss a taxonomy of regulatory instruments that could potentially be developed. Having a variety of tools is especially important given the uncertainty about the regional grouping that will eventually form (if at all), and the type of rule-setting approaches to be considered. It may be that a variety of approaches are required depending on the level of income in each jurisdiction, type of political system, and quality of institutions.

The approaches discussed represent the possible options that are open to any Asian grouping in the coming years given the variability in institutions within the region and the income levels in each jurisdiction. They are selected from a wider possible set on the grounds of most practical. So we have not considered, for example, a “one regulator” nor “one set of rules” model since it is unlikely that they would be contemplated in such a diverse set of economies.<sup>67</sup> Possibly moves in such a direction might form a second round (dynamic) effect depending on the success of an initial agreement.

Where we have a choice of approaches, we have examined four different approaches and compared them with a base case. The base case we have chosen is unilateral adoption or recognition of any particular regulation. The five areas are set out in Table 2. They are:

- The base case:
  - *Unilateralism* is one way of reducing regulatory differences. Two ways this can be done are through:
    - Regulatory adoption: where a country adopts the regulation and policy settings of another country. This is most likely to

<sup>63</sup> Murray Petrie “Jurisdictional Integration: How Economic Globalisation is Changing State Sovereignty” (PhD Dissertation, Victoria University of Wellington, 2009) at 75.

<sup>64</sup> David Goddard “Business Laws and Regulatory Institutions: Mechanisms for CER Coordination” in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002) at 179.

<sup>65</sup> Australian and New Zealand School of Government *Views from the inside: Arrangements for facilitating trans-Tasman government institutional cooperation* (Australia and New Zealand School of Government, Carlton (Victoria), 2007).

<sup>66</sup> See Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17).

<sup>67</sup> However, some economies, within whatever trade grouping is formed, might want to agree upon one set of rules, but with the proviso that they are regulated by national institutions. In fact, Petrie (2009) demonstrates that those who trade with other OECD countries are more likely to set up trade agreements than those countries outside the OECD.

occur when the international approach to regulation in a particular area is converging.

- Regulatory recognition: where a country unilaterally recognises another country's laws in a specific area. If country A recognises country B's regulation, firms from country B who operate in that sector and in country A can do so under country B's regulatory framework.
- The possible alternatives to the base case considered are:
  - *Simple cooperation* involves a diverse range of activities depending on the interests of the countries involved. They include information exchanges and company introductions, through to consultations over various matters of interest and the establishment of information networks. Sometimes these contacts are facilitated through organisations such as APEC and the World Bank or through bilateral meetings.
  - *Coordination* relates to mainly non-binding approaches to integration. These include: technical cooperation, agreeing to policy guidelines for enforcement, cross border appointments and a large number of other approaches that set out ways to develop parallel or equivalent approaches to further integrate economies. By developing systematic approaches to integration, non-binding methods assist in developing transparency towards integration while maintaining a very high degree of flexibility.
  - *Horizontal integration* represents a deeper form of integration which is binding on the parties. It entails the development of institutions and processes such as joint institutions, mutual recognition, harmonisation, contracting arrangements and other agreements that bind the partners to particular courses of action.
  - *Vertical integration* involves the imposition of rules by a third party. This could include third party rule making, third party enforcement, and third party adjudication.

Table 2: Spectrum of jurisdictional integration

Base case		Other possible approaches		
Unilateralism	Simple Cooperation	Coordination	Horizontal Integration	Vertical Integration
Unilateral adoption	Information exchange	Technical cooperation	Mutual recognition	Third party rule making
Unilateral recognition	Consultations	Jurisdictional interface rules	Joint institutions	Third party enforcement
	Information networks	Institutionalised mechanisms for policy development	Harmonisation	Third party adjudication
		Agreed policy or enforcement guidelines	Contracting arrangements	
		Sanctioned self-enforcement		
		Third party monitoring and/or review		
		Cross agency appointments		

Source: Adapted from Petrie,<sup>68</sup> *Australia and New Zealand School of Government*<sup>69</sup>

Each approach to integration has been examined in terms of its simplicity (how straight-forward the process is), certainty (will it do what was intended?), level of influence each party has, flexibility of regulations as change occurs and its feasibility.

