1. Introduction to the *Handbook on East Asian Economic Integration*: An overview of shifting paradigm in globalisation, trade, and investment in East Asia

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1. INTRODUCTION

Several key events have occurred since the work on this volume started in 2018. For the past 2 decades, East Asia has faced protectionist policy challenges from the increasing level of anti-globalisation issues in regional and global trade (Dur et al., 2020). The rise in protectionist policies is reflected by the changes in the extent of new trade interventions since 2009, as indicated by Global Trade Alert (Evenett and Fritz, 2019).¹ The harmful interventions, as defined by Global Trade Alert, account for nearly 72% of the total state level interventions from 2009 to 2021 (Global Trade Alert, n.d.).² The peak of new state level trade interventions occurred in 2018, 2 years after President Trump was elected to office in the United States (US).

During this same period, President Trump had been in office for over a year, which led to a shift in US trade policy towards more inward-oriented strategies (Bown and Irwin, 2019). By March 2017, the United Kingdom had begun the work on its withdrawal strategy from the European Union (O'Rourke, 2019). Apart from instances of the application of protectionism, other important global trade issues included problems in Asia-Pacific Economic Cooperation (APEC) processes (Dziedzic, 2018) and in the World Trade Organization (WTO) (Bown and Keynes, 2020), as well as increased bilateral tensions between the US and China (Bown, 2019). By the beginning of 2019, *The Economist* (2019) was arguing that the trade tensions were compounding a shift that had been under way since the financial crisis of 2008–2009 and that globalisation had given way to a new era of sluggishness. Later that year, Pangestu (2019) reviewed the risks associated with the US–China trade war, noting its consequences in terms of higher protection and greater uncertainty, although with some knock-on effects of trade diversion. In addition, risks were associated with its solution in terms of the application of processes of ‘managed trade’, already apparent to smaller economies. Pangestu also identified, in terms of other changes in the global trade landscape, the growth of regional arrangements associated with greater degrees of discrimination in trade and the emergence of new issues in digital trade and also with respect to the environment and climate change.

Another significant global event has been the coronavirus disease (COVID-19) pandemic shock that began in early 2020 disrupting key economic activities within and between countries, as well as regional and global trade and investment. The key dimension of the COVID-19 pandemic shock is the diversion from open economic policies to more inward-looking policies. The chapters in this volume were all conceived before the end of 2019 and the editors determined to retain the original formats rather than seek their redevelopment in the context

of COVID-19. However, in this overview, some remarks are offered with respect to the significance of the events of 2020, and the argument is made that the approach to the analysis of economic integration in the region and its consequences remains highly relevant.

Before we present a review of the handbook chapter contents, we offer material on two topics. As noted, at the time of the development of the volume, a major concern was the rising anti-trade sentiment in many countries. We review the state of that debate and the ways in which it is relevant to East Asia, and we refer to chapters in the volume where relevant. We also provide some commentary on a more recent development, which is the experience of the COVID-19 pandemic.

2. RISE OF ANTI-GLOBALISATION

Some significant shifts in the attitudes to trade in the latter part of the last decade are noted above. What was the origin of these shifts? Rodrik (2018: 13) said that anti-globalisation movements are the political backlash to the ‘advanced stages of globalisation’. In that context, a number of drivers of its emergence have been noted, including in chapters in this volume:

1. Many economies have experienced a middle-skill employment shock and shifts in the wage premium towards skilled workers. The gains from trade are unevenly distributed and biased against the unskilled. A study by UNCTAD (2011) showed uneven distribution of gains from trade in India. Although trade increases the wages of unskilled workers, the study observed that 70% of the income generated from trade is going to the top two income groups. Recent research by Menon and Melendez (in this volume) highlights the result that the impact of trade on wages is also dependent on the export intensity of the industries. Firms that are less skilled and labour-intensive, such as the garment and textiles and agricultural sectors, tend to experience less gains from trade in terms of wage increases for the unskilled and less educated (UNCTAD, 2011; Menon and Melendez, Chapter 12 in this volume).
2. As trade increases growth in more open economies, these countries have concurrently experienced a widening wage gap (between the skilled and unskilled) as well as polarisation of semi-skilled jobs. Thangavelu and Wang (Chapter 19 in this volume) show a large decline in the share of semi-skilled jobs (mostly white-collar jobs) as compared to unskilled and skilled jobs in Australia; India; Indonesia; the Republic of Korea (henceforth, Korea); New Zealand; Malaysia; the Philippines; and Thailand. The chapter also shows a widening gender gap, as trade drives growth in the East Asian region. This has a direct impact on the income and wealth of middle-income households.
3. As trade increases growth, we also experience rising business impediments and greater state level interventions (Lee, Chapter 10 in this volume). In most cases, larger enterprises have more access to finance and foreign markets than local small and medium-sized enterprises. The study by Lee highlights the roles of access to skilled workers and to finance as key impediments, along with the effect of government regulations, facing local enterprises in their effort to participate fully in open economy activities. Although larger companies have better access to regional and global markets, the rising state level trade interventions in recent years also affect their investment in markets and technologies overseas.

4. Over the past 2 decades, East Asia has experienced a massive movement of skilled and unskilled workers, especially the international mobility of unskilled workers (Ananta and Arifin, Chapter 6 in this volume). As well as its contribution to growth, international labour mobility has a direct impact on the wages of the unskilled and the vulnerability of the unskilled and poor.
5. Trade has a more direct impact on the income and wealth of the tradable sectors in urban centres compared with rural centres, creating a rural–urban divide and growth tensions between the rural and urban population (Kastrop et al., 2019).

In East Asia, however, there has been a positive response to the experience of a more open external environment, as illustrated in chapters in this volume. Driving forces include the operations of the WTO, China's entry to world markets, the development of regional agreements, widespread unilateral reform, and the processes of APEC. There has also been a positive side to the consequences and lessons of the Asian Financial Crisis (AFC), which fed into the response to the Global Financial Crisis (GFC). However, as references in the list above to chapters in this volume indicate, the issues that are relevant to the origins of anti-globalisation movements are increasingly important in East Asia.

