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Promoting Domestic Reforms through Regionalism

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Abstract

There is a strong presumption among economists that domestic reforms are promoted by regionalism. Yet strong empirical evidence for this proposition is lacking. This paper examines both the theoretical arguments and empirical evidence on this issue, drawing on the relevant economic, political, and legal literature. The authors argue that in general, the case for reciprocity in domestic reforms is weak. In the one case where a regional agreement appears to have promoted domestic reform—the European Union (EU)—the enforcement mechanisms used by the European Court of Justice played a significant role. But those mechanisms are not unique. Instead, the authors argue that the EU's success was because domestic constituents were empowered to take action against uncompetitive regulation. Thus the EU promoted economic reform in sensitive, behind-the-border areas because it overcame the problem of loss of sovereignty by internalizing the political battle to domestic interests, and yet still provided a non-political frame of reference for the debate.

JEL Classification: D02, D04, D78, F13, F15, F53, F55

Contents

1. INTRODUCTION

"This presumption [that international trade is the main vehicle for transmitting reforms and increasing economic freedom] is so ingrained, for economists in particular, that it is hard to know its precise historical origin." (Gassebner, Gaston, and Lamla 2008: 1)
"To date, the available, limited, evidence suggests that, with the exception of the European Union, most services policy reform has been unilateral." (Francois and Hoekman 2010: 678)

As the first quotation above illustrates, there is a strong presumption among economists that trade and economic reform are linked. One particular corollary is that domestic reforms are promoted by regionalism, because regionalism promotes trade. Yet the second quotation above suggests that strong empirical evidence for the second proposition is lacking. This paper examines both the theoretical arguments and empirical evidence on this issue, drawing on the relevant economic, political, and legal literature. It concludes with some proposals on how to use regional institutions to better support domestic reform efforts.

The proposition that domestic reform might be promoted through regionalism can be either a tautology or an impossibility, depending on how the terms are defined. This paper takes a broad definition of domestic reform, one that is independent of some notions of market integration. Domestic reform, defined as behind-the-border reform, comprises two key elements:

- contestability—where market competition determines economic outcomes in all circumstances where competition is appropriate; and
- appropriate regulation—where well-designed regulation guides market outcomes in those cases where market forces alone cannot be guaranteed to deliver the best outcomes.

Appropriate regulation is required in cases of market failure, where "natural" monopoly, asymmetric information, and/or externalities prevent markets from delivering efficient outcomes. Appropriate regulation may also be required where governments have additional objectives besides efficiency, such as equity, safety, and diversity.

Contestability requires that market participants not be able to manipulate the terms of entry into, or operation within, markets to their own advantage by restricting competition. This is the role of competition policy, narrowly defined—to prevent anti-competitive practices by the private sector. But in the Asian region, anti-competitive government practices are arguably a much more important impediment to the efficient operation of markets. Thus the objective of domestic reform should be two-fold (Dee 2010):

- to remove government legislation, regulation, and bureaucratic practice that restricts competition for no good public purpose; and
- to ensure that where government intervention is required to safeguard legitimate objectives (including, but by no means limited to, preventing anti-competitive practices by the private sector), the intervention is no more burdensome than necessary to achieve those objectives.

This paper also needs a definition of regionalism. It takes an equally broad definition of this concept—closer regional interaction. In the economic sphere, this closer interaction can be market-driven or institution-driven. Over the last three decades of the 20th century, Asian economic interaction was primarily market-driven. In the first decade of the 21st century, trade agreements have begun to have sufficient "bite" to promote institution-driven economic interaction (Baldwin 2006). But trade agreements are not the only institutions that promote closer regional

interaction. There is an alpha-numeric soup of institutional arrangements—including the Association of Southeast Asian Nations (ASEAN), ASEAN+3, ASEAN+6,[1] the East Asian Summit (EAS), the ASEAN Regional Forum (ARF), and Asia-Pacific Economic Cooperation (APEC)—that are designed to promote closer interaction, not just for economic but also for political and security purposes.

So the question implicit in the title of this paper has two possible interpretations. The first is whether market-led regionalism creates sufficient dynamics to promote domestic reform, without the assistance of regional institutions. However, in very open economies it may be difficult in practice to distinguish unilateral reform that has been spurred by market-led regionalism from that spurred by other factors (such as purely domestic competitive factors). So this interpretation of the question borders on the tautological. The second interpretation is whether any of the current raft of regional institutions can further promote domestic reform. This paper concentrates on the second interpretation—whether domestic reform is better promoted by regional institutions, rather than unilaterally by market factors (including market-led regionalism).

The next section examines the theoretical arguments on why formal regional agreements might usefully promote reform. The arguments are both political and economic. All have been used at various times to argue that formal regional agreements help to promote trade reform at the border. Some of these arguments extend to reforms behind the border.

The following section examines the empirical evidence, including case studies and econometric evidence from the economic, political, and legal literature. Some evidence is circumstantial—looking at what has happened in countries that have entered regional arrangements—and some is more direct—looking in detail at the commitments made in regional agreements. The empirical evidence tends to support the finding in the second quotation above—that few regional arrangements other than the European Union (EU) have successfully promoted domestic reform.

The paper next examines the reasons for these findings. Various writers have offered a range of reasons why non-EU trade agreements have not promoted domestic reform. This paper also examines the political and legal literature for the fundamental reasons why the EU has succeeded. Contrary to some popular conceptions, the key is not, or not solely, the existence of a supranational institutional framework. This is fortunate, since is it widely agreed that the Asian region has no taste for such a framework. But other elements of the recipe for success are transferrable. The final section of this paper therefore makes suggestions for how Asian regional institutions could internalize some of these lessons on how to promote domestic reform.

2. THEORETICAL ARGUMENTS

2.1 Political economy arguments

One central reason from the political economy literature as to why trade agreements can promote domestic reform is that a binding external mechanism helps to overcome the time-inconsistency problem formalized by Kydland and Prescott (1977). This problem is the inability of political institutions to bind themselves for future periods given that they are exposed to the strategic behavior of private agents (for example, electoral bribes and lobbying by vested interests). So what governments say now that they will do may not be what they actually do in the future—they cannot make credible commitments. In these circumstances, governments may agree ex ante to

[1] ASEAN+3 comprises ASEAN plus the People's Republic of China, Japan, and the Republic of Korea. ASEAN+6 includes all of these plus Australia, India, and New Zealand.

restrict their powers in the public interest. This explains why governments agree, for example, to delegate monetary policy to independent central banks.

It is also why governments may not rely on unilateral action to achieve either trade reform or behind-the-border reform, but rather bind themselves in a formal treaty with trading partners. This rationale is recognized in the legal literature (for example, Pauwelyn 2005) as well as in the economic and political economy literature (for example, Martin 2001). Legal scholars tend to stress that such arrangements also protect the commitments from the "instability" of "representative democracy"—in other words, the problem of strategic behavior is not just a problem of vested interest groups, but a problem of democracy more broadly. Thus, for example, Tallberg (2002) uses the time inconsistency problem to explain why the EU member states have chosen to delegate authority to supranational institutions beyond direct democratic control.

