

# **Regional Integration**

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Trade Creation – Through common external tariff but zero internal tariff trade is created within the regionally integrated economy

Trade Diversion – Trade gets diverted from the most efficient producers, which may violate the basic principle of Comparative Advantage

So this has short term gains versus long term efficiency issues

There are stages of regional integration

# Stages of economic integration

	Free intra-schem trade	Common commercial policy	Free factor mobility	Common monetary and fiscal policy
FTA				
CU				
CM				
EcU				
	YES			
	NO			

# South Asian integration

- South Asia is one of the least economically integrated regions
- Most efforts for economic integration in this region is done through bilateral as well as multilateral agreements like SAFTA or Bilateral FTA like India-Sri Lanka FTA or Pakistan Sri-Lanka FTA
- Unfortunately, little effort is done to try integration through markets which creates true economic inter-dependence, which is the cornerstone of ASEAN

Reporter	Partner	Indicator	2000	2005	2010	2014	Source
ASEAN+3	ASEAN+3	Cumulative FDI Share (%)	18.86292	20.13545	18.48861	18.48861	UNCTAD FDI database
ASEAN+3	ASEAN+3	Intra-regional Trade Share (%)	45.01213	47.38246	46.54453	45.46476	IMF Directions of Trade Statistics
ASEAN+3	ASEAN+3	Total Trade Growth (%)	26.40558	14.12496	31.41399	1.109864	IMF Directions of Trade Statistics
BIMSTEC	BIMSTEC	Intra-regional Trade Share (%)	3.769406	4.743707	4.66953	5.730814	IMF Directions of Trade Statistics
BIMSTEC	BIMSTEC	Total Trade Growth (%)	28.88104	24.38571	31.16478	13.53064	IMF Directions of Trade Statistics
SAARC	SAARC	Cumulative FDI Share (%)	0.09665	0.14582	0.098415	0.098415	UNCTAD FDI database
SAARC	SAARC	Intra-regional Trade Share (%)	4.411329	5.46038	4.54854	5.310792	IMF Directions of Trade Statistics
SAARC	SAARC	Total Trade Growth (%)	21.44021	30.69118	41.34384	19.52741	IMF Directions of Trade Statistics

# Intra-regional investment flows in SAARC

	India 2006-07	Bangladesh 2005-06	Pakistan 2006-08	Nepal 2006-07	Sri Lanka 2005
Share of South Asia (%)	0.023	2.82	0.102	46.6	7.0

Source: Aradhana Agarwal, 2008, Regional Economic Integration and FDI in South Asia: Prospects and Problem. New Delhi, ICRIER, WP 218.

# Intra-regional investment in ASEAN

	Malaysia 1995-2003	Thailand 1995-2003	Singapore 1995-2003	Vietnam 1995-2003
Share of ASEAN countries (%)	25.1	20.9	23.6	9.7

Source: D. Hiratsuka, 2006, Outward FDI and Inter Regional FDI in ASEAN: Trends and Drivers. Tokyo, Institute of Developing Economies, DP 77

# Nature of ASEAN +3 intra-regional trade

- Intra -regional Exports of Parts and Components of ASEAN+3 countries touched 59.3 % in 2005. Thus there was stress on Intermediate goods trade intra regionally.
- Aminian, Fung and Ng (2008) showed that RCA reveals that ASEAN+3 have transcended to more export oriented 'Processing' stage compared to import based 'Assembling' stage.
- This has helped MNCs as well as smaller sized Local companies in this region to fragment their production process
- This vertical specialisation across borders developed for economic needs. Thus this market driven integration preceded the rather slow moving and complicated agreement formulation stages.
- [Regional Integration Indices.xlsx](#)



# **Multinational enterprises (MNCs) and foreign direct investment (FDI)**

- MNCs are enterprises that operates from several countries.
- FDI is building plants or production facilities in foreign countries
- The link between MNCs and FDI arises due to the fact the MNCs have high intangible assets, especially in terms of knowledge of a production process, including industrial organisation

# Horizontal multinational

- ✓ These are MNCs which chooses to locate their production facilities across different countries
- ✓ Research has shown that MNCs have horizontal FDI when the following conditions are met (Feenstra, 2006, p.389):
  - Transport costs of exporting goods are high
  - Setting up costs of plants in a foreign country is low
  - GDPs are high or more similar across countries

The above are quite intuitive. The last condition makes the market size large. This is a reason why most FDIs flow among developed economies if one leaves outlier like China

- ✓ Additional reasons may be agglomeration effects and
- ✓ Strong Intellectual Property regimes

# Vertical multinationals

These are MNCs which have headquarter in one country but fragments production by outsourcing components across different countries. Vertical MNCs will have FDI according to the following conditions:

- ✓ There should be sufficient difference in factor prices so as to locate some component production in a foreign country
- ✓ The production is carried out by foreign affiliates of the original MNC
- ✓ The presence of such FDI may help bring the intangible assets of the MNCs to the country where components are manufactured
- ✓ This may also lead to higher trade between the countries involved through intra-firm trade.