The risk of rising anti-globalisation against trade in East Asia therefore remains. It will be important to recognise the real impacts of trade in the domestic economy and the region. The balancing of the gains of trade with inclusive growth will be the key policy challenge for East Asia as the intensity of the anti-trade movement increases in East Asia. The importance of regional cooperation under the Association of Southeast Asian Nations (ASEAN) and APEC, and also under multilateral trade arrangements such as the Regional Comprehensive Economic Partnership (RCEP), in achieving both sustainable and inclusive growth from trade will be fundamental to manage the impact of globalisation in the region (Pangestu, 2019).

Furthermore, even though the economies of the region are not, currently, driven by anti-globalist politics, East Asia remains affected by their trading partners responding to those pressures. That response in a world leader like the US is particularly significant. The question remains of how East Asia would then react. One response is domestic risk management in each economy, anticipating and responding to these movements. Another is to defend the trading system which, as the chapters below illustrate, has provided significant benefit to the region.

More specifically, then, the options for the East Asian economies include the following:

1. To respond to their own forces of anti-globalisation, the nature of which has to be defined and identified in a local context, so the responses are more tailored. However, any response is likely to involve better efforts at the management of 'insecurity', with a focus on adjustment policies. It will be important to separate these policies from the design of trade policy, but without them it will be much more difficult to maintain an open trade policy.
2. To demonstrate their capacity to cooperate with each other, and gain by doing so, and to reconsider policy tools, e.g. through forms of regulatory cooperation.
3. To anticipate and work with the rest of the region and the rest of the world to manage risks, especially at the WTO to support its operations and devise systems for new issues. This effort can be complemented in APEC, in regional agreements (e.g. the RCEP), and in other plurilateral structures (Pangestu, 2019).
4. To make the case for integration and to explain the role of national governments in the context of international cooperation.

3. COVID-19 PANDEMIC SHOCK AND EAST ASIAN INTEGRATION

Pandemic (COVID-19) shocks have had tremendous impacts on the global and Asian economies. They have disrupted global production networks. The shocks are felt across all segments of society and have great economic and social impacts on domestic and regional economies.

The World Health Organization declared COVID-19 a global pandemic in March 2020. On 10 April 2020, 1.6 million cases had been confirmed worldwide and 96,000 people had died. By 10 February 2021, there were 107 million cases confirmed with 2.3 million deaths (World Health Organization, n.d.). COVID-19 is relatively contagious, can be asymptomatic, and has a higher death rate than normal seasonal flu. The public health response to COVID-19, including lockdowns, has sent shockwaves up and down the supply side of production processes as well as on the demand side.

The effects of the COVID-19 pandemic have been huge. The World Bank (2021) found that global output fell by 4.3% in 2020 (compared to 2.3% in 2019), while the estimate for East Asia and the Pacific is a growth of 0.9% in 2020 (compared to 5.8% in 2019). Global growth is expected to be 4.0% in 2021 (7.4% in East Asia and the Pacific). The International Labour Organization (ILO, 2021) found that the COVID-19 pandemic led to an 8.8% decline in working hours worldwide (7.9% in Asia and the Pacific). The reduced working hours led to both the loss of jobs (118 million globally, with 62 million in Asia and the Pacific) and less working hours of those in employment. However, the impact of the COVID-19 pandemic is uneven, and lesser skilled and younger workers as well as women and the self-employed are disproportionately affected.

Kimura (2021) identified three types of economic shocks generated by the COVID-19 pandemic on domestic and regional economies:

1. The first is a negative supply shock from economic disruptions and border lockdowns, which directly affects global value chain (GVC) activities in goods (e.g. electronic products) and services (e.g. tourism). Trade and investment slowed as did global and regional economic activities.
2. The second is a positive demand shock due to the increased need for medical products, drugs, and key essential items of personal protective equipment (e.g. face masks, gloves, face shields, respirators, and hand sanitisers); and demand for personal computers and telecommunication devices. The initial policy reaction was to impose protectionist policies to divert the key essential products to the domestic economy, but there was a gradual recovery to normal trade activities in these essential products. In this second positive shock, we also observed an increase in services activities for home delivery of food and groceries, increased use of digitally related services such as internet connection services to accommodate the 'new normal' of working from home, and home entertainment services.
3. The third was a negative demand shock from the slowdown in economic activities, leading to bankruptcies, unemployment, and greater fragility of the financial markets. This shock will lead to structural changes in business and economic activities, which will have direct impacts on investment in new technologies to create the new 'normal' in business activities, and which will affect job creation and destruction.

Each of these shocks is mutually reinforcing. They are also persistent, as the COVID-19 virus mutates into new viral strains, creating the risk of another pandemic wave. However, Kimura

(2021) highlighted the resilience of the GVC to recover and to maintain production activities and linkages. For example, Kimura (2021) showed (using Japanese trade data) the recovery of trade in key GVC products of machinery parts and final products by October 2020.

The policy response to the COVID-19 pandemic has involved the closure and lockdown of borders to mitigate and manage the spread of infection of the virus across borders. This has a direct impact on activities in export sectors that rely heavily on the movement of people across borders. An Asian Development Bank study (ADB, 2020) forecast that the pandemic will result in adjustment at the sectoral level, particularly in agriculture and mining, light manufacturing, part components, hotels and restaurants, business services, and transport services. The study also highlighted that trade in services (e.g. tourism, retail, restaurants, hotels, and logistics) will be heavily affected by the pandemic – directly affecting less developed countries that rely on these service sectors for growth and which consist of a large number of micro, small, and medium-sized enterprises.

The impact of digital transformation on the demand side of business and consumers due to the COVID-19 pandemic is expected to be significant. The consumption behaviour of people and delivery of services is expected to change significantly in terms of visiting hotels, eating out at restaurants, visiting large retail outlets at shopping centres, and going to the cinema. Digital technology is directly changing individual consumption behaviour so that it requires less face-to-face contact with other individuals by directly offering home entertainment services, online banking services, home delivery of food and groceries, and online commerce and retailing. The behaviour of business is also expected to change significantly as services are provided through digital platforms, and services may also be unbundled into different and separately transacted tasks. We also expect more services to be offered via digital platforms which bring buyers and sellers together across borders, thereby increasing the extent of ‘virtual’ service linkages.