An interesting variant of the commitment argument is that reform can occur within a regional trade arrangement as a precursor to the "main event"—that is, World Trade Organization (WTO) membership. Ethier (1998; 1999; 2001) has formalized variants of this argument. His models are explicit attempts to capture some of the salient features of "third-wave" or "new age" preferential trade agreements (PTAs). These agreements first emerged in the 1990s and were not only about merchandise trade, but also included areas such as services, investment, competition policy, government procurement, e-commerce, labor, and environmental standards.

Ethier observes that many new age agreements are between small "outside" countries that are not yet members of the world trading system,[2] and larger "inside" countries that are. The small outside countries want to reform their internal economies so that they can be accepted as members of the global trading system. Ethier asserts that the sign of successful reform is whether these countries attract foreign direct investment (FDI). Their problem is how to signal a credible commitment to reform in advance.

An outside country's solution is to sign a PTA with an inside country involving enough trading concessions to the inside country so that it will in turn have an incentive to act as an enforcer and retaliate if the outside country deviates from its reform commitment. The aim is not necessarily to receive enormous concessions from the inside country in return. All that is required is a small trade concession, so that multinationals have an incentive to locate in the outside country. Ethier (2001) also examines the incentives of the large inside country to accede to such an arrangement, even in preference to pursuing further multilateral reform.

Finally, Ethier shows that a world equilibrium on which small countries compete for investment in this fashion is beneficial, because it internalizes an externality. The global interest calls for successful reform to be as widespread as possible, but if there are agglomeration economies, then multinationals will want to cluster their foreign investments together. A global web of bilateral PTAs, initiated by outside countries' competition for investment, internalizes the externality.

This theoretical framework explains a number of United States (US) bilateral trade agreements as "dress rehearsals" for WTO accession. But note that it is essentially WTO accession that is driving the reform, not the PTA per se. This point is recognized by Lewis (2008), for example, who argues that Lao People's Democratic Republic (Lao PDR) undertook its domestic reforms unilaterally to link its domestic policies and laws to proposed WTO commitments (despite that fact that Lao PDR also signed a bilateral trade agreement with the US). Hence it was WTO membership, and its protections of a rules-based trading system, that drove the reform.

A second reason often cited by economists, but rooted in political economy, is that concession trading can somehow help to neutralize domestic vested interests. It is difficult for governments to build support for liberalization in the face of pressures from vested interests, particularly those in

[2] Ethier (2001) identifies these as countries that until recently adopted basically autarkic, antimarket policies.

import-competing industries. Participation in regional arrangements may help to build support for liberalization, because exporters who would gain from greater access to overseas markets can counter the pressure from those in import-competing industries, who would lose from lower import protection at home. This argument is found in World Bank (2000) and in Hoekman and Mattoo (2011), for example.

A third rationale, closely related to the commitment argument, is the "skyhook" argument. Governments may be happy to take decisions in the public interest that upset particular vested interests, but find it convenient to blame third parties so as to escape electoral punishment (for example, Tallberg 2002). The third parties may be trading partner governments (in PTAs) or supranational institutions (in the EU*).*

A final line of argument is one that stresses the administrative efficiency of taking detailed reform proposals out of the political sphere. Politicians (as principals) assign the detailed rule-making to agents, who then develop and apply their policy-relevant expertise, saving politicians' time for more general policy decisions. This argument has been used to explain the delegation of powers to supranational institutions in the EU (Tallberg 2002), and the delegation of trade negotiation and rule-making to trade officials in Geneva (Pauwelyn 2005). In the context of domestic reform, it begs the question of why delegation to an external agent is preferable to delegation to a domestic bureaucracy that is, in at least some political systems, supposed to be apolitical.

There is at least one political economy argument for why a multilateral or plurilateral forum may be inimical to domestic reform. If the reform takes place multilaterally, the possibility of exchanging concessions across sectors in the future may induce countries to withhold reforms today. Harms, Mattoo, and Schuknecht (2003) claim that this explains the low level of WTO commitments by some countries in financial services, because the financial services agreement was concluded in a separate single-sector negotiation after the Uruguay Round, and participants must have had a reasonable expectation of future multi-sectoral negotiations. They also note that there is a general incentive to retain negotiation coin, and forgo the benefits of unilateral liberalization, by countries that face high entry barriers (including behind-the-border barriers) into their overseas export markets and have sufficient bargaining power to extract concessions from their trading partners.

2.2 Economic arguments

Bagwell and Staiger (1999) show that multilateral trade commitments can help internalize an externality associated with tariff protection. Countries imposing the tariffs can shift some of the cost of those tariffs onto their trading partners because their tariffs can alter world prices and generate a terms of trade decline for their trading partners. Conversely, unilateral reform can generate a terms of trade decline for the reforming country, preventing it from reaping all of the gains from reform. Bagwell and Staiger show that the WTO principles of reciprocity and non-discrimination help to neutralize the world price implications of tariff negotiations and thus allow efficient outcomes. They also note, however, that exceptions to the most-favored-nation principle for the purpose of creating a PTA revive the local-price externality, thus frustrating the ability of a multilateral system governed by reciprocity to deliver an efficient outcome.

It is not clear that this terms-of-trade argument extends beyond tariff reforms. Dee and Sidorenko (2006) point out that empirically, the terms of trade effects of unilateral behind-the-border reforms are likely to be minimal or even positive, so trade agreements may not be necessary to ensure efficient outcomes. In the context of cross-border trade in services (rather than goods), Francois and Hoekman (2010) argue that the WTO, with its principles of reciprocity and non-discrimination, may not be sufficient. They cite the work of Antràs and Staiger (2007), who look at the problem of the relationship-specific investments that might be required between domestic and foreign firms

involved in the trade of customized inputs (for example, producer services), and the opportunity for post-contractual opportunism that this provides. If firms cannot credibly commit to a price in advance, the volume of trade will be too low from the perspective of international efficiency when governments set trade policy unilaterally. By expanding the volume of trade in the customized input, trade agreements can potentially move countries toward the international efficiency frontier. But this beneficial outcome only comes about if governments have no political economy (distributional) motives, but are only concerned with maximizing real national income (efficiency).[3]

It is possible to find arguments for why trade may be inimical to domestic reform. Gassebner, Gaston, and Lamla (2008) argue instead that freer trade may reinforce a status quo bias in domestic policies. Freer trade will benefit the specific factor in the exporting sector. But diversity of economic institutions (domestic reform in one country, lack of reform in the other) may be the source of the gains from trade. If the specific factor in the exporting sector is politically influential, they may lobby for trade reform but against domestic reform, even if the two together would generate a higher benefit to the economy as a whole. They cite India as a possible example of this phenomenon. This argument would also explain why many of the regional trade agreements between developing countries in the East Asian region are heavy on merchandise trade reform but (the titles of chapters in the trade agreements notwithstanding) light on other types of reform (Ochiai, Dee, and Findlay 2010).