### (a) The base case – unilateral recognition

One approach would be to unilaterally adopt or recognise (as domestic) a law from another jurisdiction. Typically, this is seen as a viable option where world-wide regulatory approaches and policy stances are converging and where small jurisdictions have difficulty in resourcing developments in regulation.

It has the advantage of being relatively straight-forward, since New Zealand could either choose a model that is being used internationally or adopt some

<sup>68</sup> Murray Petrie "Jurisdictional Integration: How Economic Globalisation is Changing State Sovereignty" (PhD Dissertation, Victoria University of Wellington, 2009) at 75.

<sup>69</sup> Australian and New Zealand School of Government *Views from the inside: Arrangements for facilitating trans-Tasman government institutional cooperation* (Australia and New Zealand School of Government, Carlton (Victoria), 2007).

of the regulations internationally from the “menu” of possibilities in an “à la carte” fashion. The unilateral approach is a highly flexible approach that has the benefit of reducing compliance costs for firms and other entities who have to comply with one regime. It also reduces learning costs since firms only have to learn one regime; the policy is simple and easy to apply.

However, Goddard points out that:<sup>70</sup>

- New Zealand stakeholders have no voice or influence on the decision making;
- New Zealand stakeholders can not hold regulators to account for the consequences of regulation impacts in New Zealand;
- there is no attempt to tailor regulatory responses to New Zealand conditions;
- there is a risk of divergence if New Zealand departs from the approach; and
- increased costs can result if more than one standard applies.

Table 3 sets out the summary of the possible impacts of unilateral recognition. The approach is simple; it does lack certainty since there is a risk of divergence. New Zealand has little influence on the regulators, and it is highly flexible since it is simple to apply and reduces learning costs for firms. There are also advantages in adopting rules from other countries that have been tried and tested.

There is a question mark over feasibility, however, since more than one standard may apply in a jurisdiction and there is no ability to hold regulators to account.

A saving grace could be the short duration of any divergence that emerged. So policy-makers following a unilateral recognition approach might need to be certain that standards in any particular area are converging and that a world standard is emerging. Otherwise, the feasibility of such an approach is questionable.

Table 3: Factors of influence for unilateral recognition

	Simplicity	Certainty	Influence	Flexibility	Feasible
Unilateral recognition	✓	X	X	✓	?

Source: Nixon and Yeabsley<sup>71</sup>

70

David Goddard “Business Laws and Regulatory Institutions: Mechanisms for CER Coordination” in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002) at 214.

71

See Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17).



### (b) Alternatives

As discussed, the alternatives to unilateral recognition run along a spectrum from simple cooperation between countries to vertical integration where a third party imposes a solution (i.e. rules enforcement or some form of adjudication). The four alternatives set out above can be assessed against the same five factors of influence: simplicity, certainty, influence, flexibility and feasibility.<sup>72</sup> The process is the same as the one illustrated above.

### (c) Pulling the results together

Given the uncertainty of the number of regions that will be involved in an Asia-wide trade agreement and the type of rules that will apply, coupled with the diversity of countries involved, it is apparent that a number of different approaches will be required to further improve integration efficiency. It is unlikely, therefore, that applying the base case (unilateral recognition) in each instance is likely to be the answer to the development of deeper integration in the Asia-Pacific. In fact, it might be that unilateral recognition is only applied in certain specific circumstances where rules are converging. This is because the details of the industries, institutions, and behaviour of political actors matter. Table 4 shows that each approach has its strengths and weaknesses; therefore careful case by case analysis is required to uncover the crucial factors that impact on efficiency and also:

- satisfy political aspirations
- are capable of practical enforcement by the institutions in each country.

