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Beating the Recession: Prospects from a Single Asian Market in Services

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Abstract

Given their historical colonial experiences and recent attainment of independence, unlike European countries, most Asian economies are fiercely independent and nationalistic in their economic and foreign policies. This is most noticeable in the case of services, although a regional approach to the sector has the potential to produce hugely beneficial economic gains in the medium term vis-à-vis the growth and trade prospects in individual Asian countries.

While the proposition for creating a single market in services for the Asian countries as a region may seem premature given that the talks for a comprehensive East Asian free trade agreement (FTA) are still in the future, rapid market-led implementation of an integrated regional services sector merits consideration given the ongoing economic crisis. Stylised facts from past experience seem to indicate that services could easily become an additional engine of growth for the region. However, given the small size of most of the economies in the region, for this engine to generate the necessary efficiency gains, the major countries of the Asia-Pacific region (starting with the 16 players of the East Asia Summit [EAS]) will need to operate as a single market.

Dovetailing a strong services industry into the Asian integrated manufacturing economy will boost the efficiency of both sectors, as well as help the region to delink from its excessive dependence on the United States and European markets. Asia should look at a coordinated and cooperative model in developing services as the growth engine for the region and use the tertiary sector as a vehicle for a faster deleveraging of the region's disproportionate dependence on merchandise exports. A case is made for greater voluntary and market-led rather than institutionalised regionalism in services.

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Introduction

The world has been hurled into a new flux since late 2007 with the onset of the financial crisis. There are many causes for the current financial crisis, with roots in the global imbalance, in short-sightedness and excessive leverage at financial institutions, and basic failures in financial supervision and regulation. But like all financial crises, the insidiousness of the current crisis lies in the fact that it has morphed into a crisis of confidence and trust. In the globalised world that we are in, outcomes and manifestations of the 'law of unintended consequences' are magnified manyfold, often in sectors and countries that are apparently far removed from the epicentre. This also holds true for issues like confidence and trust, as has been reinforced by the present experience.

The experience of Asia in this crisis is an interesting case in point, given its geographical distance from the countries in the epicentre of the ongoing crisis, namely the United States and the United Kingdom. For many, the magnitude of the effect of the 2008 economic crisis on Asia was surprising as well as disproportionate, given the general soundness of their banking system this time around and the fact that their consumers and businesses are in fact net savers. Equally surprising has been the phenomenal bounce back effect of the nascent recovery. Asian economies seem to have gotten over the worst, as the better than expected April-May 2009 economic data from the region indicated; the resurgence of financial flows since the second week of March 2009 has helped the Asian share markets post more than 40 percent gains. However, a more realistic perspective could be that the larger Asian economies are high-beta markets, which has prompted the financial markets to respond favourably to the emergent 'green shoots' of recovery.

It is an undeniable fact that even in the aftermath of the devastating blow of the ongoing recession, Asia at large continues to be the 'arc of prosperity',[2] given that many of the world's largest and most dynamic economies belong to this region. It should therefore come as no surprise that the region has performed as well as it has in the ongoing crisis. However, one needs to remember that the March signs of revival are rapidly turning out to be little more than a technical inventory correction, and signify no substantive change in the underlying economic trend. Recent data indicates that the world economy is still contracting, though perhaps not quite as fast as at the start of the year, which has implications for the growth prospects of Asian economies. Complacency and continuing on the 'business-as-usual' mode therefore will prove disastrous, and remedial measures are required to be adopted with immediate effect; political strategies of waiting for a recovery to solve the problem and waiting for others to make the first move are unlikely to help either the countries in the region or its citizenry. What therefore, if any, should be the nature of policy intervention?

It is established that the Asian countries suffer from contagion effects of the economic and financial policies of the western industrialised countries, primarily because of their high dependence on these markets for domestic economic growth and development (the ill-famed export-led growth model). Furthermore, experience of the past few decades show that Asia has tended to recover from global crises led by a strong rebound of exports.[3] Recent analysis

[2] Sikri (2009), p. 12.