The impact of the COVID-19 pandemic shock will intensify the structural transformation of domestic economies and then redirect regional integration through information, communication, and telecommunication technologies. We expect more agglomeration of certain activities in the post-pandemic period, as businesses invest more in artificial intelligence and robotics technologies to increase the productivity of a new ‘normal’ working environment, as manufacturers increasingly buy and sell services themselves (the process of ‘servicification’) and as the service sector continues to grow. At the same time, we expect telecommunication technologies to increase connectivity and linkages across the global economy, fragmenting consumption and production in the GVC. This will affect the service linkages in the GVC.

Some key policy issues are critical to manage these outcomes of technological change and structural transformation. These issues arise because of the value of facilitating change. There is a need to:

1. understand the agglomeration and fragmentation effects, and coordinate key policies across countries and, at the regional level, to design and enhance these industrial activities;
2. develop new skills for workers to participate and be retained in the labour market with these new technologies; and
3. develop domestic industrial capacity and the capabilities of local enterprises and small and medium-sized enterprises to participate in the service linkages to support the dynamism of the GVC in the post-pandemic period.

Finally, the COVID-19 pandemic is expected to accelerate economic cooperation to mitigate and reduce the risk of future health and pandemic shocks. Reacting early to the pandemic shock reduces the pending economic shock. We believe that early policy reaction at the regional level will have a positive impact in flattening any pandemic curve but also have a positive impact on the responses of GVCs and domestic healthcare systems (Kimura et al., 2020). Regional policy coordination will also provide the opportunity to recognise infrastructure and institutional gaps in the healthcare and regional GVC network to mitigate such a pandemic shock. This allows for greater risk management and risk sharing of the pandemic shock (including its social and economic cost) across countries in the region and with businesses. Overall, the COVID-19 pandemic has increased the policy response for greater openness and liberalisation; accelerated technology adoption and innovation (e.g. artificial intelligence and telecommunication technologies); intensified digitalisation and trade; increased the servicification of manufacturing and the extent of service activities; reinforced the second unbundling; and intensified the third unbundling, involving more extensive use of skills and greater human capital accumulation.

These are topics of this volume, the content of which we examine in more detail in the next section.

4. STRUCTURE OF THE HANDBOOK

Chapters in this volume are presented in the following sequence. The volume opens with an overview of arrangements for economic integration (Chapter 2), which is followed by a review of the results of modelling of the consequences of variations in those arrangements (Chapter 3).

Then, it follows a series of chapters on the forms in which international transactions can be organised – goods, capital, people, and services (Chapters 4–7). Concluding this part is a chapter on trade in agricultural products, which is of special interest in this region (Chapter 8).

The chapter list continues to include further attention to elements of policy affecting integration, especially regulation and the institutional arrangements within economies (Chapter 9). A business perspective on these issues is also provided (Chapter 10). This part includes more detail on the treatment of transactions in preferential trade agreements (Chapter 11).

With this background, the second half of the volume contains a series of chapters on themes related to economic integration. These include its links to poverty reduction (Chapter 12) and to aspects of connectivity (Chapters 13, 14). There is further discussion on financial markets (Chapter 15), and a review of issues related to the environment (Chapter 16) and to energy markets in the region (Chapter 17). The next three chapters have a focus on the organisation of production (Chapter 18), on human capital development (Chapter 19), and on the emergence of new digital forms of international business (Chapter 20). The volume closes with a chapter on the relationships between economic integration and security (Chapter 21).

Readers are invited to consider the chapters in this order, but not all readers may have an interest in all chapters in the volume. The chapters can be read in different clusters, depending on the reader's interest. For that reason, in the balance of this overview chapter, we present the content of the chapters in a different format. The chapters are grouped here under the following headings:

- New Regional and Multilateral Trading Arrangements
- Production Networks, Investment Policies, and GVCs

- Structural Transformation, Skills, and Domestic Capacity
- Infrastructure, Digital Technologies, Regional Security, and the Environment

The key focus in this format of the presentation of the contents of the handbook is to address contemporary and future policies issues related to trade and to regional economic integration.

4.1 New Regional and Multilateral Trading Arrangements

The development of economic integration through regional and multilateral trading arrangements is discussed. The architecture of East Asian economic integration as well as the empirical models for analysing regional integration are present in this part. Various policy implications are also highlighted in the respective chapters.

4.1.1 East Asian architecture of integration (Chapter 2)

Pangestu and Armstrong discuss the evolution of the regional integration architecture in East Asia. They argue that integration was initially led by trade and investment flows that were the result of decision making in markets. These included the development of production networks, later referred to as GVCs. They also stress the contribution of China to regional integration, especially after its accession to the WTO in 2001.

The region developed more formal frameworks for integration, starting with agreements in ASEAN and then adding agreements with ASEAN's major trading partners. Pangestu and Armstrong stress that these agreements evolve, depending on the interests of the participants. The result is a lower degree of consistency amongst agreements, and a lesser degree of institutional integration, compared with those in Europe and North America. They stress that APEC plays an important role in this context by providing a set of principles and reference points for the more formal arrangements. APEC has also cemented the importance of the 'third pillar' of capacity building alongside liberalisation and facilitation, and the commitment to open regionalism, in which openness with the rest of the world was pursued at the same time as barriers to trade within the region were reduced.

In the chapter, Pangestu and Armstrong argue that the East Asia approach has provided strong support for integration, both internally and with the rest of the world. They also observe, noting the debates about integration in the United Kingdom and the US, that the East Asian model has a degree of resilience.

To the question of what happens next, in the context of the US withdrawal from leadership of multilateralism, they respond that the East Asian model has shown its capacity to respond to pressures and to innovate. They point to the adoption of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the progress on the RCEP, and they note that the RCEP in particular offers the potential for deeper integration with South Asia – the next key frontier for East Asia. They also argue that the East Asian architecture, based on the leadership of middle powers, will provide a framework in which all the relatively small members can manage their relationships with China, a challenge which is heightened by the US withdrawal.