In this respect, no one approach is likely to deliver all of the benefits sought in a trade agreement and each approach will need to be carefully examined individually.

Table 4: Summary of factors of influence

	Simplicity	Certainty	Influence	Flexibility	Feasible
<b>Base case</b>					
Unilateral recognition	✓	✓ x	X	✓	?
<b>Other approaches</b>					
Simple cooperation	✓	✓ x	✓ x	✓	?
Coordination	✓	✓	✓	✓	?
Horizontal integration	X	✓	✓ x	✓ x	?
Vertical integration	✓	✓	✓ x	✓ x	?

Source: Petrie,<sup>73</sup> Goddard<sup>74</sup> and Nixon and Yeabsley.<sup>75</sup>

<sup>72</sup> More details are contained in Appendix B.

<sup>73</sup> Murray Petrie "Jurisdictional Integration: How Economic Globalisation is Changing State Sovereignty" (PhD Dissertation, Victoria University of Wellington, 2009) at 75.

## 14.6 Implications

In thinking about the implications for New Zealand of potential moves toward wider and deeper Asian economic integration, we have used ideas from papers by Goddard,<sup>76</sup> and Nixon and Yeabsley,<sup>77</sup> to examine how we should think about approaching the issue. Goddard's application of these principles was to the trans-Tasman situation to consider an appropriate model for coordination. The same sorts of principles can also be applied to integration within the Asian region.

The principles are:

- scepticism about coordination for its own sake;
- scepticism about the significance of regulatory competition, in the absence of a significant degree of coordination;
- a careful and structured approach to assessing the objectives of coordination in each area, and the costs and benefits with alternative models;
- avoidance of unhelpful terms such as “sovereignty”, focusing on issues and fears that matter to various participants; and
- being aware of the dynamics of the coordination exercise and the incentives driving participants.

Below we examine each of these points in turn, and summarise them in Table 6, in terms of the issues that New Zealand negotiators will have to understand before they can effectively contribute to the integration process within the Asian region.

### 14.6.1 *Coordination for its own sake*

Fortunately for the New Zealand focus on economic regulation, one of the areas that have been avoided in the development of Asian preferential and free trade areas has been a reliance on bureaucratic processes and systems (relative to the European Union, for instance). From our perspective it has

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<sup>74</sup> David Goddard “Business Laws and Regulatory Institutions: Mechanisms for CER Coordination” in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002).

<sup>75</sup> See Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17).

<sup>76</sup> David Goddard “Business Laws and Regulatory Institutions: Mechanisms for CER Coordination” in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002).

<sup>77</sup> See Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17).

been an advantage for the region to focus on economic integration rather than political union.

In this respect, minimising any standards regime that firms have to deal with will assist in the integration process. So the promotion of regional standards that sit between national and international standards adds a layer of unnecessary complexity, and one that we would struggle to influence. Our take from this is that we should favour a system that, at least in principle, applied the fewest number of standards in its operations.

This suggests that New Zealand should be looking to a spectrum of flexible agreements on standards that could be put in place (from harmonisation through to mutual recognition). Where mutual recognition agreements are in place – possibly in regions with lower quality institutions or where special provisions are required to cope with local conditions – care will be needed to ensure that a consensus exists on standards equivalence, specifically, that minimum levels are required for each standard.<sup>78</sup>

### 14.6.2 *Competing regulatory regimes*

According to Goddard,<sup>79</sup> some (unidentified) commentators have argued that New Zealand, because it has high quality standards set up at low cost, should compete with Australia and by implication other international jurisdictions. However any practical assessment of the durability of any particular cross-border standards would show that the perceived quality is only one factor taken into account.

By far the most important factor in determining who sets the standards is the size and buying power of a market. Small countries such as New Zealand are policy takers and while they can influence standard setting they cannot normally aspire to control or set the international agenda on standards.