[3] This was the experience of both the Asian financial crisis of late 1990s and the information technology-bubble induced recession of early 2000. Details in Chapter 2, IMF Regional Economic Outlook for Asia and Pacific (2009). It should however be pertinent to note here that this is nothing new; the United States also reportedly 'exported' its way out of the 1930s Depression. Asia is therefore just the new kid in the game.

from the International Monetary Fund (IMF), however, indicates that this time around there is a limited likelihood of regeneration of the momentum for the demand of Asian exports. The adverse fallouts of the highly skewed and structurally-imbalanced growth strategy adopted in the recent past has prompted major shifts in the consumption behaviour of both states and individual consumers in the western industrialised economies, who are saving (and contrary to expectations otherwise by fund managers are likely to continue to save) increasingly larger proportions of their income in the coming years as compared to the pre-crisis scenario. As argued in the IMF report, much of Asia relies heavily on technologically sophisticated high-end manufacturing exports,[4] essentially high income-elasticity products, of which demand has collapsed. Hence with declining demand, the net exports' contribution to Asian gross domestic product (GDP) growth is likely to decline in the near future.

The most logical recommendation for solving the abovementioned situation therefore has been that the Asian economies need to increase their domestic and intra-regional consumption of goods and services, thus reorienting growth away from excessive dependence on extra-regional exports.[5] In fact, the notion of high intra-regional trade in Asia (intra-regional trade accounts for over 55 percent of total Asian trade) as a key source of regional growth appears a fallacy when corrected for intra-industry trade. In reality, a large fraction of trade within the region is intra-industry processing and assembly through vertically-integrated production chains of transnational manufacturing companies that use the region as a base for global supply. Thus given that final demand for products from the region rested largely in demand from western industrialised economies, any sustainable increase in domestic/regional consumption will necessarily require structural changes of the economies in the region that can support such major rebalancing.

So what can be a viable model of such economic restructuring? Notwithstanding the important role still to be played by deeper manufactured goods trade integration, the preferred regional integration instrument of choice for the Asian heads of state, and the proven merit of countercyclical fiscal policies,[6] which is a popular economic tool, this paper will argue that a closer integration of the service sectors in the Asian economies will help to generate a sustainable alternative growth engine that will not only help these economies come out of the ongoing recession quickly and more vigorously, but also act as a buffer in future crises and recessions. The arguments of this paper will address the concerns of and make projections based on the imperatives of the larger economies in East Asia and the Pacific, and the South Asian region. In other words, to begin with, we argue the case for a closer integration among

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4 In particular, automobiles and electronic consumer goods, and electrical and electronic capital machinery that go into manufacturing of the first two sectors. These sectors also tend to exhibit a stronger cyclical response, and heavy reliance on financing, all of which contributed to increasing susceptibility to the financial crisis and more rapid deleveraging following the onset of the crisis of confidence. Source: IMF (2009), Chapter 1, *op. cit.*

5 Almost all economists and western policymakers, analysts from all the multilateral agencies as well as consultants from private firms have inevitably recommended the need for Asia to rebalance its current account and reorient its demand pattern inwards. These voices were first heard in the aftermath of the Asian Financial crisis a decade ago, but have become much stronger since 2002-03.

6 The most popular countercyclical fiscal policy tool of choice for the neo-liberal Asian policymakers is increased investment in physical infrastructure, mostly in roads, rail, mass transit and maritime transport infrastructure. This was based on the natural additional advantage such investments accorded to a region dependent on trade in manufactured products. But the time has come perhaps to look at stimulating other kinds of infrastructure spending, namely in the services infrastructure industries.

the members of the EAS or the Association of Southeast Asian Nations (ASEAN)+6, comprising the ASEAN 10,[7] Japan, China, India, South Korea, Australia and New Zealand.

The paper will further argue that for the regional services market to operate on an efficient and competitive basis, the aforementioned pan-Asian market needs to be integrated into a single economic entity, as opposed to the present sub-regional integration processes which as smaller groupings can only be modest catalysts. A viable decoupling of the region from the developed west and minimising the disruptive effects of the necessary structural economic change would, therefore, depend on promoting domestic final consumption and institution of a self-generating and self-sustaining demand stream, which a boost of the regional services economy can provide with relative ease. Asia needs to start planning for its own future rather than hoping for the United States and European recoveries to pull it out of global downturn.

This paper analyses the limitations as well as opportunities in boosting domestic untraded services and enhancing the integration of tradable services sectors in the pan-Asian scenario through formal negotiations. The paper evaluates the impact of crisis on trade liberalisation in services for the Asian countries in the context of the region's service trade composition, and recommends a deep regional integration in select service sectors to begin with. The analysis is based in the context of the demand scenario in the Asia-Pacific region and a macro perspective of the growth and job creation potential of a single market in services in Asia. Finally, this paper argues that the EAS integration will work better and faster if it were to take place through a voluntary market-led process of cooperation and unilateral liberalisation rather than through formal trade negotiation institutions and mechanisms.

