



Policy Brief

Comparison of Regional Economic Integration in Asia and Europe: Policy Implications for the CAREC Region

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Executive summary

Regional integration is one of the most effective ways to foster stability, address regional challenges, and increase the rate of economic growth. Strengthening regional cooperation and integration in different Asian sub-regions, including the Central Asian Regional Economic Cooperation (CAREC), offers great potential to eliminate poverty and achieve inclusive and sustainable development.

This policy brief compares the economic integration perspectives in Asia and Europe in order to provide policy recommendations for the CAREC region. The paper concludes that CAREC needs an effective and efficient system for policy coordination, for infrastructure development and infrastructure financing, also reduction of non-tariff measures (NTMs), and establishment of effective intra-regional energy trade.

Compared with Europe, the Asian economic diversity is more pronounced, ranging from rich and modern to poor and traditional economies. Europe is more homogenous economically. The EU process had a major impact on political stability whereas the situation in Asia is still rather fluid. Asia's integration is market-driven, and fueled by trade, while the EU's integration is on top based on institutions and a legal framework. There are hurdles for further integration in Asia which need to be overcome. Most important for this is the will for "unity in diversity." Asian cultures, political regimes, economic systems, and religious beliefs are more diverse than the ones in Europe.

In most Asian sub-regions, including CAREC, in the present context, there are no such political ambitions, as witnessed in Europe, for economic integration. This indicates a more cautious approach in Asia than in Europe. However, studying the case of Europe provides some practical recommendations for fostering economic integration in various Asian sub-regions, including CAREC.

Firstly, regional economic integration should ensure the maximization of benefits which is possible only by pursuing an appropriate policy at the national and regional levels. Hence, in order to achieve a regional economic integration in different Asian sub-regions, including Central Asia, such policies are needed to be adopted and followed coherently by all countries at national and regional levels. In other words, regional economic integration will happen through the development of an effective and efficient system for policy coordination.

Secondly, a well-developed infrastructure and the absence of trade barriers constitute some of the key reasons behind efficient connectivity in Europe. The CAREC region, on the contrary, suffers from the lack of infrastructure which slows down trade among members. Difficulties in accessing finance presents one of the main obstacles for development of infrastructure. In this regard, the role of infrastructure financing is very important. In Europe, while the European Investment Bank (EIB) focusses on intra-EU projects, engagement with partner countries under the umbrella of various initiatives also plays a role (Pascha, 2020). During the past 30 years, different institutional mechanisms and initiatives have come into existence in Europe that created a basis for the strategic re-orientation in this field. Such institutional mechanisms and initiatives are lacking in CAREC. Development of infrastructure has a potential to decrease transportation costs and boost intra-regional trade.

On the other hand, trade barriers are not limited to physical infrastructure or tariffs alone. With the fall of tariffs in many markets around the world, especially in OECD countries, the focus of trade policymakers has gradually shifted to tackling unnecessary costs associated with non-tariff measures (NTMs). A large body of evidence suggests that NTMs have become relatively more important in trade policy. These measures are mostly non-discriminatory regulations aimed at preserving legitimate interests, such as protection of security and health of consumers or the environment (ITC,

2016). UNCTAD estimates that 80% to 90% of all trade is affected by non-tariff measures (World Energy Council, 2016).

Thirdly, one of the factors that can foster economic collaboration in the CAREC region is trade in energy as all countries need it and the region is rich in energy resources. The energy supply pattern in CAREC region shows that while some CAREC countries are rich in fossil fuel (oil, gas, coal) and hydro resources, others lack sufficient domestic resources to adequately cover their energy demand. Seasonal variability among countries is also particularly pronounced. Focusing more on intra-regional energy trade might increase regional economic integration and enhance the energy security status in CAREC at the same time.

1. Introduction and background

Economic integration can cause a permanent increase in the rate of economic growth. Starting from a position of isolation, closer integration can be achieved by increasing trade in goods or by increasing flows of ideas (Rivera-Batiz and Romer, 1991).