A different kind of economic argument is a "spillovers" argument articulated by Kawai and Wignaraja (2011) and Czaga (2004), among others. Kawai and Wignaraja (2011) argue that East Asia's market-led integration and its development of production networks and region-wide supply chains has begun to require not just further liberalization of trade and FDI, but also the harmonization of policies, rules, and standards governing trade and investment, as well as the protection of investment and intellectual property rights. Thus liberalization at the border has begun to create pressure for harmonization behind the border. They argue that Asian policymakers view PTAs as vehicles to support this harmonization effort. They are thus part of the policy framework to deepen production networks and supply chains formed by global multinationals and emerging Asian firms. Japan's support for the development of an ASEAN Economic Community through its funding of the Economic Research Institute for ASEAN and East Asia is consistent with this idea.

Kawai and Wignaraja (2011) also note that the region's response to the Asian financial crisis has demonstrated how Asian economies can cooperate to address common challenges. The key product of that cooperation was the Chiang Mai initiative—a multilateral currency swap arrangement among ASEAN member countries; the People's Republic of China (PRC); Hong Kong, China; Japan; and the Republic of Korea to manage regional short-term liquidity problems. Nevertheless, this arrangement was not used during the recent global financial crisis. The authors also note that Asian countries have been attracted to PTAs because of slow progress in the WTO Doha negotiations. In those negotiations, developed countries are being asked to liberalize agriculture while developing countries are being asked to liberalize industrial goods and services. To date the negotiations have focused on agriculture and industrial goods, with not much effort being devoted to behind-the-border issues.

[3] The argument of Bagwell and Staiger (1999) in the context of simple tariff reform does not depend on the motives of government.

3. EMPIRICAL EVIDENCE

Given the variety of theoretical arguments why regional institutions may promote domestic reform, one would expect the empirical evidence to bear them out. The purpose of this section is to canvas the empirical literature.

3.1 Case studies

Individual case studies establish that regionalism is neither necessary nor sufficient for domestic reform. Several examples can be cited to show that formal regional agreements are not necessary.

Martin (2001) shows that while East Asian reformers have successfully made many of the reforms to domestic and trade policies required to secure export and income growth, there has been no single approach to achieving this. The PRC's reform process focused mainly on unilateral reform and WTO accession. Martin argues that several East Asian transition economies (Cambodia, Lao PDR, Myanmar, and Viet Nam) used accession to the ASEAN Free Trade Agreements (AFTA) as part of their reform strategy, though he notes that some of the exceptions allowed under the original liberalization commitments were excessive. He notes that Viet Nam's and Lao PDR's bilateral agreements with the US required more extensive reforms. But as noted above, these were essentially dress rehearsals for WTO accession. WTO accession has also been a key driver of unilateral reform in Cambodia.

Francois (2005) argues that EU accession would not exert much pressure on Turkey to restructure its transport, because Turkey has to a large extent undertaken the required reforms and put in place the required regulatory frameworks unilaterally.

While these examples show PTA membership or accession is not necessary for domestic reform, the experiences of Canada and Mexico show that it is not sufficient.

Barichello (2004) argues that the effect of the North American Free Trade Agreement (NAFTA) or its predecessor, the Canada–US Trade Agreement (CUSTA), on domestic agricultural policy reform in Canada has been minimal. He notes that the negotiations were conducted specifically to avoid sensitive nontariff barriers. In one instance CUSTA actually led to an increase in protection from nontariff measures. In contrast, the Uruguay Round Agreement was associated much more closely with actual or potential policy reforms. And there was significant unilateral reform in the form of substantial cuts in budgetary support, driven by the domestic imperative to eliminate budget deficits.

Francois (1997) notes that Mexico's reform process started well before NAFTA. Starting with its WTO accession, Mexico began a major restructuring program in the 1980s. This included reforms of trade, intellectual property rights, foreign exchange restrictions, foreign investment, and privatization. Francois also notes that formal consultation mechanisms with the United States (US) were also in place before the NAFTA negotiations. Graham and Wada (2000) identify a trend break in the pattern of US FDI into Mexico in 1989. From 1966 to 1988 the stock of US FDI grew at 3.1% a year; from 1989 to 1998 it grew at 5.6% a year. They argued that this was not caused by NAFTA or the series of bilateral deals between the US and Mexico that preceded it, but as a response to Mexico's unilateral reforms.

More tellingly, Tornell, Westermann, and Martínez (2004) document how Mexico failed to attain rapid growth in the 1990s, and that after 2001 its GDP and exports stagnated. They argue that the lack of growth cannot be blamed on NAFTA or the other reforms that were implemented. The source of the problem was a lack of structural reform after 1995, as well as Mexico's response to

the peso crisis—a deterioration in contract enforceability and an increase in nonperforming loans.[4]

While PTAs may be neither necessary nor sufficient for domestic reform, what is the preponderance of empirical evidence? It comes in two types—broad-brush econometric exercises, and more detailed comparisons of PTA commitments with domestic policies.

3.2 Broad-brush econometric evidence

3.2.1 Evidence from economic papers

The empirical findings of Gassebner, Gaston, and Lamla (2008) are in line with their theoretical arguments. Using a panel of 144 countries over 1995–2006, they find that empirically, economic reforms are not driven by greater trade openness. They also find that reforms are not habit-forming—instead there is a status quo bias. But they did find evidence of the importance of reforms in other countries. The important mechanism is not international trade, but geographical and cultural proximity. Countries that are more integrated in the process of the global exchange of information also tend to be more reform-minded. Finally, they find that EU membership also helps.

Harms, Mattoo, and Schuknecht (2003) examine empirically what drives (the lack of) liberalization commitments in financial services trade (an example of a behind-the-border commitment made through a trade agreement). They find empirical evidence to support the idea that members of international trade coalitions in agriculture and textiles held back financial services commitments, possibly to use them as bargaining chips in future negotiations.

3.2.2 Evidence from legal and political papers

The EU is supposedly the archetypical example of a formal regional agreement that has generated domestic reform. What does the EU-focused literature say? For empirical evidence on this score, we need to turn to the legal rather than the economic literature, for the following reason.

The EU Treaty is a negative list agreement—everything is liberalized unless otherwise stated. This is in contrast to positive list agreements, such as the specific commitments of the General Agreement on Trade in Services (GATS) under the WTO, where nothing is liberalized unless otherwise stated. Furthermore, the EU Treaty covers a wide range of areas and unlike most negative list PTAs, does not have detailed annex lists of exceptions and reservations,[5] though it allows general exceptions on grounds such as public morality, public policy, public security, or

[4] Francois (1997) notes that the crisis did not lead to the re-imposition of exchange controls or a dramatic increase in protection, in part because of strong intervention by the United States and the International Monetary Fund (IMF)—in this qualified sense, NAFTA did provide a policy anchor to the reforms already in place. But NAFTA had not led to further structural reforms.

[5] Becoming a member of the EU is like becoming a member of a club: the state does not get to pick and choose which parts of the treaties it will bind itself to. However, in particular instances—the United Kingdom's and Northern Ireland's refusal to adopt the euro, for example—all the member states agree upon the primary provisions of EU law in relation to the euro and then they all agree to a Protocol under which, in this case, the United Kingdom and Northern Ireland can "opt in" at a later stage, upon notifying the Council of Ministers of their intention to do so. So in an EU context, the exercise of state sovereignty and the adoption of treaty provisions operate differently from mainstream public international law, including that of the WTO and regional trade agreements.

public health (similar to the Article XX exceptions of the General Agreement on Tariffs and Trade (GATT), though in the EU Treaty the details vary depending on the area covered).