Services in the EAS Economies – GDP Composition and Composition of Trade[8]

The EAS economies under analysis currently account for a significant proportion of world trade, controls the bulk of global foreign exchange reserves[9] and host about half of the world's population, most of whom are in the prime of their economically-productive life. In 2007, the EAS member countries accounted for 3.3 billion of the 6.7 billion global population and about 4.1 billion people in the Asia-Pacific region, which is approximately 49 percent and over 80 percent of the total global and Asia-Pacific population respectively. In comparison, North America and Europe together hosted about 14 percent of global population in 2007. While this has implications for poverty and performance of other social indicators in the region as a whole, there are also potential gains to be maximised which we address later. The more relevant point from the perspective of present analysis is that of the total population in the Asia-Pacific, only about 40 percent are employed in service sectors in the region, though at around 72 percent the service industries in the four high-income

[7] The 10 member countries are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

[8] Data reported in this section is sourced from the United Nations Economic and Social Commission for Asia and the Pacific (UN ESCAP) Statistical Yearbook for Asia and the Pacific 2008, and the WTO Trade Profiles 2008. The employment figures are based on the International Labour Organization methodology. The details in Annex 1.

[9] The average foreign exchange reserve data for the EAS economies tend to mask the fact that even in April 2009 (after adjusting for the financial crisis induced readjustment/decimation of reserve holdings) large reserves were held by several countries in the region. China with US$1.98 trillion, Japan US$1 trillion, India US$251billion, South Korea US$212 billion, Singapore US$170 billion and Thailand US$120 billion were among those in the region with significant accumulated reserves. Source: IMF data on current international reserve holdings http://www.imf.org/external/np/sta/ir/8802.pdf and The World Factbook, CIA: https://www.cia.gov/library/publications/the-world-factbook/rankorder/2188rank.html.

countries in the group (namely Japan, Singapore, Australia and New Zealand) employ a much larger proportion of their combined population. There is thus huge untapped potential for service sector job creation in the region.

More significantly, the EAS countries together account for a considerable share of the global economy. In 2007, the real GDP of the EAS member countries was US$12.24 trillion (at current prices), which was 81.3 percent of the real GDP of the Asia-Pacific region and about 22.4 percent of the global real GDP in 2007.[10] It is also notable that the group's real GDP in 2007, growing at an average of 5.8 percent as compared to the world's real GDP growth rate of 3.8 percent, was nearly twice as high as in 1990 (when compared in 1990 constant prices), and the best performers have been the middle-income economies in the group whose income went up by more than 1.5 times the 1990 value. However, the contribution of services to real GDP in the EAS member countries is much lower at an average of 50 percent, though in the four high income countries in the group, services value added to GDP is around 70 percent. This implies that for most economies in the group, the potential for services to act as an important growth engine remains yet unrealised, as even in the economies known to be services-oriented, namely South Korea, India, Philippines and Thailand, the share of services to national GDP in 2007 was less than 55 percent. Furthermore, on average, in 2007, the rate of growth of the services sectors in the middle- and lower-income countries of the EAS was higher when compared to the high-income members in the 16-country group. All of the above further strengthens our proposition that services can be a potential growth engine for the region at large.

Lastly, some aggregate figures on international trade in services of the EAS members. The emergence of Asia as the third hub of world merchandise trade – after Europe and North America – followed a distinctive pattern over the past four decades. Following Japan's export success in the 1950s and 1960s, the four newly-industrialising economies of Hong Kong, Korea, Singapore and Taiwan began to enter export markets as Japan's industrial structure shifted away from labour-intensive goods to more sophisticated products, to be in turn succeeded by the other ASEAN majors in the 1980s and 1990s. The evolution of merchandise trade in the region shows that rapid export growth in developing Asia has been underpinned by export structures that have increasingly shifted away from primary commodities and toward manufactures. However, the commercial service trade in the region is yet to demonstrate any evolution, or follow in the footsteps of the flying-geese pattern observed in case-manufactured goods. This implies the following two situations: (a) the region's GDP and exports are still overwhelmingly dependent on the manufactured goods sector, and (b) while the region is moving onto becoming a largely middle-income to high-income group of countries, the structural transformation characteristic of high-income economies, namely a gradual and orchestrated shift away from industry to services is not evident. Though there exist country-specific specialisations which will determine the comparative advantages and thereby the export composition in the years to come, the general increasing thrust on services in the domestic economy (GDP composition and employment structures) and thereafter onto commensurate trade specialisation typical of countries with rising incomes is yet to be observed in the region.