Economic integration can be classified at five levels:

- 1) The first level is free trade. At this level, tariffs between member countries are significantly reduced, some abolished altogether. Each member country keeps its own tariffs in regard to third countries. The general goal of free trade agreements is to develop economies of scale and comparative advantages, which promotes economic efficiency.
- 2) The second level is the custom union. At this level, member countries set common external tariffs, implying that same tariffs are applied to third countries; a common trade regime is achieved. The custom unions are particularly useful to level the competitive playing field and address the problem of re-exports.
- 3) The third level is the common market. Services and capital are free to move within member countries, expanding economies of scale and comparative advantages. However, each national market has its own regulations such as product standards.
- 4) The fourth level is the economic union (single market). All tariffs are removed for trade between member countries, creating a uniform (single) market. There is also free movement of labor. Monetary and fiscal policies among member countries are harmonized, which implies a level of political integration. The next step concerns a monetary union where a common currency is used (example of Euro).
- 5) The final level is the political union. This represents, potentially, the most advanced form of integration with a common government where the sovereignty of member country is significantly reduced. This is only found within nation states, such as federations where regions having a level of autonomy from the central government (Rodrigue, 2017).

The Asian sub-regions and Europe are at different levels of economic integration. Each of these entities has taken different paths. Except for the ASEAN, Asia has chosen a loose economic cooperation based on free trade agreements. The ASEAN has created a common market, which is the third level of economic integration. Europe has already reached the highest level of economic integration: The European Union (EU) represents the third level, and the single currency and the European Central Bank represent the fourth level.

It is important for different Asian sub-regions, including the CAREC region, to learn from the European experience to increase the level of regional economic integration for higher endogenous growth which is the objective of this policy brief. Although it needs to be noted that not all successful experiences of a region are practical in other regions due to the social, cultural, political, geopolitical, and economic differences.

The two world wars convinced Europe of the importance of integrating the societies and economies. It was understood that pooling economic resources (labor, capital, energy) together could produce better results than isolated activities. The EU reaped significant economic benefits within the region by developing common rules and increasing coordination among regional and national authorities which affect regional economic integration. The EU also closely cooperated in security and foreign policy, home affairs, and justice.

The process of integration in Asia is more driven by markets than governments. Integration and cooperation among the national authorities is less intimate and more recent. Among Asian sub-regions, Central and South Asia have the lowest level of economic integration. These two sub-regions have nearly always been experiencing movements of goods and people. However, today's intra-regional trade remains low and significantly below regional trade in Africa, the Middle East, Latin America, and Southeast Asia. Lord (2015) estimated that intra-regional trade in Central Asia is less than 5% and that of South Asia is 1.5% of trade with all countries.

Although there are several differences between Asia and Europe, there are some important similarities between the two continents:

- During the nineties, Asia and Europe were hit by serious financial, economic, banking, and currency crisis. Both regions share a similar ambition to regulate the measure of financial and economic globalization in order to establish economic stability that promotes high growth and sustainability with improvement in regional welfare amenities.
- Both regions exhibit complex models of the civil society that puts a higher price on the need to control the factors of globalization. Both regions are ambitious to preserve the positive aspects of the complex and social economic models. Also, both regions seek to retain the ability to effect changes in the fast-evolving environment.

Both regions are different in some of the following aspects:

- In Asia, there is a high level of economic, social, and cultural diversity. E.g., economically, it ranges from developed economies (such as Japan and Republic of Korea) to others which are mostly developing. While, the EU has developed into a high level homogenous economic group.
- Also, there is a significant difference in the level and timing of efforts which are made towards deeper regional economic integration. Since the World War II, Europe has shown more ambition than Asia in developing a transparent political goal to create a deeper union among the Europeans. Such an attempt was triggered by the extent of devastation in both moral and material aspects resulting from the wars. Mainly because of this approach, Europe accepted a significant sovereignty pooling on the entire economic and political issues.