# Outsourcing by MNCs to Non-affiliates

## Outsourcing by MNCs to Non-affiliates

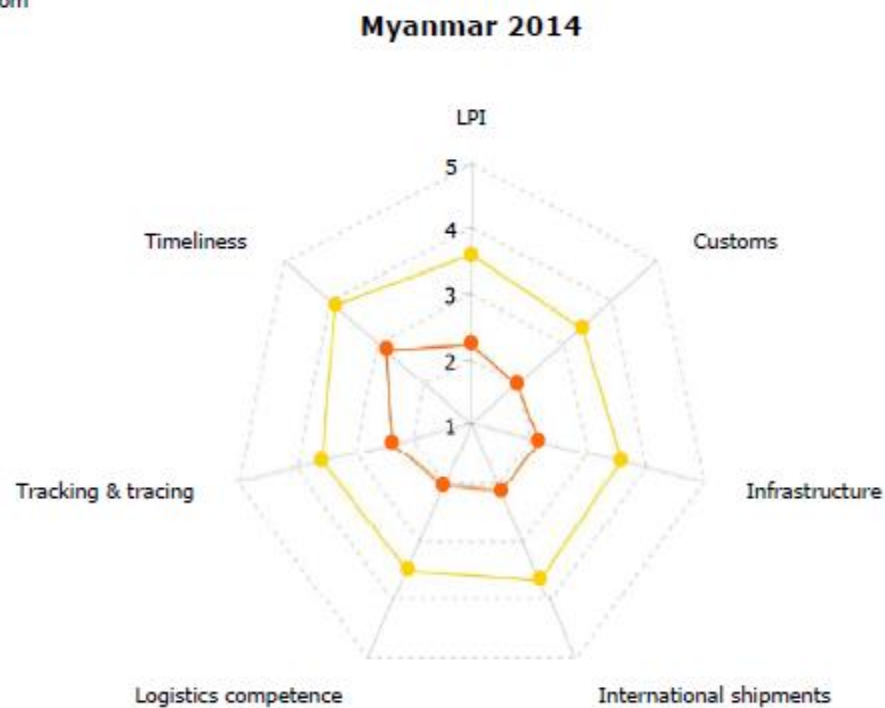
This phenomenon has gained ground from the last decade of the last century giving rise to

- ✓ Increased FDI by MNCs through component production by low wage cost non-affiliates
- ✓ Increase in services trade whereby many developing countries took advantage of advancement of technology by which services could be fragmented from the manufacturing process and outsourced by MNCs based in developed countries to developing countries.

“Infrastructure investment facilitates regional economic integration through trade and investment expansion, it motivates regional cooperation, including cooperation in infrastructure development, generating a virtuous cycle. The diversity of Asian economies, combined with infrastructure expansion and improvement to lower trade costs, has helped the region to benefit as a leader in global patterns of production fragmentation, expanding intraregional trade, and diversification of development opportunities. (Brooks, ADBI Working Paper no 123, 2008)”

“Factors like high freight costs, delays in customs clearance, unofficial payment solicitations, slow port loading or landing and handling, and poor governance create barriers to trade. Institutional bottlenecks (administrative, legal, financial, regulatory, and other logistics infrastructure), information asymmetries, and discretionary powers that give rise to rent seeking activities by government officials at various steps of trade transactions also impose costs. These costs can be lowered through cooperation that facilitates merchandise and services trade logistics, for both inbound and outbound shipments. (Brooks, ibid)