[10] For the sake of comparison, it may be interesting to note that in the same accounting period, real GDP of the other heavy weight regions of the world, viz. North America and Europe were US$15.21 trillion and US$17.92 trillion respectively. The EAS countries, as a group, therefore, compare well with these two high-income regions.

Recent research at the National Bureau of Economic Research (NBER)[11] show that with rising per capita income, countries chose to specialise in different types of services, which in turn leads to the specificities of service sector growth in different economies as they develop. The first wave in service sector growth appears to be made up primarily of traditional services, and the second wave of modern (financial, communication, computer, technical, legal, advertising and business) services that are receptive to the application of information technologies and increasingly tradable across borders. In addition, the research finds that while there is evidence of the second wave occurring at lower income levels after 1990, this change in the second wave is not equally evident in all economies, which in turn points to the need for certain domestic political and economic initial conditions that can help countries capitalise on the opportunities afforded by an increasingly globalised post-industrial economy.

The NBER paper further finds that when one distinguishes groups of services according to whether their shares in GDP have (1) fallen, (2) risen slowly, or (3) risen rapidly over time, the second group comprises of a hybrid of traditional and modern services consumed mainly by households (education; health and social work; hotels and restaurants; and other community, social and personal services). However it is the third group that constitutes modern services consumed by both the household and corporate sectors (financial intermediation, computer services, business services, communication, and legal and technical services), which are also amenable to greater tradability than those in the second group. It is therefore conceivable that as incomes rise, economies would tend to shift domestic production and trade of services towards the second and more importantly the third group; the last being high income-elasticity services with a demand and/or the greater tradability that indicate(s) a higher capacity to export of participating firms.

The conundrum observed in the EAS countries is that this last shift is yet unobserved, other than in a very few countries. And even in the countries where the trend is observed, we find that the trade basket does not indicate transition to the third category of services. This is highlighted by the preponderance of transportation and travel services in the total commercial services exports of the EAS countries, irrespective of whether the countries are high-, middle- or low-income countries. For example, an analysis of the commercial service trade of even highly service-dependent economies like Singapore[12] indicate that the share of direct trade-related and transportation services accounted for approximately 53.45 percent of its global commercial exports in 2007, followed distantly by finance, insurance and business management (the key infrastructure that other commercial services needed for merchandise trade) with a share of 17.89 percent. The corresponding figures for the composition of Singapore's bilateral commercial services within ASEAN members are: 64.99 percent for trade-related and transportation services, as opposed to 17.57 percent for finance, insurance and business management. Singapore, therefore, appears to be overly dependent on trade- and transportation-related services in its total commercial trade composition, both vis-à-vis the

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11 Eichengreen and Gupta (2009).

12 Services constitute the most important part of Singaporean economy, contributing about 69.1 percent of value-added to Singaporean GDP in 2007. Singapore being an entrepot nation necessarily has a high trade intensity of GDP (with a trade-GDP ratio of 443.7, and external demand constituting over 81 percent of total demand growth), and also figures high up the trade and transport related service activities. Nevertheless, other commercial services accounted for 53 percent of the country's total exports in 2007. The key trading partners of Singapore in commercial services are Asia (50.2 percent), Europe (20.3 percent) and North America (15.3 percent). Collectively, in 2007, countries like the United States, the European Union (27 percent), ASEAN, Japan, China and Hong Kong constituted 64.4 percent of exports and 73.3 percent of imports.

rest of the world as well as with ASEAN partners.[13] Similar analysis can easily establish that this particular pattern of specialisation and composition of commercial service trade is uniform across the EAS countries. It should not come as a surprise that the current recession has so deeply affected the service sectors of the regional economies, given the high dependence of the region's service economies on transport and trade-related services. A quick overview of the composition of trade in commercial services by the EAS members can be seen in Annex 2.

Why Integrate the EAS Services Markets?

Having outlined the composition of GDP and service trade in the EAS economies and drawn some preliminary implications thereof, we come to the next question: will a regional integration of service sectors of the EAS members lend better traction against the fight with the recurring crises and recessions? Can the countries not pursue individual nationalistic policies to rebalance the composition of demand and trade and hope to circumvent the boom-bust cycles? This section will attempt to establish the rationale and need for operationalising a *de facto* single market in services in the region. The preview of our response to both queries, based on the GDP and population (potential final demand) data reported above, is that the economies of scale and complementarities of sectoral specialisation and demographic trends that the region will be able to offer as a whole will be lacking for most of the EAS economies (all other than China and India) should they decide to make the transition on their own. Even the viability and efficacy of rapidly reorienting growth and consumption patterns to services through sub-regional integration processes is limited, for the catalyst effects of smaller groupings are naturally modest. Of course, the argument here pertains to how much intra-regional consumption demand can be generated and whether that demand is sufficient to generate economies of scale and optimise operational efficiency.