### 14.6.3 *Careful and structured approach to assessing the costs and benefits*

Up until the end of the GATT Uruguay Round in 1994 what New Zealand could gain from any particular trade agreement or standards setting arrangement was relatively easy to see: if high income countries reduced barriers, and

<sup>78</sup> David Goddard "Business Laws and Regulatory Institutions: Mechanisms for CER Coordination" in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002) at 215–217.

<sup>79</sup> David Goddard "Business Laws and Regulatory Institutions: Mechanisms for CER Coordination" in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002) at 210.

standards were relatively transparent, New Zealand would gain. Our institutions looked to support this.

The trade policy game has since changed dramatically. The questions about what New Zealand can gain are more specific to the core concerns of New Zealand and less generic; therefore, we need a capacity to understand what changes in trade policy (including standards setting and other behind the border issues) mean.<sup>80</sup> In this world, careful consideration of the costs and benefits are required, backed up by the expertise and tools to do it. The development of a capacity in New Zealand to carry through this type of analysis is possibly a core competitive trade policy skill.

One of the issues we need to consider is the trade-off between flexibility and certainty. Deeper integration requires a greater commitment and less flexibility of action. Possibly, more certain agreements are more durable because of the high cost of exit.

The trade-offs between harmonisation and mutual recognition should also be considered. To what degree should we adopt laws from other jurisdictions? Mutual recognition agreements are sometimes seen as useful because they remove the need to conform to two sets of rules. However, mutual recognition agreements are supported by consultation, referrals, and commitments to policy coordination all of which can reduce flexibility. Harmonisation can be used as a way of sharing the costs of standard-setting processes. Harmonisation can be underpinned by joint institutions such as Food Standards Australia and New Zealand ("FSANZ"). Flexibility can be built into these agreements by the development of opt-out clauses (such as occurred with Country of Origin Labelling "CoOL").<sup>81</sup>

### **14.6.4 Avoidance of unhelpful terms**

Governments and their citizens have well-founded fears about further integration. Therefore, understanding those fears is an important part of any negotiation, because addressing them is part of the process. Terms such as "preserving sovereignty" are unhelpful since they do not uncover why politicians and sections of society are against further integration, nor do they illustrate what it might take to "pay for" a specific loss of sovereignty.

After all, every international agreement involves a reduction of sovereignty. The real question, however, is by giving up some aspect of sovereignty does

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<sup>80</sup> A good example of this is the Kyoto climate change agreement. No other country has to untangle the combination of issues that New Zealand faces –that is, no other country relies to the same degree on agricultural and forestry exports as does New Zealand. These products have a particular set of impacts under the Kyoto agreement that only New Zealand has to face.

<sup>81</sup> For further information see NZIER (2005) Cost benefit analysis of country of origin labelling P292. Report to Food Standards Australia and New Zealand 7 March 2005.

society gain or lose? The most helpful way of answering this question is to specifically address the issues of concern in any particular region.

In standard-setting bodies Goddard suggests focusing on issues such as:<sup>82</sup>

- Voice: what mechanism does the New Zealand government, firms, and citizens have to voice concerns?
- Accountability: what level of accountability (and thus redress) occurs if standards are openly flouted or not accepted, despite agreements in place?

### 14.6.5 *Understanding the dynamics of coordination*

A key issue is gaining an understanding of how the cross-border agreement will unfold over time. The risk is that there are unanticipated consequences that perhaps disadvantage small, marginal participants such as New Zealand. One way of mitigating this risk is to ensure that the overall agreement is economically coherent and to ensure that incentives are aligned in such a way as to promote good practice.

## 14.7 Conclusions

The challenge of further integration in the Asia-Pacific region is daunting for a small player with high aspirations. However, world economic trends, competition between nations, and the demonstration effect of specific events/performance over time (such as the rise of China, stagnation of Japan, and the Asian financial crisis of the 1990s) have led to continued efforts to create agreements that further integrate the region.