Therefore, one measure of actual reform in the EU is provided by the enforcement of these original broad commitments through dispute resolution, rather than by the gradual accumulation of more ambitious commitments. And in the early years, despite their obligations under the Treaties, member states were not dismantling trade barriers, either at or behind their borders (McNaughton 2011), so dispute resolution was the key mechanism by which actual reform took place. Seminal empirical work in this area is by Stone Sweet and Brunell (1998).

They conceive of European integration as a response to the demands of those individuals and companies who need European rules (that is, a more reformed regime), and those who are advantaged by European law and practices compared with national law and practices. Thus from a legal perspective, they argue that integration depends on the development of more liberal rules to govern transnational activities, the capacity of supranational organizations to respond to those demands, and a stable and effective means of resolving legal disputes.

Furthermore, they argue that to the extent that the legal system actually removed national barriers to exchange within the EU (a process known in legal circles as *negative integration*, and in trade circles roughly equivalent to the adoption of negative list liberalization commitments that immediately require the elimination of all non-conforming measures), it put pressure on governments to adopt EU market regulations (known in legal circles as *positive integration*, and in trade circles roughly equivalent to the development of EU directives and other secondary legislation to provide a reformed behind-the-border regulatory structure, such as through harmonization, to ensure that the benefits of liberalization were realized).[6]

To test this proposition, Stone Sweet and Brunell (1998) undertake regression analysis over the period 1961 to 1992 to test whether the extent of transnational dispute settlement (measured by the annual number of so-called Article 177 references, whose significance is explained in a later section) is influenced by the level of transnational activity (measured by annual levels of intra-EU trade) and the number of European rules (measured by the annual number of directives and regulations promulgated by the European Commission). Note that according to the original EU Treaty, all national measures restricting trade were required to be abolished by the end of 1969, and by virtue of the doctrine of direct effect initiated in 1963 (the significance of which is also discussed later), traders could then ask national judges not to apply such measures. Given the time period covered by their regressions, it seems that the argument is a two-fold one. Where trade was already significant, traders had an incentive to ensure that negative integration actually occurred, and hence mounted dispute action when they perceived that it had not. As the negative integration further spurred trade, this first incentive was strengthened. It also provided pressure to create additional directives and regulations to further promote transnational activity (though econometrically the authors do not correct for the resulting endogeneity of either their measure of intra-EU trade or European rules), and thus further dispute settlement to enforce the additional rules.

They find that both variables have a significant positive effect on dispute settlement. However, adding EU rules to the regression does not explain a great deal more of the variation in dispute settlement activity than trade volumes alone (the adjusted R squared in both cases is 0.92). Thus it might appear that additional rules and directives have not generated much additional reform. This does not mean that behind-the-border reform has not occurred. The original Treaty itself contained commitments across a broad range of behind-the-border matters. In fact, Stone Sweet and Brunell (1998) present data on both the extent and subject matter of dispute resolution activity over time. They show that in the 1971–1975 period, more than half the references

[6] See Stone Sweet (2010) for a summary in precisely these terms.

concerned just two sectors—the free movement of goods and agriculture. From 1991 to 1995, these two areas accounted for only 27% of total references, while areas such as establishment (that is, commercial presence), transport, competition, social provisions, social security, taxes, and the environment had grown in relative importance.

What the finding does suggest is that it was the actions of individuals involved in trade that drove the liberalization. The activity of the European Commission in generating additional directives and regulations was much less important (though still statistically significant). In fact, the use of directives reached its peak between 1986 and 1992, and thereafter the Commission found it increasingly difficult to promote integration through direct legislation (McNaughton and Furlong 2008).

Pitarakis and Tridimas (2003) undertake much more careful econometric analysis, paying particular attention to directions of causality (and hence the endogeneity of intra-EU trade). They confirm that legal challenges to instances of incompatibility between EU law and national law (a process they call legal integration) has significantly boosted EU trade. Interestingly, Carrubba and Murrah (2005) also find that public support for EU integration and public political awareness also boost the use of the legal system to support economic integration.

Not only has the subject matter of challenges to national legislation become broader over time, so too has the legal interpretation of what constitutes a regulatory impediment to economic integration. Because the Treaty obligations are based on the principle of negative integration, (that is, the removal of barriers to trade) and are broad-brush, it has been through judicial interpretation and the accretion of case law that regulatory barriers have been defined. Barnard (2010) documents how a gradual widening of interpretation has occurred across all the key pillars of EU integration—free movement of goods, free movement of services, free movement of persons (both natural and legal, where the movement of the latter occurs through establishment), and free movement of capital. Interpretations initially focused on "non-discrimination", but the case law then widened to include barriers to "market access"—regulatory measures that may not explicitly discriminate against foreign sources of goods, services, people or capital, but which nevertheless impede their access. Most recently, the concept has widened even further to any measure that is a "restriction on" or "obstacle to" free movement.

In the area of goods, under the so-called Dassonville formula, for example, "all trading rules" that are "capable of hindering, directly or indirectly, actually or potentially" intra-EU trade are considered as having an effect equivalent to quantitative restrictions, and are therefore prohibited. The jurisprudence has also tackled the problem of goods having to meet the regulatory requirements of more than one regulator. The so-called Cassis de Dijon decision replaces dual regulation of a product (by home and host states) with single (home state) regulation, which the host country is required to respect under the principle of mutual recognition. Under this principle there is a presumption of the equivalence of the regulatory measures.

A wide variety of national rules have been judged to be restrictions on the freedom to provide services—authorization requirements, translation requirements, requirements to swear an oath of allegiance, maximum or minimum staffing levels, minimum fees, rules regulating gambling, and advertising restrictions.[7] In the case of people movement, the interpretation is now even wider—there is no longer a requirement for the movement to be linked to economic activity.

The original Treaty provisions on the movement of capital were weaker than those elsewhere, because capital movements were seen to be closely linked to the stability of economic and monetary policy. It was not until 1992 (with the advent of the Single Market) that capital

[7] Note, however, that with the final version of the recent Services Directive, the EU has stopped short of allowing the regulation in the country of origin to automatically prevail when services are traded cross-border (McNaughton 2011).

movements were finally liberalized, and not until 1995 that barriers were allowed to be the subject of transnational dispute settlement actions (and thus subject to judicial interpretation) in the same way as barriers to goods, people or services. But the jurisprudence has developed along similar lines to that for services. The free movement of capital was a condition of entry into the first stage of monetary union.

3.3 Evidence from examining PTAs

The above econometric evidence is relatively broad-brush—it tests for links between trade and domestic reform, without looking systematically at the influence of regional trade agreements. A great deal of literature examines the effects of having a PTA in place. A relatively small but growing literature looks beyond the existence of PTAs, to examine the effects of their detailed provisions. We now consider each type of evidence.