For example, ASEAN countries account for only 17.5 percent of the group's population and only 10 percent of the GDP. Without the demand from the rising middle class[14] in the more populous parts of the group in addition to the richer consumers, the services market will operate only at less than efficient levels. The catalyst effect of the South Asian Free Trade Area or the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation is expected to be even more modest than that of ASEAN. The rich complementarity of the intra-sectoral specialisation in the different members of a larger economic bloc can provide a unique opportunity to explore the complete range of services potentially demanded in both the tradable and non-tradable sectors, and for the different consumer classes, thereby making EAS a more viable proposition. For example, cooperation among healthcare providers in the different EAS member countries could efficiently and profitably cater to the different economic classes of consumers in each country (as there exists a consumer-class based demand and preference for different types/qualities of products and services), which would not be viable should the region be split into sub-regions or if countries decide to go alone. Trade and domestic consumer demand would increase regionally, as well as provide opportunities of greater synergies for extra-regional trade in commercial services. Welfare gains are expected from both the price and quality of the services provided, as in the case of goods.

[13] Details in Karmakar and Gopalan (2009, forthcoming).
[14] Ablett, Jonathan et al (2007).

Services market integration would need to foster a closer alignment of the different regulatory standards in the member countries, which in absence of tariffs are *de facto* trade barriers in services. It is a well documented fact that trade barriers among and between Asian countries are still very high, and member countries vary widely in their regulatory processes and requirements. The remarkable growth of developing Asia in recent decades owes much to the market-led expansion of its international trade, including intra-regional trade. However, to continue to capitalise on the benefits of international trade, more vigorous cooperative efforts are needed in the region to lower transaction costs of international (and especially intra-regional) services trade and thereby contribute to greater growth, integration, and poverty alleviation. Clearly, Asia's trade expansion has been facilitated and stimulated by the development of supporting infrastructure, both physical and institutional.[15] But a closer regional regulatory cooperation can further promote Asian economic convergence. In particular in services, the region needs to move away from its narrow band of service specialisation discussed in the earlier section and trade therein. Concerted efforts need to be made by policy makers to restructure and reorient the production and consumption to the wider range of the third group of high-income-elasticity and highly trade-intensive modern services consumed by both the household and corporate sectors.

While the relative demerits of a narrow band of product specialisation has been empirically verified and established for merchandise trade, it is not a surprising find that even in services, the same story holds. Preliminary analysis and stylised facts on the evolution of the region's service sectors indicate that the sectors that are relatively more open are those related to international trade and production, namely finance, trade-related and transportation services, which have been affected by the financial crisis, which was at the root of the current recession. But even in these sectors, a closer analysis of the national policies and regulations indicate that integration among the region's different service sectors has hardly begun and countries continue to operate from highly differentiated national regulatory silos. Regressions run on the gravity equation[16] for services trade (of the Organisation for Economic Co-operation and Development [OECD] member countries' trade with both OECD and non-OECD countries) indicate that membership of regional agreements has a significant impact on services trade,[17] presumably because the services agreements tend to promote mutual recognition of regulations and business practices between the negotiating countries which contribute to greater alignment of national policies, which in turn is critical for increased service flows.

Services constitute a large share of GDP in most economies in the region, with a share of over 50 percent in almost all countries and going beyond 75 percent in the developed Asian

15 Brooks et al (2005), Brooks (2008): The results demonstrate that regional integration is the way forward for rapid and sustainable economic growth in Asia. By differentiating its traditional trade patterns toward growing demand within itself, developing Asia can leverage superior domestic growth rates, accelerate economic diversification, and broaden the basis for regional development. Integration will not only secure a more reliable basis for continuing established growth patterns, it will also confer substantially greater opportunities on many of the region's poorest economies. In this way, rapid growth can be sustained while greater convergence is achieved in the region.

16 Gravity models represent a relevant benchmark, given their high explanatory power and wide use in the empirical literature on trade. They relate trade flows between countries to a set of fundamentals, including GDP, distance and participation in a free trade area, as well as dummy variables for countries sharing a common language, a common border or a common history. Most studies conducted so far on the limited available data in services indicate that the gravity equation performs better with international trade in services than with trade in goods.