The high-level motivation for an all-encompassing agreement is well established for most of the participants. The real issue is how to make this happen over time in a way that will benefit all by putting together transparent rules and standards that enhance good regulation and create a virtuous circle, since good regulation not only promotes trade, but attracts more investment, which in turn generates further trade.

To date, we have seen bilateral and regional agreements developed, though there is still no great momentum to embrace a wider Asian free trading agreement. There are a number of bets in the Asian trade policy market place which centre on the ten-member ASEAN grouping of states. What we do know is that the widest possible agreement with as many members as possible will bring the best results.

<sup>82</sup>

David Goddard "Business Laws and Regulatory Institutions: Mechanisms for CER Coordination" in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002) at 220.

As well as uncertainty about the type of agreement there are also a number of hurdles that need to be overcome – including the variable quality of institutions within Asia and the variable enforcement of rules. In any ASEAN + 6 jurisdiction the quality of institutions and how the rules are applied has a major impact on the benefits of further integration.

Importing the European Union model of integration is not an option. More likely in the Asian region is the idea that the development and enforcement of standards falls on national institutions, one way or another. So any conformity of standards is likely to be more akin to mutual recognition than to harmonisation, although this would not stop countries harmonising regulation where they find it (politically, administratively or economically) efficient so to do.

New Zealand's regulatory interest here is to seek ways to profit from our existing institutional structures, or to influence the development of the integration process so that our style of regulation behind the border does not need radical overhaul. We have considered a series of different scenarios. These entailed considering both demand and supply side factors.

In modelling any particular approach, the most important elements are on the demand side, since it is the demand side that sets the parameters of possible outcomes in any particular negotiation – this side holds the levers that drive the process.

Key factors on the demand side are political, economic and administrative feasibility. On the supply side are bets in the trade policy market and the potential steps to further integration. Currently, it is highly uncertain how the process will play out and who will be in and out of any particular agreement. Our view is that we are likely to see very slow progress; however, once an agreement in principle is reached for a wider trade agreement there will be a rush to join. How many join the process, and whether or not the United States will be invited to be involved, will be the most interesting issues. Once the participants are set the progress will again slow down as countries haggle over the details.

The integration choice depends on the number of participants, the types of economies involved, institutional arrangements and political actors.

Table 5 sets out the base case (unilateral recognition) and compares it to other approaches. Each approach has its strengths and weaknesses and it is possible that hybrid solutions will be used.

Table 5: Summary of factors of influence

	Simplicity	Certainty	Influence	Flexibility	Feasible
<b>Base case</b>					
Unilateral recognition	✓	✓ x	X	✓	?
<b>Other approaches</b>					
Simple cooperation	✓	✓ x	✓ x	✓	?
Coordination	✓	✓	✓	✓	?
Horizontal integration	X	✓	✓ x	✓ x	?
Vertical integration	✓	✓	✓ x	✓ x	?

Source: Petrie,<sup>83</sup> Goddard<sup>84</sup> and Nixon and Yeabsley<sup>85</sup>

We have also thought about the general implications for selecting an appropriate model based on the principles set out in Goddard:<sup>86</sup>

- *Scepticism about coordination for its own sake*<sup>87</sup> Fortunately, the focus on economic integration is likely to mean that Asian nations are likely to be more amenable to less regulation rather than more. A key issue for New Zealand will be when to harmonise and when to develop mutual recognition approaches, for example regional standards are probably not necessary or desirable. However, care will be needed to understand how closely mutual recognition approaches translate between different jurisdictions<sup>88</sup>
- *Scepticism about the significance of regulatory competition*, in the absence of a significant degree of coordination. Going it alone on the “regulatory standards setting road” is not an option for New Zealand. Small countries are policy takers and can not set the international agenda

<sup>83</sup> Murray Petrie “Jurisdictional Integration: How Economic Globalisation is Changing State Sovereignty” (PhD Dissertation, Victoria University of Wellington, 2009) at 75.