4.1.2 Modelling Asia-Pacific regional integration (Chapter 3)

Petri, Plummer, and Zhai review models for measuring and examining the impact of trade and investment on domestic and regional economies. The chapter focuses on the gravity modelling framework (ex-post) and computable general equilibrium (CGE) (ex-ante) models. The

authors review the evolution of CGE models to take into account the developments in trade theory, such as models involving heterogeneous firms. The chapter also highlights the key challenges of incorporating the key effects of GVCs, foreign direct investment (FDI) flows, and regulatory barriers. The authors illustrate the application of CGE models to mega-regional arrangements. They find that proceeding with the Trans-Pacific Partnership (TPP) without the US (i.e. with what became the CPTPP) continues to generate benefits to members but at a level only about a quarter of the arrangement with the US. This is because many members already have trade agreements with each other. The authors also find that no member gains from replacing the TPP with the CPTPP, which indicates the significance of the US market. They stress that there are greater gains from large-member groups such as the RCEP compared to smaller arrangements. With respect to the RCEP, they recognise the contribution of its size to the gains available, but note the limitations associated with the presence of existing agreements and their expectation that the RCEP, at least initially, will not offer much more progress than is already contained in those agreements.

4.1.3 Trade creation and utilisation of regional trade agreements (Chapter 11)

Hayakawa and Shiino examine the analytical and empirical framework for the utilisation of free trade agreements (FTAs). They first consider the analytical framework for the trade-creating effects of FTAs through the application of the gravity equation methodology. They review the empirical evidence of trade creation in East Asia in terms of the type of trade agreement, whether the impacts are evident via the number of exporters or exports per firm, and according to the treatment of tariffs versus non-tariff measures. The chapter also provides examples of studies which found significant trade diversion effects of preferential agreements. The chapter highlights the dynamic processes associated with regional agreements and the extent to which they support further reductions in most favoured nation tariffs.

The chapter reviews a number of studies undertaken to explain variation in the FTA utilisation rates, while presenting an empirical framework based on the ‘new-new’ trade theory of the firm. The authors identify a number of explanators, including the degrees of restrictiveness of rules of origin. The chapter highlights the result that the FTA utilisation rate is positively related to an easing of restrictions on rules of origin in terms of a rule of cumulation, especially because of the support it provides to the development of GVCs.

4.2 Production Networks, Investment Policies, and GVCs

The development of regional production networks and GVCs in East Asia is discussed and reviewed in the respective chapters. The analytical and empirical frameworks are discussed, with a key focus on the GVCs in the region. GVCs in manufacturing and services, the role of FDI, and the movement of people are highlighted and discussed. The policy discussions on balancing the effects of agglomeration and fragmentation due to technological impacts in the GVC are discussed.

4.2.1 Reorganisation of production (Chapter 18)

Kimura and Narjoko examine the reorganisation of production in East Asia in terms of production networks, the international division of labour, and GVCs. They provide a conceptual framework of unbundling effects in the GVC and related theories of trade and relevant concepts. The chapter reviews the empirical literature on what is called the second unbundling.

The first unbundling was the separation of consumption and production, facilitated by a fall in trade costs, which promoted the movement of raw materials and finished products. In the second unbundling, promoted by a fall in communication costs, production processes could be decomposed into a series of tasks. The chapter argues that growth in East Asia is best interpreted in terms of the step from the first to the second unbundling.

The complementary frameworks discussed are fragmentation theory, economic geography and the place of the core and the periphery, and the concept of trade in value added. An important complementary concept is that of industrial agglomeration. The authors argue that a special part of the experience of East Asia was the formation of production networks that involved not just task sharing across borders (as observed elsewhere in the world) but also connections between locations of industrial agglomeration.

The chapter further examines the consequences of the reorganisation of production, both with respect to the impacts of GVCs and to other impacts at the firm level. GVCs here cover the whole international industrial linkages in both the first unbundling (e.g. trade in primary products and materials) and the second unbundling (e.g. back-and-forth trade in parts and components). The chapter also examines the backward and forward linkages in the GVC, focusing on the drivers of the position of firms in Thailand and the Philippines. It also highlights the importance of domestic capacity to participate effectively in production networks. An important driver of that capacity, and another feature of the East Asian market-led approach to integration, is the presence of multinational enterprises, from which skills and technology spill over to local firms. The spillovers occur via a number of channels that include the demonstration effects on domestic firms, movement of skilled labour, exports, local absorptive capacity, and the conducive business policy regime.

The chapter also includes a discussion of what is called the third unbundling or cross-border services outsourcing, driven by further revolution in information and communication technology, which will facilitate the division of labour at the personal level. Workers in one nation, in this scenario, will be able to provide services in another in order to complete one task.

4.2.2 FDI activities and integration in ASEAN and East Asia (Chapter 5)

Thangavelu, Urata, and Ambaw discuss the key trends of FDI flows in the East Asian region and the key investment policies in the region. The chapter highlights the important impact of FDI on the growth of the region, ranging from its contributions to the ‘flying geese’ model of dynamic comparative advantage to the more recent development of GVCs.

Except for a slight decline in the FDI flows during the GFC, the FDI flows to ASEAN and East Asia are stable, but still lag the FDI flows of developed countries. In recent years, the bulk of the inflows have gone to the services sector, especially wholesale and retail trade, as well as to the financial sector, which have been declining in recent years. The authors also stress the significance of flows into the manufacturing sector and other large host sectors such as real estate and agriculture. ASEAN accounts for about 12% of global inflows: its share of inflows grew rapidly in the late 1980s and early 1990s, and has been stable since then. Intra-ASEAN flows account for 15%–18% of the total inflows (Singapore accounts for three quarters of these flows, some of which may have originated elsewhere, including outside ASEAN). Other East Asian economies have accounted for 29% of the inflows, so intra-regional flows account for just under half of the total inflows (OECD, 2019). East Asia (including ASEAN) accounts for about a third of global outflows (UNCTAD, 2019), so the flows into ASEAN are relatively intense (accounting for a higher share of flows into ASEAN than the share of global outflows).

Thangavelu, Urata, and Ambaw discuss the motivations for FDI flows, including efforts to secure resources, find markets, increase efficiency, and buy what are regarded as strategic assets. They contrast the relative importance of these various motivations between different source countries and over time, noting the contribution of vertical FDI to GVC development. They discuss the impacts of FDI on local firms, and the channels of those impacts, including on productivity, exports, and wages paid. The extent of a positive result is critically dependent on the absorptive capacity of the host economy.

The authors also identify a number of policy issues that impede FDI flows and discuss the treatment of FDI in the ASEAN Comprehensive Investment Agreement. Their policy discussion includes reference to investment facilitation and the role of promotion agencies as well as various behind-the-border measures which may impede inflows. They stress the role of liberalisation of investment in the services sector and its contribution to the performance of GVCs, and the participation of host economies in those chains.