3.3.1 Econometric evidence from looking at the existence of PTAs

A large amount of literature examines empirically the link between the existence (or much more rarely, the content) of PTAs and measures of economic performance. The most well-known framework is the gravity model, which explains bilateral flows of merchandise trade, and is often used to test for the influence of having a PTA in place. But to the extent that merchandise trade flows are affected by the presence of PTAs, they are likely to be driven in the first instance by commitments on border trade measures such as tariffs, as much as by any commitments on behind-the-border reforms. So this literature is not the best source of evidence on the existence of behind-the-border reform commitments in PTAs.

The gravity model framework and its successors have also been used to explain bilateral FDI. This evidence is more likely to indicate the presence and effectiveness of behind-the-border reforms, because at least some of the key barriers to FDI, both pre- and post-establishment, operate behind the border. Unfortunately, there is little comparable evidence on bilateral services trade, which is governed by a raft of behind-the-border regulation, because there is little bilateral data available on services trade flows.

The study of FDI that probably comes closest to establishing a link between PTAs and domestic reform is Park and Park (2008). They argue that while PTA membership can be an important factor in attracting FDI, it cannot be a sufficient condition—PTA membership should be accompanied by domestic reform measures. This is essentially an empirical test of Ethier's argument that was summarized above. But they also say that PTA membership works by being a commitment device for domestic reform, so it is the domestic reform that is attracting the FDI, not the PTA membership. They show that both reform and PTA membership boost FDI, but do not examine empirically the interaction between reform and PTA membership.

Dee (2008) does a careful mapping of PTA provisions on cross-border trade in services, investment, and the movement of people, and looks at their impact on FDI. She uses a specification of the behavior of FDI taken from theoretical models that jointly explain patterns of trade and FDI, and allow for complex network patterns of both. She finds evidence that patterns of FDI (and trade by implication) in the Asian region are driven by fundamentals, in a way that makes use of fine divisions of comparative advantage, but is also subject to considerations of economies of scale and transport costs. This is in contrast to investment patterns in some other regions (such as in Latin America, where distance and risk considerations are found to dominate). The resulting network patterns of investment in Asia do not appear to have been driven by the investment and services provisions of PTAs signed with the bilateral providers of FDI. But the network nature of regional investments in Asia means that individual members have been insulated from any investment diversion when their FDI source countries have signed PTAs with

third countries. This is because the investment that the sources make in third countries can be a general equilibrium complement to bilateral investment within the overall Asian network. So PTAs are seen as being neither a threat nor a promise to FDI in the region.

Many more such studies of the effects of PTA membership on trade and investment flows can be cited. But most only look at the existence of PTA membership, and do not distinguish the behind-the-border features, as Dee (2008) does. At best, the evidence these studies provide is only circumstantial.

3.3.2 Evidence from looking at the detailed provisions of PTAs

It is not possible to tell whether PTAs have promoted domestic reforms, simply by looking at the PTA commitments themselves. This is because:

- PTA commitments may simply reproduce commitments made in the WTO; and
- even when they go beyond WTO commitments, they may still lag actual practice.

It is incredibly time-consuming for "outsiders" (that is, those outside the trade negotiation fraternity) to compare PTA commitments with WTO commitments. It is not sufficient to look at chapter titles, nor even the broad content of the chapters in each agreement, because the "devil is in the detail"—particularly in the detailed annexes of reservations and exceptions, as well as in the product classifications used to describe the goods and services for which commitments are being made. Further, in some chapters, such as those on intellectual property, the language is highly technical and legalistic, and difficult for nonspecialists to understand. In other chapters, the commitments being made are "soft" (for example, on a "best endeavors" basis), so it is not at all clear that they should be counted as substantial commitments. One comprehensive comparison of a single PTA, the Australia-US Free Trade Agreement, with the WTO commitments of its two partner countries confirms that a great deal of the PTA was already committed in the WTO (Dee 2005). A more selective comparison, limited to services commitments, made for a number of East Asian free trade agreements comes to a similar conclusion, particularly for the less developed members (Fink and Molinuevo 2007).

It is even more time consuming to compare PTA commitments with actual practice. The tariff schedules of most countries are publicly available, so it is reasonably straightforward to compare PTA tariff commitments with actual practice. But for virtually all behind-the-border areas, actual practice is defined in a complex web of legislation, regulation, and formal and informal bureaucratic practice. Collecting information on all the strands of this web is a major undertaking. As will be seen, there is growing evidence that PTA commitments can lag actual practice, sometimes by a considerable margin, particularly in developing countries. Accordingly, it is not possible to take exercises that just look at provisions (for example, Fink and Molinuevo 2007; Kawai and Wignaraja 2011; Plummer 2007) to impute actual reform.

Studies that have made systematic comparisons of PTA commitments with either WTO commitments or actual practice are not yet comprehensive, but are slowly growing in number. This section concentrates on reporting comparisons that have been made for commitments in services and investment. In part, this is because these areas are where most comparisons have been made to date. Nevertheless, the commitments in services are highly relevant to the broader issue of whether PTAs promote domestic reform. This is because restrictions on trade in services usually take the form of domestic regulation, as services tend to be highly regulated, reflecting a variety of important public policy objectives (Czaga 2004).

The services agenda (broadly defined, and including commercial presence) is also aligned relatively closely with the revealed integration objectives in the East Asian region. The ASEAN Economic Community Blueprint—a document outlining the priorities for economic integration in that region—contains reasonably "hard" targets for services, investment, and transport and

information infrastructure, while those in areas such as competition policy, consumer protection, and intellectual property rights are weaker and/or on a best endeavors basis. Kawai and Wignaraja (2011) stress the importance in the East Asian region for harmonizing the policies, rules and standards governing trade and investment. But harmonization is an agenda that even the EU has not achieved, having moved instead to the weaker and more decentralized principle of mutual recognition.

3.3.2.1 Comparing PTA commitments with WTO commitments[8]

Roy, Marchetti, and Lim (2006) compare the commitments undertaken by 29 WTO members (counting the EC as one) for cross-border supply and commercial presence in services in 28 PTAs negotiated since 2000, and compare these with both the prevailing GATS commitments and the Doha Round offers at the time of those countries.

The authors find that PTAs appear to offer limited value added over GATS disciplines in the areas of rules governing safeguard mechanisms, subsidies, domestic regulation, and the like. Their main contribution appears to be in their level of commitments.

On commitments, the authors find that PTAs tend to go significantly beyond GATS offers in terms of improved and new bindings. Further, the proportion of new or improved commitments is generally much greater in PTAs (compared to GATS offers) than in GATS offers (when compared to existing GATS commitments). Some countries are described as showing impressive improvements in their PTA commitments. Among them are countries that have signed a PTA with the United States (and hence made services commitments on a negative list basis). On average, these countries now have commitments on cross-border trade and commercial presence in more than 80% of services' subsectors, compared to commitments in less than half of services' subsectors in their GATS schedules or offers.

In most cases where PTA commitments improve on WTO commitments, it is primarily through new bindings rather than through improvements on existing bindings. Arguably, though, the commitments are more likely to imply real liberalization in the latter case than in the former. Exceptions to the general trend include the PRC and India, whose PTA commitments (PRC's with Hong Kong, China and Macao, China; India's with Singapore) tend to take the form of improvements to sectors already committed under GATS schedules/offers rather than new bindings, and are mostly limited to commercial presence.