- In Asia, under the present context, there are no such political ambition as witnessed in Europe. Therefore, we cannot assume that lessons drawn in one region can simply be copied and implemented in another region under particular conditions or circumstances.

2. Economic integration in Europe

According to Balassa (1961), the regional economic integration is a process in which the differences and discrimination between the national economies are eliminated gradually. Munakata (2006) pointed out that regionalism is basically an institutional nature whereas regionalization, which is the process of regional economic integration, occurs by way of market development. The regional economic integration should be examined in a broader perspective which would represent all aspects of economic, political, and legal dimensions. The process of financial and economic integration in the EU emphasizes issues related to the accessibility of public goods along with the free movement of capital and labor and market competition. It is noted that the internal European market development and security considerations are the main priorities for the European Union.

The European economic integration boasts the following major economic achievements:

- Creation and development of a single market. In such a market, people, capital, goods and services move freely across borders without significant obstacles, barriers, or constraints. The implementation of a liberalized market and a common regulatory mechanism has moved closely, hence the achievement of remarkable and deep integration. The regional economic integration enabled investors and institutions formulate the Europe-wide strategies. This has resulted in stronger development of trade and financial areas. Further, such strategies have resulted in higher economies of scale as well as efficiency in the economic integration mechanism.
- Creation of an economic and monetary union (EMU) and adoption of a single currency. These developments consolidated and accelerated the single market mechanism largely. Also, the equity capital markets started evolving quickly. The euro area witnessed a strong increase in the capitalization in stock markets and several new enterprises entered the market.
- Effective and efficient system for policy coordination. Creation of a new institution pooled together monetary policies. In areas of employment policy and structural reforms, the practice of consensus was adopted. Further, integration efforts benefited from the member state pressure (Taghizadeh-Hesary, Subramanian and Panchanatham, 2020).

The regional economic integration process in Europe has been going on for over five decades. This period can be considered as the post war birth of economic integration and deepening and enlargement of the EU. The regional economic integration in Europe has been a big success both in terms of economic and political considerations. Of course, there were failures and tensions in the process, however, it is possible to draw some of the main lessons from the European economic integration experience. The features of institutional, political, and economic development of the EU are significant achievements.

The initiative of regional economic integration in Europe has started within a small association of economies, most of which were at the same level of development. These countries started integrating the neighboring countries which were at a much lower level of economic development. Another feature of the European integration process is that the economically stronger countries

(Germany and France) took the leadership and promoted the economic integration of the EU. Whereas, in Asia, the larger economies (People's Republic of China, Japan, and Republic Korea) are not taking this role that seriously.

Another important factor behind the economic integration in Europe is removal of trade barriers, including tariffs, as well as non-tariff barriers. During the last 20 years, international trade has been subject to an increasing number of policy measures aimed to regulate market access and/or to ensure that imported products conform to public policy objectives such as consumer safety. These policy measures are generally referred to as non-tariff measures (NTMs) and comprise a vast and diverse array of measures, all of which are government policies that – intentionally or unintentionally – alter the volume, direction, or product composition of international trade.

The NTMs include not only border measures (e.g. quotas), but also domestic policies (e.g. subsidies), and measures whose distortionary impact on trade is felt along the marketing chain (e.g. standards, distribution restrictions). Some NTMs are also targeted at exports, in some cases to stimulate, in other cases to restrict exports (Melo and Nicita, 2018). In a survey conducted by the International Trade Center in 2015 and 2016 on a sample of EU exporters (8100 companies) across 28 countries and 26 sectors (ITC 2016), some 8,000 European exporters responded that 64% of them experience no major regulatory obstacles in their main markets, 36% reported facing restrictive regulations or related obstacles that act as important impediments to their exporting activities. This means even in the EU with the high level of economic integration, the NTMs still represent a challenge, hence authorities need to navigate the NTMs and take necessary steps for elimination of measures that distort trade rather than to protect consumers.