17 Kimura and Lee (2006). The study also concludes that even in cases where the regional agreements do not have an explicit service component they facilitate trade of services incidental to trade in goods.

countries like Japan, Singapore, Hong Kong and South Korea. However, most economies have erected regulatory barriers and restricted the integration of service sectors with their neighbours. Even when investment, goods and tourist flows contiguously within the region, countries have been hesitant to promote the economic integration of services. Even ASEAN, with a mandate for a single goods market and free movement of nationals (though initially for tourism purposes only), expects a single market in services to be operational only after 2015. This reticence is understandable. Given their historical colonial experiences and recent attainment of independence, most Asian economies, unlike the European countries, are fiercely independent and nationalistic in their economic and foreign policies. However, the existing isolation does also imply that there is much to gain from the cooperation and establishment of a regional recognition system for national regulatory policies and institutional accreditation in key service sectors.

The import of these findings on the proposed single EAS services market is that members need to focus more on a closer alignment of the regulatory requirements in individual countries if they are to benefit from the integration; simply trading market access concessions are unlikely to integrate services regionally, given that the quality of services provided is primarily a function of the regulations determining the technical standard of the service provided, along with the qualification and credibility of the service provider. Studies have shown that growth potential in both traded and untraded services are seriously hindered by the existence of multiple and discriminatory regulations and requirements for the provision of services, domestic as well as tradable. A single market in key services with harmonised and mutually recognised regulatory standards and requirements will go a long way in promoting both domestic consumption and intra-regional trade in commercial services.

A Way Forward

Having argued the need for establishing a single EAS service market, let us now explore the regionalisation modality which is likely to be most suited to the Asian sensibilities and address their specific concerns. It is imperative that an efficient mobilisation of the EAS services engine calls for the exploitation of region-wide synergies of service specialisation which is able to optimise the potential benefits arising out of the demographic dividend (both in the relative youth of the working age population and the rising consumer demand from an ever-growing middle class, and the richer sections of society) that the region stands to gain only when the EAS countries come together. South-south trade in services is rapidly gaining in significance. The EAS region however has the unique characteristic of exploiting both south-south and north-south trade potential within itself. Furthermore, the seamless market that EAS service sector integration will provide to the businesses operating in the region will not only benefit the domestic businessmen and consumers, but also encourage vertical integration in the service industries and encourage relocation of more transnational service firms. This in turn has the potential to benefit the region much more than the gains the region has shared in the last century because of the relocation and vertical integration of the transnational manufacturing firms.

In view of the ongoing recession and the specific challenges the region faces this time around, looking at services as an alternate source of consumer demand and an avenue to channel government spending to boost future productivity of the economy does make for a strong case. The fiscal stimulus and government expenditure in the region needs to move away from its almost-exclusive focus on the creation of physical infrastructure to increased spending on boosting social infrastructure (viz. health and education sectors) and in restructuring and reorienting economic focus through investments in infrastructure services like finance, information and communication technologies (information technology and telecommunications) and business services, as well as on sustainable energy, pollution control, and water and sanitation projects. Asia, in other words, needs to stimulate other kinds of spending on soft infrastructure development.[18] All these together will over time help create the initial conditions, which in turn will incentivise greater private consumer spending within the region. However, the EAS countries need to move rapidly with unilateral liberalisation of their service sectors and agree mutually to align their domestic regulatory policies governing the supply of services. In the event that harmonisation is difficult to attain, mutual agreement to cooperate, recognise and accredit regulations and operational requirements of partner countries will help in creating the desired seamless services market discussed previously.

So how is this services regionalism to be attempted? Should the EAS members work to recreate a European Union-style blueprint of legal and charter-based treaties to institutionalise the regional integration attempt, as recommended in a Report on East Asian FTAs in Services by a team of researchers[19] commissioned by the Regional Economic Policy Support Facility (one of the components of the ASEAN-Australia Development Cooperation Program)? In the view of this analysis, however, Asian countries may feel uncomfortable with the European Union-style of regional integration through institutionalisation, and therefore be reluctant to commit and accede to legally enforceable bindings on implementation and timelines. Recent experience in the European Union has shown that while the big idea of regional cooperation continues to have traction, the European Union's current top-down bureaucratic approach is clearly losing support from its members, especially as European Union regionalism increases its remit from economic and monetary union to the development of common regulatory standards.