Finally, the authors note that PTAs have provided for advances both for sectors that have tended to attract fewer offers in the GATS (for example, audiovisual, road, rail, postal-courier), as well as for sectors that were already popular targets for GATS offers (for example, professional, financial services). One exception was health services, where PTA commitments did not appear to go significantly beyond GATS offers.

Overall, Roy, Marchetti, and Lim (2006) conclude (p. 33) that "PTAs generally have provided for significant improvements over GATS commitments, sometimes even leading to real liberalization of the market."

Fink and Jensen (2009) also examine the services commitments in PTAs negotiated in the 1990s and 2000s. They come to a similar conclusion to Roy, Marchetti, and Lim (2006)—in areas where there are no WTO disciplines, there tend not to be rules in PTAs either (safeguards, subsidies, procurement, domestic regulation). They also find that the tendency is for PTAs to have more commitments in sectors where countries have also made more extensive commitments in the GATS. Sensitive sectors such as health, transport, and financial services as well as the movement of natural services suppliers tend to be subject to the fewest commitments.

[8] Parts of this and the following subsection draw on Dee and Findlay (2009).

But Adlung and Morrison (2010) looked at evidence of where the services provisions in PTAs fall short of the same countries' GATS commitments. They find that instances of such "negative preferences" can be found in most recent agreements, including those involving some of the largest WTO members. Of the 56 PTAs whose contents (including sectoral classification) are compared with GATS commitments, 46 (or 80%) contain some form of GATS-minus commitments in either their horizontal or sectoral sections. The authors also document some of the GATS-minus components in three particular agreements—the Economic Partnership Agreement between the EU and the Caribbean Forum of African, Caribbean, and Pacific (CARIFORUM) States, the agreement between Australia and the United States (AUSFTA), and the PRC–ASEAN Agreement. They conjectured that such GATS-minus commitments are mutually conceded in "sensitive" sectors or tacitly accepted in view of "side-payments" in what they call non-WTO currency (including development finance).

3.3.2.2 Comparing PTA commitments with actual practice

One recent comparison of PTA commitments with actual practice has capitalized on a pre-existing database of actual regulatory practice that was compiled for a different purpose. Barth et al. (2006) make use of a database on actual regulatory practice in banking as it stood around 2000, as reported in responses to a detailed World Bank survey. The database had been used previously to assess the impact of that regulation on banking performance (for example, Barth, Caprio, and Levine 2004). In a more recent exercise, Barth et al. (2006) compared regulatory practice with actual WTO commitments in the financial sector for 123 WTO Members.

The authors find significant differences between commitments and actual practice. Some of their examples are as follows.

More than 30 WTO members that prohibit foreign firms from entering through acquisitions, subsidiaries, or branches in their WTO schedules allow such entry in practice.

Six WTO members do not allow foreign entry through subsidiaries or branches even though in their schedules they indicate they do. This anomaly may reflect the "prudential carveout" in the GATS, whereby members are not required to schedule limitations maintained for prudential purposes. However, it is highly questionable whether bans on foreign entry could be defended as purely prudential measures.

A large number of WTO members prohibit banks from engaging in insurance or securities activities in their schedules, but allow such activities in practice.

26 WTO members in practice set the same minimal capital entry requirements for domestic and foreign banks, even though in their schedules they do not commit to such non-discriminatory treatment.

The authors also look for evidence of statistically significant correlations between WTO commitments and regulatory practice. Even if the two do not match exactly, they expect the correlation to be positive. However, their finding does not bear this out.

> The results … indicate that on average countries are more open based on actual practice than their WTO commitments. The difference in means between actual practice and commitments, moreover, is statistically significant. Also, there is no significant correlation between actual practice and commitments. These results hold for developing countries and countries with more than 2 million people, but not for the developed countries. The latter group of countries is on average less open based upon actual practice than commitments. (Barth et al. 2006: 25)

The authors also explain the gap between commitments and actual practice. One of their findings is that countries with greater foreign ownership of total bank assets also tend to have the biggest

divergence between the indices for commitments and actual practice. Countries with greater foreign ownership also tend to display less actual discrimination against foreign banks, but tend to display more discrimination based on commitments. Lastly, developed countries that made commitments earlier in time tend to display less discrimination, while the opposite is the case for developing countries.

In general, therefore, the authors find many instances where WTO commitments are significantly less liberal than actual practice. They also find instances where WTO commitments are more liberal than actual practice, particularly in developed countries.

As evidence about whether PTAs promote real liberalization, the findings are merely circumstantial. However, if WTO commitments lag actual practice by a significant margin, then even if PTAs improve significantly on WTO commitments, they may still themselves lag actual practice.

Furthermore, if actual practice lags WTO commitments, as it appears to in a few cases, then there is clearly an enforcement problem that may also carry over to PTA commitments. One reason for the enforcement problem in a WTO context may be that trade partner countries are not equipped to check the compliance of all other WTO members. Such a monitoring problem may be less severe in a PTA context. But another reason for an enforcement problem may be that trade commitments are made by trade negotiators who are divorced from what is really going on in their own countries. This problem may well carry over to PTAs, especially in countries where problems of coordination among different government ministries are endemic.

Some recent, more comprehensive evidence along similar lines is cited by Hoekman and Mattoo (2011). They report on research by Borchert, Gootiiz, and Mattoo (2010) that collected information on actual policies in the major services sectors of 102 countries—78 developing countries and 24 OECD countries. This information has been compared with GATS commitments for the 93 WTO members in the sample. The comparison shows that there is a very significant gap between applied and "bound" policies (the commitments) because most services' liberalization around the world has been undertaken unilaterally. The Uruguay commitments are on average 2.3 times more restrictive than currently applied policies. Borchert, Gootiiz, and Mattoo (2010) also look at the Doha Round offers made by 62 WTO members. They find that the best offers submitted so far improve on current GATS commitments by about 10%, but remain on average twice as restrictive as actual policies.

According to Hoekman and Mattoo (2011), there are some PTAs that have induced significant market opening. They cite the example of the liberalization of telecommunications in several Central American countries as a result of the United States–Dominican Republic-Central America Free Trade Agreement (CAFTA) with the United States. But their general assessment is that although recent PTAs have wider sectoral coverage of services, they do not appear to have induced significant change in applied policies.

Roy, Marchetti, and Lim (2006) also assess whether PTA commitments lead to real liberalization. They do not make direct comparisons with regulatory practice, but look for instances where PTA commitments are phased in over time, using the phasing mechanism as an indication that real liberalization is taking place. They note that the group of countries making such phased commitments is fairly widespread, although it appears that financial services and telecommunications dominate. Most phase-out commitments have been contracted by countries as part of a PTA with the United States, although not exclusively.

Dee (2011) tracks actual policy changes in four services sectors in the ten ASEAN countries between 2008 and 2010, and gains some insight into how much has been driven by commitments under the ASEAN Framework Agreement on Services (AFAS). A brief summary of the policy changes affecting trade in medical, health, banking, and insurance services in ASEAN countries

from 2008 to 2010 is shown in the Appendix. The Appendix shows that there has been at least some progress in all four sectors.