chart by amcharts.com

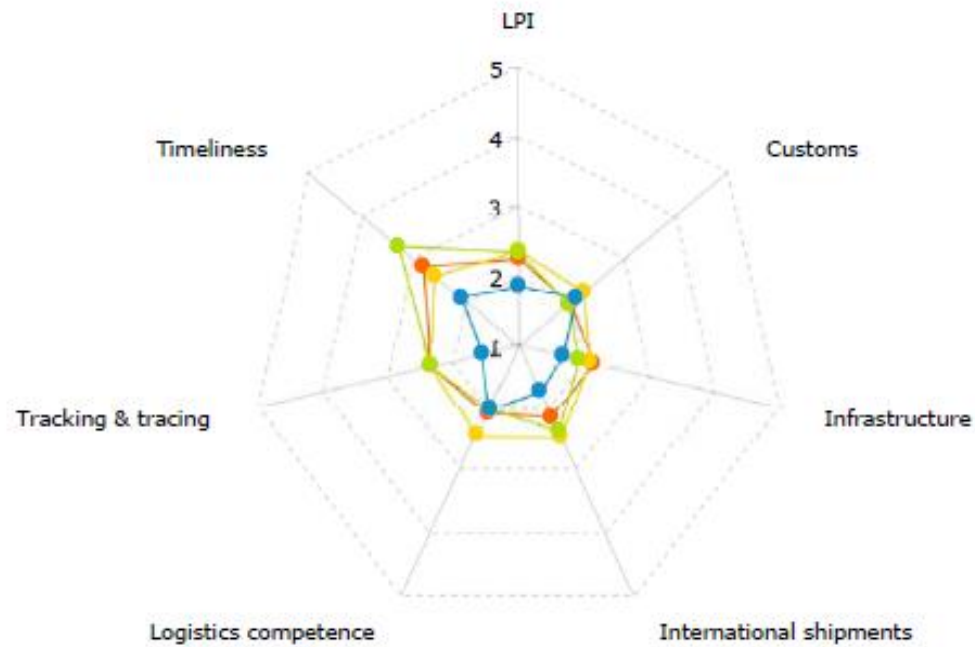


Note: Comparison with best performer Malaysia in 2014

Source: ARIC database, ADB

chart by amcharts.com

### Myanmar 2014



Note: Red=2014, Yellow=2012, Green=2010, Blue=2007

Source: ARIC data base, ADB

### Vertical Specialization in Asia

	Millions of 2000\$			Percentage of Total Exports				
	1990	1995	2000	1975	1985	1990	1995	2000
CHN	966	5,373	13,932		2.2	4.3	7.2	9.5
IND	584	1,583	2,873	1.4	1.9	3.0	4.9	6.9
JPN	5,742	11,451	14,939	3.8	4.1	3.6	4.1	5.1
KOR	5,710	11,819	19,673	20.6	18.5	16.1	17.6	19.8
MYS	2,906	11,303	25,606	7.2	12.7	15.1	23.5	37.2
TWN	7,938	14,420	24,368		15.5	19.7	25.0	26.4
PHI	990	2,623	7,687	4.3	10.4	15.7	18.8	30.6
SIN	8,281	19,354	17,811	20.9	36.1	35.8	42.6	35.5
THA	2,326	7,690	10,815	3.0	8.2	19.0	24.4	26.5
USA	2,107	6,431	7,438	0.9	1.7	2.1	3.8	4.3

Vertical specialization (VS). The dollar (or %) content of exports comprised of imported inputs

Equals (Share of Imported Inputs in Gross Output) \* Value of Exports

Source: Yoko Uchida, "Trade Growth and Vertical Specialization in East Asia"



# **Outsourcing and Growth of Services Trade**

All over the world, the manufacturing sector has been outsourcing or sub-contracting the service activities to specialised producers instead of carrying out these activities within their in-house production system. In international trade literature, when such sub-contracting crosses national boundaries, it is widely called 'fragmentation' or 'outsourcing'

- Most of these services are needed in the production of some manufacturing activities, where these trade services can be transportation, insurance, banking, finance, accounting and so on.
- Similarly, when services are used as direct inputs in the production function, trade liberalisation helps the developing countries since they overcome the small market size disadvantage and strengthen their low wage costs advantages
- Most of the developing countries have comparative advantage in (low-skilled) labour intensive services (construction services) and (in some cases) natural-endowment-intensive services (transportation, travel services) which is consistent with trade theories

- Developing countries successfully export a variety of services but only a relatively limited number of developing countries seem to be heavily involved in services exports trade across a range of sectors, This concentration of service exports on limited number of services may create volatility in such export values
- It is further observed that African countries, except South Africa, do not have successful record of services exports. This may be due to lack of proper infrastructure like tele-communications as well as lack of good governance.

### Countries with Revealed Comparative Advantage

Category of Services	Sector	Countries with RCA>1
Labour and resource intensive	Transport	Argentina, China Hong Kong, Egypt, India, Korea, Kuwait, Romania, Russia, Singapore, Thailand, Turkey, Ukraine
Labour and resource intensive	Travel	Argentina, China Mainland, Egypt, India, Malaysia, Mexico, Philippines, South Africa, Thailand, Turkey
Labour intensive	Construction	China Mainland, Egypt, Malaysia Romania, Russia, Thailand, Turkey, Ukraine
Skill and technology intensive	Communications	Argentina, Brazil, Egypt, India, Indonesia, Philippines, Romania, Turkey, Ukraine
Skill and technology intensive	Computer and information services	Argentina, India, Romania
Skill and technology intensive	Financial services	China Hong Kong, India, Singapore
Miscellaneous	Personal, cultural and recreational services	Argentina, Egypt, Mexico, Romania, Turkey

Source: Raychaudhuri and De (2012)

# Economic geography and location

- Centripetal forces like availability of large variety of intermediate inputs, skilled labour force and large market size promote agglomeration
- Centrifugal forces act against this- for example congestion as well as trade barriers
- The relative strengths of the two determine geographical locations.
- Sometime it leads to core-periphery models if transporting manufacturing goods is high

**Thank you**