<sup>84</sup> David Goddard “Business Laws and Regulatory Institutions: Mechanisms for CER Coordination” in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002).

<sup>85</sup> See Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17).

<sup>86</sup> David Goddard “Business Laws and Regulatory Institutions: Mechanisms for CER Coordination” in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002) at 219–220.

<sup>87</sup> See also discussion in Susy Frankel and Megan Richardson “Trans-Tasman Intellectual Property Coordination” in this volume (ch 18).

<sup>88</sup> David Goddard “Business Laws and Regulatory Institutions: Mechanisms for CER Coordination” in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002).

on trade or standards because their economic power (in terms of the size and buying power of the domestic market) is relatively weak. By engaging, possibly, there are chances for New Zealand to influence standard setting in other countries.

- *A careful and structured approach to assessing the objectives of coordination in each area*, and the costs and benefits with alternative models. The details of the integration process matter; therefore it is extremely important to understand the possible impacts. This is highlighted by the ongoing debate over the noodle bowl impacts. The initial work done suggests that the web of agreements may have a very negative impact; however, firms are suggesting the impact is not as great as first thought.
- *Avoidance of unhelpful terms* such as loss of “sovereignty”, focusing instead on issues and fears that matter to various participants. In any negotiating strategy it is important to understand the very real fears of those who oppose further integration and demonstrate how issues can be mitigated. Use of terms can be detrimental because they do not address or uncover the real fears and preclude analytical attempts to demonstrate how these real issues (such as voice and accountability) can be accounted for in any particular trade agreement and can be dealt with in a satisfactory way.
- *Being aware of the dynamics of the coordination exercise and the incentives driving participants*. Key to understanding the dynamics depends on the economic coherence of the agreement, including how the incentives align. The more economically coherent the more we can anticipate how participants will react as changes occur.

None of these issues are easy to solve and unlike seemingly similar challenges in the past, they will require more understanding than previous New Zealand negotiators have needed to be successful. This will require the building of a capacity to understand these issues so that trade negotiators are better informed about the likely outcomes of the various scenarios that are on the negotiating table.



## **Appendix A: Relevant FTAs**

Apart from CER we have left out the bilateral agreements already signed.

CER: Its full name is ANZCERTA, Australia New Zealand Closer Economic Relations Trade Agreement.

ASEAN: Association of Southeast Asian Nations. The ten nations of ASEAN include Myanmar, Brunei, Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, and Vietnam.

CEPEA: The Comprehensive Partnership in East Asia. Essentially this is the ASEAN + 6 proposal.

TPP: Trans-Pacific Partnership includes Brunei, Chile, Singapore and New Zealand. Currently talks are underway with Australia, United States, Malaysia, Vietnam and Peru to join.

ASEAN + 1: A number of +1 agreements have been signed with China, India, Japan, and the Republic of Korea.

ASEAN + CER: Part of the ASEAN +1 process. This is called the AANZFTA – ASIAN Australia New Zealand Free Trade Agreement.

ASEAN + 3: Includes the ten nations from ASEAN and China, Japan, and the South Korea.

ASEAN + 6: Includes the ten nations from ASEAN and China, Japan, Republic of Korea (RoK), New Zealand, Australia and India.

APEC: 21 nations make up the Asia Pacific Economic Cooperation process. These include: Australia, Brunei, Canada, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand, United States, Chinese Taipei, Hong Kong, China, Mexico, Papua New Guinea, Chile, Peru, Russia and Vietnam.

# Appendix B: Alternative approaches and their assessment

## B.1     *Simple cooperation*

Simple cooperation involves a diverse range of agreements that at a practical level amount to information exchanges, consultations and information networks (see Table 6). These exchanges, consultations and networks can be at a bilateral level (that is, between countries such as New Zealand and South Korea on television and film), at a regional level (such as APEC Finance Minister meetings) or at a multilateral level (like World Customs’ meetings).