Not surprisingly, some of the recent policy changes in banking and insurance services involved a tightening of prudential regulation in response to the global financial crisis. Prudential regulation has a legitimate purpose of ensuring systemic stability. It is generally not regarded as a barrier to trade in financial services, and for this reason it is carved out of the GATS. Nevertheless, Viet Nam appears to have instituted stricter licensing requirements for banks to an extent that goes beyond purely prudential oversight. Within ASEAN, this is an isolated example of possible overreaction to the global financial crisis. In addition, both Brunei Darussalam and Viet Nam have required (or clarified) that foreign bank branches must lend against their local capital rather than their parent capital. This is a "gray area" measure—while it further constrains the activities of foreign bank branches, it also gives the local prudential authorities some control over the capital reserve requirements of foreign branches, rather than having to rely on the prudential oversight of the authorities in the branches' home countries.

The Table also shows the extent to which countries in the region have instituted genuine trade reforms in response to commitments made under AFAS or the GATS. In banking, both Thailand and Viet Nam have instituted multilateral reforms in line with commitments under the GATS, while Thailand has also relaxed restrictions on hiring foreign personnel on a preferential basis under its AFAS commitments. In insurance, Viet Nam expects to implement a package of reforms in the near future in line with its WTO commitments. In health services, Indonesia has relaxed the minimum bed size for foreign-invested hospitals on a preferential basis. In medical professional services, Cambodia has implemented a mutual recognition agreement with its ASEAN neighbors. In all other respects, the reforms recorded in the Table are unilateral and non-preferential, or if they have a regional dimension, it is because of geographical constraints rather than preferential commitments.

Some of the more notable unilateral reform efforts are the relaxation of interest rate controls in Cambodia and Viet Nam. Malaysia also awaits a new Financial Master Plan that will further liberalize the banking and securities markets in the near future. Lao PDR has implemented a package of reforms in the insurance sector, although at the same time, the government does not want to issue any new licenses. While this moratorium is explained because of the small market size, it also has the potential to offer protection to the existing government–foreign joint ventures. In Myanmar there has been a slight expansion in the range of insurance products on offer, although there has been no weakening of the monopoly position of Myanmar Insurance.

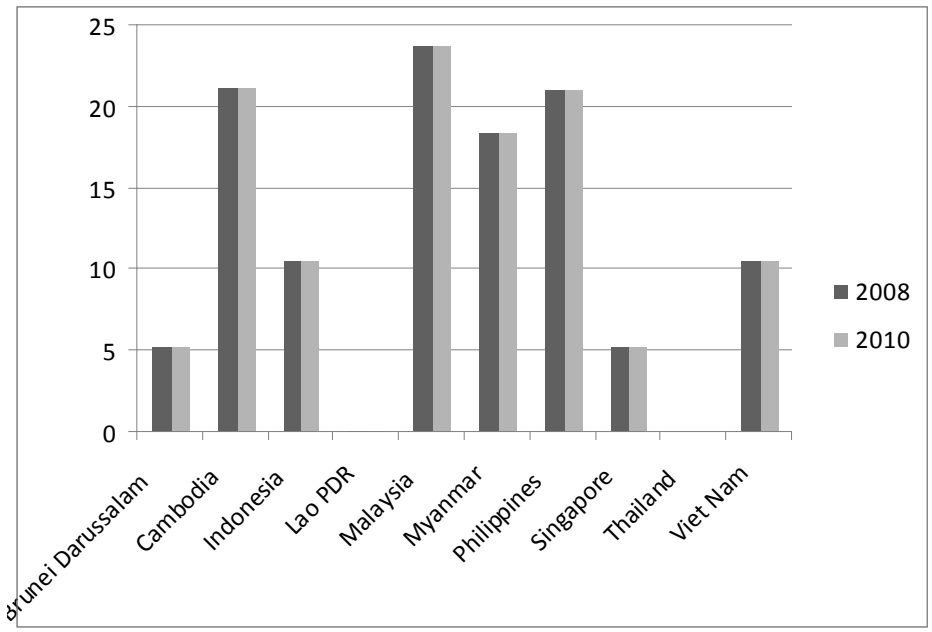
In medical and health services, there have been significant reforms in Indonesia and the Philippines, and a slight easing in Myanmar. Indonesia has introduced new legislation to fill the significant gaps in the regulatory framework (Dee 2009). In a few cases, the introduction of explicit legislative guidelines has the potential to limit practices (such as the hiring of foreigners into relatively unskilled positions) that might have occurred otherwise. In most cases, however, the legislation has somewhat reduced the scope for bureaucratic discretion. The legislation also tightens the quality assurance framework in Indonesia by making the hospital accreditation process mandatory every three years. Finally, the Indonesian legislative reforms have also been accompanied by a slight easing of foreign equity limits. In the Philippines, there has been a lifting of the regulatory restrictions on the entry of new hospitals and medical laboratories. In Myanmar there has been a growth in cross-border trade in medical and health services and some limited evidence of foreign investment occurring.

Thus there is evidence of worthwhile reform efforts in all four services. Some have been driven by AFAS or WTO commitments but in general, the more significant reforms have taken place unilaterally.

A further key question is whether the recent reforms have made a significant difference. This is indicated in Figures 1 and 2, for domestic and foreign medical services providers respectively. The figures compare the overall prevalence of restrictions in 2008 and 2010. The differences reflect the reforms summarized in the Table. The reforms have made only a slight difference to the overall prevalence of restrictions on foreign suppliers, and no difference to the prevalence of restrictions on domestic suppliers.

Figure 1: Changes in Restrictions on Domestic Medical Services over Time

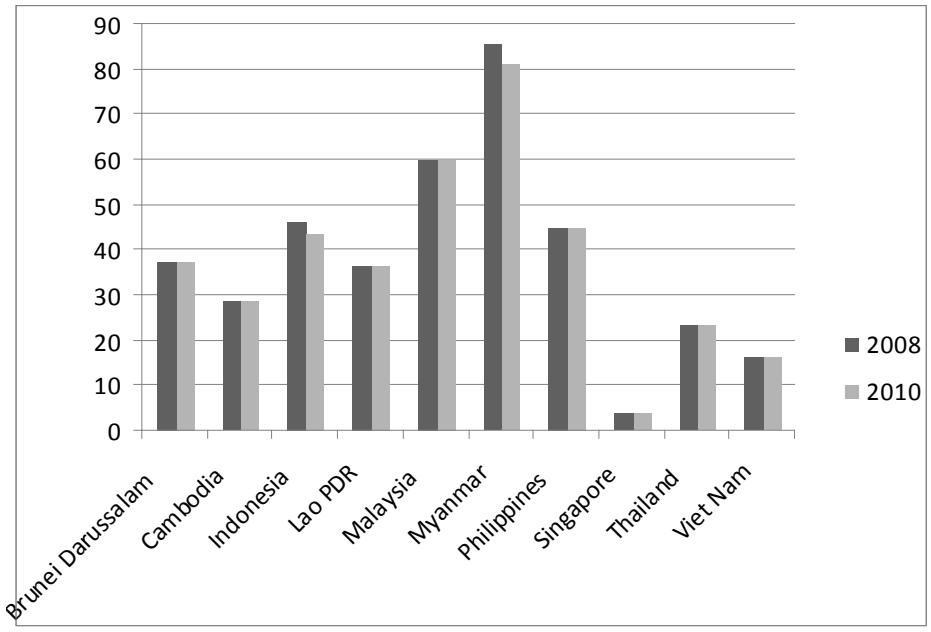
(Prevalence in %)



Note: Lao PDR = Lao People's Democratic Republic

Source: Dee (2011)

Figure 2: Changes in Restrictions on Foreign Medical Services over Time (Prevalence in %)



Note: Lao PDR = Lao People's Democratic Republic

Source: Dee (2011).