3. Lessons from the European economic integration

During the last two decades, Asia experienced higher trade and investment growth compared with other regions (even after excluding the PRC data). Asia's supply chain development and production fragmentation deepened trade and economic integration and facilitated economic growth. Bilateral trade agreements have proliferated since the turn of the twenty-first century and have become the major focus of trade liberalization and international commerce. Currently, considering the US-China trade war and the criticism directed at the World Trade Organization, Asian economies need to focus more on the intra-Asia trade and promote the regional economic integration to keep the growth rate. Some European experiences which could be borrowed to foster economic integration in Asia, include:

- The regional economic integration processes should ensure maximization of benefits. This is possible only by pursuing an appropriate policy at the national and regional levels.
- At the regional level, cooperation in terms of fiscal policy, investments, and trade would be required to strengthen and extend the ties among Asian member states. Regional cooperation is essential for making substantial progress in the regional economic integration of the financial market structures.
- At the domestic level, proper cooperation is necessary for developing an effective and uniform regional business environment. Several countries liberalized commercial and capital flows. This has resulted in losing significance at the regional level while performing transactions internationally.
- The major economies such as Japan, the PRC, and the Republic of Korea need to take more prominent leadership role for promoting the regional economic integration. The initiatives of ASEAN as well as ASEAN+3 have contributed towards an improved sense of community in Asia. However, such institutions have not yet achieved high political

potential. The Asian economic progress depends on the region's ability to reduce political tensions between the Asian economies.

- One of the key reasons behind the ease of connectivity in Europe is well developed infrastructure. Many Asian sub-regions are suffering from lack of infrastructure that slows trade with neighboring countries. In this context, role of infrastructure financing is very important. In 1958, the European Investment Bank (EIB) was created as a policy bank of the European Economic Community. Over the years, infrastructure has become a "top priority" with investments in the transport sector of more than 153 billion Euros between 2005 and 2015 alone (EIB 2016). While EIB focusses on intra-EU projects, engagement with partner countries under the umbrella of various initiatives also plays a role (Pascha, 2020). During the past 30 years, different institutional mechanisms and initiatives have come into existence in Europe that created a basis for the strategic re-orientation in this field.

Finally, it is important to note that, the objectives, purpose, dynamics, sequence, and form of the Asian regionalism will continue to remain distinct. Therefore, although there are some practical lessons from the European experience, the Asian regional economic integration should not be examined only from the angle of adopting the regional economic integration in Europe.

4. Policy recommendations for promoting the economic integration in CAREC region

Tackling tariffs and non-tariff measures (NTMs)

There are obstacles in cross-border economic interactions among CAREC members, including high tariffs and delay of cargo at the border, that slows the intra-regional trade. At the same time, the barriers are not limited to tariffs alone. In fact, NTMs are key factors influencing trade which has implications on economic development. The World Trade Organization estimates that NTMs have twice the impact than tariffs on global trade. According to UNCTAD, 12 NTMs that affect the inter-regional trade are: local content requirement, customer procedures, conformity assessment and technical regulations, government procurement, tax laws, subsidies, investment restrictions, administrative licensing, process and production methods, intellectual property protection, legal system and export controls (World Energy Council 2016). CAREC member authorities need to identify the most inhibitive NTMs and address them.

Fostering infrastructure investments for easier connectivity

Experience of Europe shows that specialized banks such as the European Investment Bank (EIB) had significant role in financing and boosting the investments in intra-EU infrastructure projects that fostered connectivity in EU. Establishment of CAREC Investment Bank (CIB) by engagement of the partner countries and multilateral development banks (such as ADB, World bank, EBRD) could play a significant role to attract the long-term finance and private investments in intra-CAREC infrastructure projects.

A fully integrated CAREC energy market for higher economic integration

Energy is the prioritized sector, free flow of which can bring better economic integration in CAREC region, as the region is rich in energy resources, and there are both energy exporters and importers in this region. Energy should flow freely across the CAREC - without any technical or regulatory barriers. Only then, energy exporters can freely compete and provide the best energy price, and the CAREC can achieve its self-sufficiency in energy which can also improve the regional energy security status.

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