It is undeniable that regionalism has progressed much further in Europe than Asia. But the contextualisation of the above is needed, as is the attention to timelines. First, the moves for regional cooperation in Europe started almost after the Second World War, and the first seed of the European Union was sown in 1957 with the formation of the European Economic Community. In contrast, Asian regionalism began only in the 1960s, with the formation of the ASEAN by Indonesia, Malaysia, the Philippines, Singapore, and Thailand to promote political cooperation to combat terrorism and regional stability, which was formalised in the ASEAN Declaration a decade later in 1976. Hence, a couple of decades of lag in the degree of integration of the two regional groups are perhaps justifiable or explicable.

But second and the more important fact remains in that European regionalism was a response to the willingness of the war-devastated European economies to integrate economically to build and bind their economies and societies together. They realised that by pooling their sovereignty with their neighbours in certain areas they could achieve more than by acting alone. By drafting common rules, promoting close coordination among national authorities, and developing strong regional institutions that advance economic integration, the European Union has generated huge economic gains and sharply narrowed the income gap among

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[18] Asian countries have traditionally focused on physical infrastructure development as a counter-cyclical policy, and the thrust continues even in the ongoing recession. For example, about 72 percent of China's massive US$586 billion stimulus programme undertaken to counter the negative impact of the ongoing recession is devoted to infrastructure (at the national level). If we add the local and municipal stimulus programmes this and the bank lending programmes encouraged, the share goes up further.

[19] Trewin et al (2008).

member countries.[20] In other words, regional cooperation in Europe is extensive in scope and intensive in formal institutions and legal norms. Europe is also a more cohesive region in terms of having a common culture and societal practices.

ASEAN, on the other hand, was formed in response to an external threat in the form of communism and socialism that emanated from post-cultural revolution China, which the smaller south-east Asian economies hoped to combat through an agreement of security cooperation. Economic integration was certainly not the prime mover, unlike in the case of the European Union. Furthermore, disparities in economic development, social structures, political systems and the extant cultural diversity in Asia needed to be accommodated together with the need to retain sovereignty, a legacy of the past colonial experiences of all the countries in the region.[21] The result was the adoption of a model of consensual decision-making, driven more by markets and the development of increasingly sophisticated production networks than governments. Cooperation among national authorities is more recent and less intimate. It remains focused on economic issues (with some social components) and is light on formal institutions. Asia's pragmatic and flexible approach to regionalism is therefore partly dictated by history. The catalyst for the recent enhancement of regional cooperation in Asia was the 1997-98 financial crisis. Asia does not yet have a single market in goods and services, but though slow, Asia's regionalism remains outward-oriented and focused on supporting market relationships rather than supplanting them, and on sustaining its openness to global markets.

It is, therefore, unlikely that even if the EAS economies are convinced about the relevance and merits of a single regional market in services, integration would work better on a platform of institutionalisation which creates legally-binding norms. The EAS members are therefore more likely to continue with tested practices and regional integration mechanisms of incremental and market-led integration of service networks in Asia, wherein the promotion of policy coherence and mutual recognition in key services could be attained through the mutual cooperation of authorities convinced of the benefits of integration but without the legal and institution-based strictures of European Union-style policy harmonisation.

Economists argue that market liberalisation experiences under the many East Asian FTAs are weak and inconsequential. Analysis of the individual service sector commitments in the Asian FTAs and regional groupings highlight the lack of any significant World Trade Organization (WTO)-General Agreement on Trade in Services (GATS)-plus liberalisation measures. Mostly, regional commitments on services have better commitments than WTO in Mode 4, but not dramatically so, while Mode 1 commitments generally do not reflect the increased technical feasibility that have come into play in the years since the signing of GATS. However, there exist examples of unilateral liberalisation in regional services agreements; economic benefits are seen to come mainly from the removal of non-discriminatory market access which involves little reciprocity.[22] In short, negotiations appear to have proved ineffective in promoting services liberalisation in the Asian region when compared to actions taken unilaterally as part of market-led compulsion. Integration by fiat is unlikely to result in any meaningful service sector liberalisation in Asia, as is also experienced in the European Union.

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20 Capannelli (2009), Okagaki (2009).