Simple cooperation has the advantage of being relatively easy and flexible. The processes focus on particular issues and aims. However, whether anything actually happens will depend on the incentives of the parties, which are not always clear when any information exchange agreements are signed. Therefore, whether or not there is certainty (that any useful information changes hands) or a signatory has any influence on what information changes hands is difficult to know on at the time of signing. In many cases, it can be luck or the development of strong personal relationships between the actors that drive simple cooperation.

Feasibility is therefore unknown since the motivations for signing or participating in these engagements are unknown prior to the contact occurring.

Table 6: Factors of influence for simple cooperation

	Simplicity	Certainty	Influence	Flexibility	Feasible
Simple cooperation	✓	✓ x	✓ x	✓	?

Source: Nixon and Yeabsley<sup>89</sup>

## B.2     *Coordination*

Coordination involves a whole raft of different agreements that are mainly non-binding on the parties involved. These include technical cooperation, jurisdictional interface rules, institutional mechanisms for policy development, agreed policy or enforcement guidelines and other coordination activities.

For integration to work efficiently cross border coordination is extremely important. The ability to obtain documents, agree on like-for-like approaches to goods, services and other issues, and take enforcement action from other jurisdictions on a consistent basis is key to deeper integration, at least cost.

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<sup>89</sup> See Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17).

Table 7 suggests that coordination between regulators is potentially an important element of the integration process. However, effective cooperation between regulators on trade issues has not typically been a feature of trade agreements. For example, only now, nearly 30 years after CER, is cooperation under way between the competition authorities in Australia and New Zealand. Possibly then, to expect this type of close cooperation in the Asia-Pacific as part any initial agreement is a little ambitious, although for deeper integration to occur regulator coordination is relatively important.

Countries that enter into coordination agreements are normally incentivised to make them work. Therefore, as well as simplicity and flexibility there is likely to be more certainty and influence relative to simple cooperation agreements. The real question, however, is whether agreements are being made in areas that have an impact on deeper integration or are they peripheral?<sup>90</sup>

Table 7: Factors of influence for coordination between regulators

	Simplicity	Certainty	Influence	Flexibility	Feasible
Coordination	✓	✓	✓	✓	?

Source: Nixon and Yeabsley<sup>91</sup>

### B.3 Horizontal integration

Binding agreements between two or more countries create deeper integration and improve efficiency – the more countries involved the more likely efficiency will increase further (see [4.2]).

Deeper horizontal integration involves the development of joint institutions and mutual recognition and harmonisation. In practical terms, this allows for reciprocity between countries, that is, allowing each country to have regard to each others' laws while undertaking reforms that seek to reduce compliance costs. These undertakings essentially allow for a commitment to further integration (through avenues such as mutual recognition) while still maintaining some flexibility. An example of this is the joint institution Food Standards Australia and New Zealand ("FSANZ"), where New Zealand can opt

<sup>90</sup> Goddard comments that cross-border cooperation on competition policy issues and consumer protection laws is much less used than in other issues such as security laws. This possibly reflects the policy reality that in the decision process producers (most affected by securities laws) are seen as more internationally mobile than consumers (most affected by competition and consumer protection): David Goddard "Business Laws and Regulatory Institutions: Mechanisms for CER Coordination" in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901–2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002).

<sup>91</sup> See Chris Nixon and John Yeabsley "Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration" in this volume (ch 17).

out of any particular standard. This happened with Country of Origin Labelling (“CoOL”), where New Zealand decided not to put CoOL labels on all loose fruit, vegetables and nuts, while Australia did.

This approach has the advantage of certainty and flexibility (depending on institutional design), and it also allows for influence by having a seat at the decision table.<sup>92</sup> However, it does require that there is consensus about minimum standards and what they consist of. This means New Zealand policy-makers need to focus on a number of factors. The *amount of influence* we have on other countries’ regulation is potentially important if regulators in one country make decisions that impact on New Zealand business. Also, it is possible that New Zealand plays catch up with regulations in other jurisdictions and often could be out of step.