4.2.3 Business impediments to economic integration in Southeast Asia (Chapter 10)

Lee reviews the impediments to integration from a business perspective. The chapter identifies a set of business impediments, which are factors external to the firm but which affect its performance, in both the domestic economy and in international transactions. These factors might operate with respect to conditions for entry, operations, and exit. With respect to performance, the elements of interest in this review are those likely to be contributors to economic growth. The set of impediments therefore includes measures adopted by governments which affect markets in goods, services, and factors of production, including those with implications for cross-border flows of trade and investment.

Further, the chapter reviews the literature that has attempted to measure the extent to which different types of firms are exposed to impediments in various countries. The chapter also summarises data from surveys of firms in which respondents are asked to identify the key impediments to their performance, accounting for country variations. It also examines the impact of these indicators on the propensity to export across countries. The key factors affecting the propensity to export include the terms of access to finance and to land, regulation in labour markets, and corruption, as well as the performance of particular institutions (tax, legal, and customs authorities). Common positive drivers of export participation are firm size, foreign ownership, and firm age. The chapter also highlights the importance of policy reforms that includes specific measures related to infrastructure quality, labour market regulation, foreign investment policy, trade facilitation, and governance.

4.2.4 Trade in goods with internationalised production activities (Chapter 4)

Matsuura and Obashi develop the key analytical and empirical framework to understand the trade in goods in East Asia. The chapter refers to the measurement of trade data at the product level and the decomposition of trade to inter- and intra-industry trade in goods. The study breaks down these trade flows by types of products within the region (defined as the RCEP members) and outside it. The authors highlight the difference between primary products, parts and components, and final goods.

For all categories, intra-regional trade has grown faster than both world trade in total and East Asian trade with the rest of the world. The region therefore became more integrated. The surge in component trade is evident in data for the 1990s, but again component trade in East Asia grew nearly twice as fast as that in the rest of the world. Both component trade (especially

so) and final product trade slowed after 2000, but East Asia internally recorded faster growth in both categories. Matsuura and Obashi also observe that East Asian trade exports to the rest of the world are dominated by final products, while imports from the rest of the world are mainly primary and processed products.³

Matsuura and Obashi also discuss other methods of identifying the extent of activity in value chains, using data from input–output tables, rather than the categorisation of trade products. They apply that methodology to review the position of various countries in value chains. They identify drivers of participation in value chains, including location advantages, and decreases in trade costs due to tariff cuts and efforts on trade facilitation. The authors note, however, that significant issues remain in the region with respect to non-tariff barriers.

The growth of China has created opportunities for the rest of the region, rather than crowding out other exports. With respect to opportunities for small firms, an issue which is critical to the question of the inclusiveness of integration, the authors identify a range of factors that might encourage participation in trade. They note the relative importance for smaller firms of some of the barriers to exporting. Finally, they discuss the durability of value chains, and they review the debate in the literature on the ‘trade slowdown’. They observe the durability of value chains in machinery industries, but they also ask questions about the long-term effects of the upgrading that is occurring in China in particular, and its implications for sourcing inputs, and for the impact of digital technology.

4.2.5 Services (Chapter 7)

Findlay and Roelfsema review the key drivers of trade in services in East Asia. They begin with the key characteristics of services, which leads to the forms in which transactions are organised and thereby the options for international exchange in services. The chapter stresses the requirement for interaction between producers and consumers, which contributes to a higher degree of regional intensity in services trade. New data on trade by different modes are highlighted, and of interest is the continued importance of the delivery of services via offshore establishments. The next stage of services trade development will depend on digital platforms, which also creates the possibility of a more global orientation and falling regional intensity in services trade over time. The process of servicification of manufacturing and the ways in which services are embodied or embedded in goods will have different impacts across the region in cross-border trade compared to value added included in goods.

Various features of services contribute to risks of market failures which then drive the regulatory policies applied to services, and which in turn can become barriers to international transactions. The chapter on services includes a review of the various measures of these barriers. The chapter notes that services reform appears to lag in the East Asian region.

Chapter 7 also reviews the treatment of services in FTAs. Generally, commitments in FTAs exceed those made in the General Agreement on Trade in Services (GATS). Given the nature of services transactions, and the nature of the regulatory policy which applies, the question remains of the extent to which FTAs can contribute to regulatory reform.

4.2.6 East Asian financial integration in banking, markets, and regulation (Chapter 15)

Hanna and Sheng evaluate the degree of integration of capital markets in the group of ASEAN Member States (AMS) plus China, Korea, and Japan (the ASEAN+3 economies). The chapter examines the evolution of the markets, and their regulation, since the AFC in 1997, taking into

account its consequences and those of the GFC. The chapter highlights the forces which may drive the next round of adjustments and offers an assessment of their current stage.

The AFC experience triggered a series of changes in East Asia. These include a more flexible exchange rate regime, to help insulate domestic liquidity. Bond markets were developed to diversify funding sources. Swap arrangements were set up to offer officials greater capacity to respond to capital outflows. Financial regulation was strengthened. However, these reforms were not sufficient to avoid the GFC a decade later, though they did add to the ability of the region to withstand the global shock. The GFC affected the US and Europe more than it did the ASEAN+3 countries because of the use of expansionary fiscal measures, by China in particular.

Reforms after this shock include work at the global level to strengthen the banking systems and their capacity to absorb global shocks and those generated by non-bank financial intermediaries (or shadow banks) in their own economies. Meanwhile, the ASEAN economies sought to continue to integrate their economies to generate growth, and included a commitment to open capital markets. ASEAN+3 officials worked on further development of bond markets. Swap arrangements were improved and a macroeconomic monitoring group was set up.

The chapter also reviews the state of the region's financial markets. The authors conclude that markets are still dominated by banks, and that equity and bond markets remain relatively underdeveloped. Financial systems are less complex in the region, but there is growth of shadow banks and new types of instruments. Exchange rate arrangements are evolving, with the possibility of less reliance on the US dollar and more use of the renminbi for transactions and as a store of value (though in the short term there is a degree of lack of confidence in the latter). Economies of the region are relatively large holders of foreign exchange. Savings are growing rapidly and the financial sector is growing faster than gross domestic product (GDP). The diversity of the region provides opportunities in integration but also complicates the process, which the authors describe as likely being a slow and jerky dance, though they hope that the recognition of mutual interests will convert this to a more graceful flow.