21 "Regionalism in so far as it relies on sovereign parts to cohere (as experienced in the European Union) is not likely to prove acceptable in Asia, as increased cooperation is, since decolonisation and nation-building is still within the recent historical memory of the region": Capannelli (2009), *op. cit.*

22 Fink and Milinuevo (2007), Trewin et al (2008), *op. cit.*

Hence, the EAS single market in services stands a better chance of becoming a reality if members recognise the benefits and work together towards voluntary and unilateral actions aimed at realising the economic benefits that such unification promises. Thus, the case for the EAS single market in services for policymakers, paraphrasing Paul Krugman, remains essentially unilateral, based on mutual cooperation and in recognition of each country's long-term comparative advantages, through an articulated regional division of services labour. The Asian financial crisis led the region to cooperate on creating a regional financial institution and monetary fund in the form of the Chiang Mai Initiative. It is hoped that the current crisis will acknowledge the role of services in boosting domestic/regional consumption and thereby its importance as a counter-cyclical growth policy tool, as well as encourage the regional economies to initiate the process of integrating their domestic service sectors into a single services market.

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Annex 1

Table 1: Economic Factsheet of the EAS Members: Selected Indicators for 2007

	Population (million)	GDP (Billion US$ current)	GDP, per capita (at 1990 US$)	Services Value Added (% of Total VA)	Services (% of total employment)*	Foreign Exchange Reserves, (Billion US$ current)**
Australia	20.74	945.67	27663	69.3	75.2	37.31
Brunei	0.39	12.39	12716	28.1	77.2	..
Cambodia	14.44	8.64	358	41.3	19.1	..
China	1328.63	3400.35	1602	39.1	20.7	1946.00
India	1169.02	1141.35	792	54.1	20.3	251.70
Indonesia	231.63	432.82	1160	40.4	38.0	56.57
Japan	127.97	4379.62	29793	69.5	67.2	1011.47
South Korea	48.22	956.79	13593	56.3	65.2	212.48
Lao, PDR	5.86	4.16	432	25.7	11.1	..
Malaysia	26.57	186.72	4847	43.2	55.1	87.73
Myanmar	48.80	18.51	457	34.9	25.1	..
New Zealand	4.18	130.45	17612	69.9	70.8	10.91
Philippines	87.96	144.13	958	54.6	48.1	39.32
Singapore	4.44	161.35	25023	69.1	76.4	170.10
Thailand	63.88	245.35	2916	44.7	37.1	116.83
Vietnam	87.37	71.17	259	38.0	24.7	..
World	6671.23	54635.98	5396	63.0	..	7471.09

Source: UN ESCAP Statistical Yearbook for Asia and the Pacific 2008

Note: * Services Employment data is not the 2007 share; reflects the latest country reported ratios

** IMF Data on International Reserves, Official Reserve Assets on April 2009

Annex 2

Table 2: Commercial Service Trade Profiles of the EAS countries: 2007 (US$ Billion)

				Breakdown by Principal Services Exports (%)			Breakdown by Principal Services Imports (%)		
	Exports	Imports	Net Trade Balance	Transportation	Travel	Other Commercial Services	Transportation	Travel	Other Commercial Services
Australia	39.74	38.19	1.55	18.2	56.2	25.6	34.3	37.3	28.4
Brunei	0.74	1.03	-0.29	51.2	30.1	18.7	35.6	39.5	24.9
Cambodia	1.51	0.86	0.65	13.9	75.1	11.0	59.4	14.3	26.3
China	121.66	129.25	-7.59	25.7	30.6	43.6	33.5	23.0	43.5
India	89.75	77.20	12.55	9.8	12.4	77.8	40.3	11.4	48.3
Indonesia	5.14	17.17	-12.03	16.6	78.5	4.9	28.1	18.0	54.0
Japan	127.06	148.69	-21.63	33.1	7.4	59.6	33.0	17.8	49.2
South Korea	61.54	82.52	-20.98	54.9	9.4	35.7	36.2	25.3	38.5
Lao, PDR	0.22	0.17	0.05	16.3	72.5	11.2	69.7	11.3	19.0
Malaysia	28.18	27.78	0.40	25.0	45.8	29.2	39.5	18.9	41.6
New Zealand	9.19	8.95	0.24	21.7	59.0	19.3	33.0	34.3	32.8
Philippines	7.86	7.25	0.61	9.3	62.7	27.9	52.7	22.3	25.1
Singapore	67.33	70.11	-2.78	34.3	12.6	53.0	36.9	16.0	47.2
Thailand	28.77	38.02	-9.25	21.1	54.1	24.8	47.2	13.8	39.1
Vietnam	6.03	6.92	-0.89	..	..	..	..	..	..

Source: WTO Trade Profiles, 2008