The *accountability mechanisms* in place in which New Zealanders could seek some redress for perceived transgressions, and the *administrative practicalities* around how regulators would cooperate, also need to be considered.

The *incentives to produce coordination efforts* as the situation changes should be monitored. This includes the risks of the system breaking down and the opportunities for closer cooperation.

Another factor is *how closely aligned the rules are across the trade grouping*. Goddard<sup>93</sup> suggests that there is a possibility of regulatory arbitrage particularly where compliance costs are an important component of the regulatory costs.

And finally, policy-makers must be alive to the *dynamics of the regulatory process* – particularly how changes in one jurisdiction impact on the willingness of other jurisdictions to recognise the regulatory outcome.

Table 8 sets out the factors of influence for mutual recognition. It is relatively simple and provides some certainty in outcome. However, New Zealand is likely to have little impact on setting standards, although some flexibility in how standards are interpreted.

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<sup>92</sup> The dynamics of influence will change depending how many countries are involved. The more countries involved does not necessarily mean that we have less influence. However, it does require resources and bigger research capacity to understand the impact of further integration and the development of strategies that impact on the process.

<sup>93</sup> David Goddard “Business Laws and Regulatory Institutions: Mechanisms for CER Coordination” in Arthur Grimes, Lydia Wevers and Ginny Sullivan (eds) *States of Mind: New Zealand and Australia 1901-2001* (Victoria University of Wellington Institute of Policy Studies, Wellington, 2002).

Table 8: Factors of influence for horizontal integration

	Simplicity	Certainty	Influence	Flexibility	Feasible
Horizontal integration	X	✓	✓ x	✓ x	?

Source: Nixon and Yeabsley<sup>94</sup>

## B.4 Vertical integration

Vertical integration is more closely aligned with the unilateral approach than other approaches (see Table 9). Essentially, rules, adjudication or enforcement are imposed upon a jurisdiction through a multilateral agreement (for example, through agreements such as the Uruguay Round Agreement of GATT). The impact of such agreements depends on how aligned a country is with international norms.

These agreements are relatively simple to adopt and they provide certainty. In fact, small developed countries, such as New Zealand and Singapore, are normally the biggest supporters of such agreements because they provide protection against possible unilateral decisions made by larger trading areas such as the EU and United States, such as in the 1980s when the United States and EU were able to increase export subsidy rates for agricultural products without too many restrictions. With the conclusion of the Uruguay Round and creation of the WTO, the amount of subsidised exports was restricted. This has had a positive impact on world dairy prices.

However, the amount of flexibility small countries have under these multilateral agreements' depends on whether mechanisms can be built into the agreement to allow for opting out of certain parts of the agreement, since once signed it is almost impossible for a small country to renege on the agreement (unless of course everybody else is as well, such as with the Kyoto Protocol on climate change).

Similarly, how much influence a small country has on an international agreement will depend on how useful that country has been in constructing any particular agreement. Normally, a small country does not set the international agenda, however; it can play a role in bringing parties together and finding solutions where bigger countries are a long way apart.

While these types of agreements have the biggest potential to assist in deeper integration of the world economy, whether or not they are feasible (and durable) will depend on their economic, institutional and political coherence.

<sup>94</sup>

See Chris Nixon and John Yeabsley "Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration" in this volume (ch 17).

Table 9: Factors of influence for vertical integration

	Simplicity	Certainty	Influence	Flexibility	Feasible
<b>Vertical integration</b>	✓	✓	✓ x	✓ x	?

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*Source: Nixon and Yeabsley*<sup>95</sup>

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<sup>95</sup> See Chris Nixon and John Yeabsley “Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans-Tasman Integration” in this volume (ch 17).