The chapter concludes with a discussion of current forces which may drive the next rounds of reform and integration. These include the development of new e-payment systems (led by China), the disruptions to traditional banking services from fintech (e.g. trade finance), the contribution of cryptocurrencies to lower the costs of managing payment systems, and other uncertainties associated with the shifts in the design of supply chains and with tensions between the major trading partners.

4.2.7 International population mobility in East Asia (Chapter 6)

Ananta and Arifin examine the analytical framework of migration and the key trends in population mobility in East Asia. The chapter reviews the research on the drivers of migration, including factors associated with various stages of development and demographic transition as well as those related to technological change. East Asia will continue to be both a sending and a destination region, but the movement of people might shift more towards mobility (shorter-term movements) than migration. There is a two-way impact of migration, as migrants may not only reside in a number of other countries but may also return home, having accumulated human capital. The chapter also reviews the application of policy measures to migration, including mutual recognition agreements which are relevant for skilled migrants. With respect to mutual recognition agreements in ASEAN, there is more progress for tourism professionals; some progress for accounting, architecture, and engineering; and less progress in fields related to health services.

The chapter also focuses on the movement of people associated with the ASEAN+3 economies and on longer-term mobility. From 1990 to 2015, the stock of migrants in these economies more than doubled, rising from 6.8 million to 17.4 million. Economies with high shares of migrants to the total population are Macao, Singapore, Hong Kong, and Brunei. Thailand showed the largest growth over this period, to become the largest destination. Malaysia and Singapore also showed large increases, and these three plus Japan and Hong Kong make up the top destination country positions. The largest sending countries are China, the Philippines, Indonesia, Myanmar, and Viet Nam. The countries with the largest remittance flows are India, China, and the Philippines. Ananta and Arifin highlight the drivers of changes in patterns of migration, and show that current source countries can switch to be destination countries.

The patterns of migration are relatively intense in the region, which as a sending region accounts for about 14% of the stock of global migrants, but only about 7% of the stock as a destination. While the regional flows are intense, the region has a relatively global orientation in its migrant flows.

4.3 Structural Transformation, Skills, and Domestic Capacity

Regional integration and structural transformation in the East Asian region are discussed in the respective chapters. Successful structural transformation is critical to shift to more efficient and productivity-driven economic growth in the AMS. The respective chapters highlight the challenges and opportunities for structural transformation from regional integration in the East Asian region in the agricultural sector and with respect to skills, regulatory reforms, and the capacity to improve the welfare of the people through poverty reduction.

4.3.1 Agricultural development, structural transformation, and East Asian trade (Chapter 8)

Anderson examines the analytical framework of agricultural development and key trends in regional trade in agricultural products. The chapter provides the theory of the evolution of agricultural comparative advantage in terms of the development of domestic economies. However, the chapter asks to what extent the actual pattern in East Asia is consistent with that theory. It finds that trade-related policies have restricted the agricultural trade of East Asian economies in various ways. In particular, several countries have restricted their exports of key farm products while their incomes were low, which implies the imposition of a tax on agriculture. Other countries have gradually raised barriers to agricultural imports as the international competitiveness of their farmers declined in the course of economic growth and industrialisation. The chapter identifies the ‘tradition’ of gradually moving away from taxing and towards protecting farmers relative to producers in non-farm sectors. The chapter also observes that there are new and cheaper means of achieving the policy objectives of agricultural policies, even in the region’s poorer countries. One possibility is to allow countries to move away from less-efficient price- and trade-distorting policy instruments to more efficient ones for redistributing the benefits of economic growth and integration. While switching to these new measures is not a trivial task, doing so would help integrate regional trade in these products and provide better options for responding to supply shocks such as pandemics and local events associated with climate change.

4.3.2 Skills and human capital development policies of ASEAN (Chapter 19)

Thangavelu and Wang examine the analytical and empirical framework of the policies on human capital and skills development in the East Asia. The chapter highlights that the long-term experience of the region, and a contribution to the success of economic integration, has been the alignment of the education and training system with the changing demands for skills from the industrial structure. It illustrates the ways in which skill demand shifts, in a more recent context, by mapping various positions in GVCs with the skills required to support the transition to higher GVC activities. The transition is vital to continuing to gain from GVC participation, including its contributions to wage growth and technology transfer.

The chapter also discusses the institutional framework for upgrading of skills in the domestic economy and the region. It provides more information on how human capital development might be organised, with reference to the experience in East Asia. The chapter refers in particular to the contribution of technical education and the value of a lifelong learning framework which combines education, training, and learning in employment. In particular, the development of a portfolio of human capital and skills is important for the adjustment to international competition and the structural change that is associated with economic integration.

The chapter also refers at various points to the value of mobilising the private sector in the provision of education, including in partnerships. Its presence brings not only additional capacity but potentially also drivers for innovation. The scope of the private sector can be extended to include foreign providers. Education is a tradable service through various formats, including via digital delivery and the portfolio of human capital and skills. Barriers to international education remain high in many economies in the region, and reform offers greater scope to contribute to regional integration in its own right but also to support the success of integration in other sectors.

4.3.3 Trade, poverty, and Aid-for-Trade (Chapter 12)

Menon and Melendez evaluate the links between trade growth and poverty reduction in the East Asian region. East Asia's openness to trade is often credited as one of the main drivers behind the region's impressive gains in economic growth and poverty reduction. The authors examine the literature to determine whether there is a sound theoretical and empirical basis for this presumed relationship between trade and poverty reduction. Like many other studies on this topic, they find that the linkages are not automatic; the impact of trade on poverty is highly context-specific, and many factors come into play. Complementary policies are necessary to maximise trade's potential impact on poverty reduction. They also explore the role of Aid-for-Trade in addressing specific trade-related capacity constraints which prevent developing countries from maximising the benefits from trade.

4.3.4 Institutional reform, regulatory reform, and integration in East Asia (Chapter 9)

Shrestha and Doan examine the process of regulatory reform associated with economic integration in East Asia. Regulatory reform is associated with the broader category of institutional change, including the rule of law, anti-corruption policy, and the effectiveness of government and the regulatory system. The chapter examines the relationship in two directions – one in which there is a positive relationship from the quality of the institutional environment to economic integration, and the other the reverse – where economic integration becomes a driver for institutional reforms. It is important that better institutional quality can support trade by reducing uncertainty and the associated transactions costs. The link in the opposite direction

operates via three channels, creating incentives for unilateral reforms to support the competitiveness of domestic firms in more open markets, making commitments to reform in the process of integration (e.g. via trade agreements), and adding to the capacity to undertake reform via collaboration.

The chapter also reviews the progress of institutional reform in East Asia since 1998 and focuses on indicators of government effectiveness and regulatory quality, taking data from the World Bank Worldwide Governance Indicators. There is a positive correlation between GDP per capita and institutional quality at a point in time, but not all economies have improved in both dimensions over the whole period. The improvements could be associated with developments in commitments such as accession to the WTO and the adoption of the ASEAN Trade in Goods Agreement.

The chapter concludes with three case studies of institutional reform in the AMS. These are trade facilitation; reduction of non-tariff measures (NTMs), including differences in standards; and regulatory reform in general. With respect to the last of these, concerted efforts by each economy as part of the ASEAN process can contribute to improvements and sustained regulatory reforms. On trade facilitation, the chapter highlights instances of AMS making faster progress than might be expected given their level of GDP per capita. On NTMs, the challenges to date have been more significant, with a large number of initiatives associated with progress which is uneven and limited. Actions to accelerate progress, they suggest, include implementing commitments on reporting NTMs and related disputes about them, accreditation of testing facilities for the application of standards, training of personnel, and mechanisms for coordination across government agencies within economies.

4.4 Infrastructure, Digital Technologies, Regional Security, and the Environment

The development of soft and hard infrastructure is critical to shift the economic activities in the region to higher value-added activities in the regional and global value chains. The respective chapters discuss the analytical framework and key challenges facing the East Asian countries in terms of infrastructure connectivity, digital technologies, and security issues in the region.

4.4.1 Investment in connectivity (Chapter 13)

Elek and Findlay examine the scope for economic integration to resolve issues in the provision of infrastructure finance. The focus is on projects which contribute to connectivity amongst East Asian economies. There is, according to some estimates, a gap between the stock of projects that would be demanded to meet expectations of growth and structural change and the actual flow of projects, according to current trends. The chapter refers to assessments that greater private sector participation in funding would be important to help close the gap. Funding appears to be available, but bottlenecks remain. Various short-term responses such as ‘deal sweeteners’ were noted, but fundamental policy reform at the national level is more important.

Reform can be supported in various formats through international cooperation. The chapter reviews options, including capacity building and agreed policy frameworks, to which commitments are made (as in the Master Plan on ASEAN Connectivity (MPAC)), as well as cooperation involving funding flows such as the Belt and Road Initiative. The role of multilateral development banks is also noted in both policy reform and funding flows. The value of coordination to capture spillovers and network effects is stressed.

The chapter highlights a virtuous circle between integration and investment for connectivity.

The direction of policy reform that supports a greater private sector role and helps resolve the funding gap would also lead to much more integrated economies in the region. In the process, these reforms create a virtuous circle, since the connectivity projects which are completed reduce trade costs and lead to higher levels of economic integration overall. This outcome, in turn, supports the returns on the flow of new connectivity investments.

4.4.2 Connectivity and the geographical simulation model (Chapter 14)

Isono and Persyn examine the empirical framework for quantifying the benefits of connectivity, including not just the gains from trade but also the implications for the location of economic activities and patterns of trade. This includes a discussion of the drivers of agglomeration that follows from reductions in transport costs, the sensitivity of location decisions to small policy changes in a low transport cost environment, and the redistributive effects. The chapter discusses the scope to include these additional effects to those considered in the traditional methodologies of modelling the gains from trade.

Given the presence of these extensive gains from connectivity, the chapter considers the prospects for the MPAC. There is some progress in ASEAN but several issues and thereby constraints remain, including those around decision making, access to funding and to human resources, regulatory reform, and expectations of revenue failing to be met.

The chapter considers a number of ways to promote the positive progress of connectivity in ASEAN. One response is to provide more information on the benefits and consequences of connectivity. This can be done in two possible ways. One involves a pair of case studies of actual integration: the examples offered are in air transport and the automotive industry. The other involves the application of a simulation model which is designed to capture the trade and spatial consequences of improved connectivity.

In this case, the model could consider the implementation of the MPAC, with a focus on the Greater Mekong Subregion Economic Corridors. One of the important contributions in this chapter is to identify the flow of benefits across countries, even of national projects. This leads to discussion about the scope to share funding in infrastructure projects.

Finally, the chapter suggests that the design of projects for connectivity need not be bound by ASEAN membership. Connectivity matters within the group and between its members and others. ASEAN can lead the development of thinking on connectivity, but projects could be developed at a higher level, involving other economies (the authors provide examples of working with China, for instance) or a subregional level. In either case, the modelling work remains useful in order to capture the distribution of consequences beyond those economies directly involved.

4.4.3 Economic integration, climate change, and sustainable development in East Asia (Chapter 16)

Tay examines the connections between economic integration and environmental issues, where the treatment of the latter has not kept pace with the former. The chapter notes that the East Asian economies have begun to pay more attention to environmental issues, both because of pressure from the rest of the world but also because of demands to do so from within. In particular, there has been an increase in efforts in this respect by China, Indonesia, and Singapore, as well as India. Originally, the concerns in the region were on pollution that is evident and which affects public health. Over time, there have been two developments – one is greater attention to climate change and the other is more consideration of the determinants of

environmental outcomes. In addition, there are others, so far of less concern in Asia but more so elsewhere, such as endangered species, biodiversity, and deforestation.

The chapter highlights the two-way relationship between trade and the environment. One question concerns the links from trade and growth to better environmental outcomes, and the review of the literature seems to be inconclusive, since the results are dependent on the context of the analysis. There is also lack of attention to climate change in these sorts of studies.

The chapter also examines how the treatment of environmental issues might affect the trading systems, the application of its rules, and its operations. For example, some environmental measures may sanction the application of trade measures, demand actions not consistent with trade measures, and insist on the application of standards which add to trade costs. There is also a concern that unilateral action could be applied to trade measures on environmental grounds as an excuse for a protectionist policy. The chapter refers to resentment and suspicion by developing economies about the unilateral application of environmental measures by their trading partners.

The chapter also considers the ways in which attempts have been made to resolve these issues cooperatively. The WTO has failed to make any progress, one reason for which is the very different interpretation of WTO text by pro-trade and pro-environment stakeholders. Relevant WTO cases are considered, but the WTO's dispute settlement process has a lack of consistency and thereby also legitimacy. It is also important to note the failure in ASEAN to connect the economic integration agenda with the rising community interest in environmental issues (as a result of a lack of connection between its three 'pillars' of integration).

The chapter concludes with discussion of new measures being applied or considered to environmental issues. These include carbon taxes, which in the trade context leads to discussion about the application of adjustments to taxes at the border. Subsidies which are complementary to the operation of carbon management regimes also trigger trade policy concerns. Some countries place greater attention on the application of standards (of product performance but also the process of their production), which as noted can affect trade costs, or at least some effort at regulatory alignment. The development of green finance (tied to environmental performance) for infrastructure projects is another trend of interest.

4.4.4 Energy transition for fuelling economic integration in East Asia (Chapter 17)

Anbumozhi reviews the opportunities and challenges in energy market integration in the region. The strong regional growth leads to increased energy demand, and thereby a degree of concern about the security of supply. The extent to which this is an issue varies between economies, depending on their energy sources and their overall balances in supply and demand. These variations also create the scope for gains from cooperation, including through trade in energy. Capturing that opportunity is constrained by a number of barriers, however, including differences in technical standards and concerns about environmental impacts. The former is especially important, for example, in connecting electricity grids. The latter matters more for some conventional fuel sources.

The chapter examines a number of other specific issues. One is the scope to develop a clean energy value chain in the region. This is an important part of the response to the environmental constraints to meeting the demand for energy. However, there are a number of constraints on this development, including barriers to trade in the components used in the production of renewables and barriers to foreign investment. A second is the extent of subsidies in place for conventional fuels. The chapter argues the case for a reform of these subsidies, which would

moderate the growth in demand and remove a bias against energy with lower emissions. A third important topic is the manner in which the region can accommodate China into regional energy markets, given its scale. The chapter includes a discussion of the ways that institutions in the regions, including those led by ASEAN, can help integrate markets and respond to these additional issues.

4.4.5 Digitalisation and market integration (Chapter 20)

Lee-Makiyama examines the nature of the integration by digital means and the issues that it involves. The chapter observes that the digital economy involves an ecosystem of infrastructure alongside flows of goods, services, and data. Within that ecosystem, transactions are organised digitally but may lead to either digital or physical delivery. These transactions might be between businesses and will also involve consumers.

As an indication of the extent of integration in this area in East Asia, the chapter presents data on the sources of final demand for information technology and information services. The trends indicate that the domestic supply within the ecosystem is very high (about 80%) and that over the decade to 2015 this share only fell by 10 percentage points. This indicates that there is a low degree of integration, which is due to the impact of policy restrictions that impede trade. The chapter refers to work on measuring the restrictiveness of policy, and finds that on average digital trade is more restricted in East Asia than in the world in general, though some economies in the region are relatively open. Recent forecasts for the growth of the digital economy in the CGE modelling framework indicate the consequences of reform, at the economy level, to reduce the levels of restrictiveness. The results of the simulation indicate very large positive results.

The chapter also reviews a series of issues associated with the growth of the digital economy, including data localisation requirements, online censorship, cybersecurity, industrial policy, competition policy, and corporate taxation. Key results include (i) the relatively high costs of data localisation requirements; (ii) the presence of inconsistencies in – and the significant consequences of – the different approaches to censoring content which is deemed to be undesirable; (iii) the trade and investment impeding effects of the application of national security tests in the digital economy; (iv) the challenges posed by digital technologies (where network effects are important) to traditional approaches to industry policy; (v) the pro-competition effects of digital technology and, at the same time, the presence of risks of consolidation and of differences in thinking about how to respond (pre-emptively or otherwise in the context of incentives for entry into the long term); and (vi) the risks involved in abandoning traditional principles applied to taxation of income generated by cross-border activity.

The chapter concludes with a discussion of three different paths available to East Asia to facilitate digital integration. First, new disciplines in recent trade agreements such as the RCEP and the CPTPP could curb some of the most restrictive practices; second, a regional certification could alleviate issues on data flows, as exemplified by the APEC Cross-Border Privacy Rules; and third, the region could look to converge various regulatory practices in the long term.

4.4.6 The economics–security nexus and East Asian integration (Chapter 21)

Chacko and Jayasuriya consider the relationships between integration and security in the context of East Asia. Policy advice in earlier times, with respect to this linkage, was based on a

positive effect from integration to security. Subsequent improvements in the latter would lower the impediments to integration that might otherwise be present. Since the circle was a virtuous one, then policy advice on integration could rest on its positive consequences for security. Benefits of further integration, if anything, would be understated. The chapter presents some different ways of thinking about the relationship of trade to security. The complicating factors which have not been sufficiently studied are related to domestic political processes. This chapter highlights the reciprocal role of geopolitical relations and global economic relations in shaping the interests of domestic social groups in relation to strategies of trade and regional integration. These issues have been neglected by much of the existing literature on regional integration and the economics–security nexus. Further, the economic relations and security relations are always linked through their mediation by domestic social groups. More recently, the emergence of competing regional regulatory and infrastructure projects very much complicates the anticipation of integration in the region in future.

NOTES

1. For more recent data, see Global Trade Alert (n.d.).
2. Global Trade Alert (n.d.) categorises interventions as follows: (i) red triangle: the intervention almost certainly discriminates against foreign commercial interests; (ii) amber triangle: the intervention likely involves discrimination against foreign commercial interests; and (iii) green triangle: the intervention liberalises on a non-discriminatory (i.e. most favoured nation) basis or improves the transparency of a relevant policy.
3. The indicator of regional integration discussed here refers to shares of trade. An extension in further work is to consider those shares relative to the shares of the respective economies in world trade, that is, an indicator of trade intensity. Studies of this indicator generally report falling intensity in East Asia, and in ASEAN, at least from the mid-2000s (see for example Korwatanasakul (2020)). Falling intensity can follow from success with respect to competitiveness in world trade, often driven by the growth of regional trade, leading at the same time to a rising share of world trade (Korwatanasakul, 2020, p.17). China's participation in world trade since joining the WTO in 2001 has also contributed to this outcome.

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