Comparable figures for the other three sectors are not reproduced here, but tell a similar story. In health services, recent reforms have removed the last restrictions facing domestic suppliers. But the prevalence of restrictions against foreign health services providers is still quite high, and the recent reforms since 2008 have made only slight inroads into those trade barriers. In banking also, the reforms have made only a slight difference to the overall prevalence of restrictions. In some countries, such as Viet Nam, banking reforms in some dimensions (such as easing of interest rate controls) have been offset by a tightening in others (more stringent non-prudential licensing requirements). Thus there is evidence that ASEAN countries are still using unnecessary regulatory restrictions in place of better-targeted prudential requirements. Finally, there has been very little reform of regulatory restrictions on trade in insurance services from 2008 to 2010. In Lao PDR, legislative reforms have been essentially negated by the recent moratorium on granting new licences. Insurance is a sector that is typically under pressure during WTO accession negotiations, so some ASEAN countries have already undergone market opening in this context. Other ASEAN countries will need to accelerate their reform efforts in this sector if the ASEAN Blueprint targets are to be met.

To summarize, empirical evidence to show conclusively whether formal regional institutional arrangements promote domestic reform is hard to come by. This is because the required research is labor intensive, and requires monitoring actual policy changes, not simply recording PTA commitments. The most compelling evidence to date is more circumstantial. In services—a sector that accounts for well over 50% of most economies—where the trade barriers are overwhelmingly regulatory, even the best WTO Doha Round offers are on average twice as restrictive as actual practice. PTAs tend to improve on WTO commitments in services, at least in terms of sectoral coverage, if not in the depth of sectoral commitments or the disciplines on safeguards, subsidies, procurement, and domestic regulation. But even if they improve on WTO commitments by a substantial margin, they are still likely to lag actual practice. It is on this basis and other evidence

summarized above that Francois and Hoekman (2010) draw their conclusion—except in the EU, services trade reform has been primarily unilateral.

4. WHY HAS REFORM BEEN UNILATERAL OUTSIDE THE EU?

If PTAs have not succeeded in promoting regulatory reform in services outside the EU, it is not because the reforms do not generate economic benefits. Francois and Hoekman (2010) survey recent econometric evidence showing that openness in a range of producer or intermediate services sectors is linked to productivity improvements and increased export performance in manufacturing. They also survey recent studies that have shown links between services sector liberalization and economic growth. Prospective studies have also highlighted the potential gains from future services trade reform. As noted by Francois and Hoekman (2010), these studies tend to show that services liberalization can generate much larger welfare gains than goods liberalization. One reason for this finding is that regulatory barriers in services can create deadweight costs, not just allocative inefficiencies of the sort generated by tariffs. Accordingly, services liberalization can generate larger welfare gains than tariff reform.

A recent example of such prospective studies is the study by the APEC Policy Support Unit (2011) into the impacts and benefits of structural reforms in the transport, energy, and telecommunications sectors in APEC member economies. It found that US$175 billion a year in additional real income (in 2004 dollars) could be generated from further reforms in the APEC region. APEC-wide, the projected gains from these structural reforms are almost twice as big as the gains from further liberalization of merchandise trade. Yet the sectors where the structural reforms occur are less than a quarter of the size of those engaged in merchandise trade. When structural reforms lead to lower real production costs, even by half as much as the report estimates, they create a return to reform effort that is much greater than that from border trade reforms.

So why have trade agreements (other than the EU) failed to deliver services reform (and by implication) other types of structural reform? Hoekman, Mattoo, and Sapir (2007) speculate on the reasons, some of which are relevant to domestic reform more broadly. They note that despite significant unilateral reform, barriers to trade and FDI still remain. One explanation is the standard political economy problems of resistance by vested interests. But the authors note that in the case of services (and other behind-the-border reforms more generally), the reciprocity mechanisms that have traditionally been used to counter the resistance by incumbent producers are much less effective. One of the key reasons is that in services, the balance is tilted in favor of incumbents because of regulatory concerns—it is hard to design trade commitments that distinguish or separate protectionist policies from those that have a legitimate domestic efficiency or social equity rationale. Hoekman and Mattoo (2011) also note that export interests may be weaker in services because services markets tend to be either very open or very closed, and in neither situation do exporters have a strong incentive to mobilize politically.

The desire to retain regulatory autonomy has clearly been a major consideration in services negotiations. The GATS explicitly recognizes the right to regulate. And as Francois and Hoekman (2010, p. 681) observe, “The EU experience illustrates the difficulty for (unwillingness of) polities to converge on common norms and to allow for ‘regulatory arbitrage’ even in situations where in principle all are agreed that common minimum standards exist.” This argument also suggests a limited role for regional agreements to push domestic reforms more generally in those areas involving cross-border trade, when domestic regulatory regimes go head-to-head. They may have more success in promoting reforms in those areas involving FDI, where host country regulations unambiguously apply.

While these authors point out one of the key limits of reciprocity in dealing with the political economy resistance to reform, various authors have pointed out the limits of reciprocity in dealing with the economic externalities associated with reform. The arguments by Antràs and Staiger (2007) and Dee and Sidorenko (2006) have already been summarized above. In a similar vein, Hoekman and Mattoo (2011) note that when reforms reduce deadweight costs, the benefits of reform are fully internalized and the pressure for reform will be unilateral. Blanchard (2007) notes that when firms can deliver services via FDI, governments have less incentive to manipulate the terms of trade on cross-border trade, so once again, reciprocity is not needed.

Yet there is agreement that the EU alone has generated significant policy reforms. But it is *sui generis*—one of a kind. So what is it about the EU agreement that has contributed to its success? And what lessons if any can been drawn about the factors that can facilitate domestic reforms elsewhere?

5. WHAT IS SPECIAL ABOUT THE EU?

As noted above, the original EU Treaty contained broad commitments to the four freedoms—the free movement of goods, persons (both natural and legal), services, and capital. The real liberalization came in the enforcement of those broad commitments, a process that also led to increasingly broad definitions of what was meant by a violation.[9]

It is important to understand the process by which this came about. The legal literature points to two key decisions of the European Court of Justice. The first was the seminal decision in Van Gend en Loos (Case 26/62, Van Gend en Loos v. Nederlandse Administratie der Belastingen, 1963 E.C.R.) in which the European Court of Justice (the Court) developed the doctrine of "direct effect". The other key decision was that in Costa v. ENEL (Case 6/64, Costa v. ENEL, 1969 E.C.R. 585) in which the Court developed the doctrine of "supremacy".

Under the doctrine of direct effect, certain provisions of the EU Treaty have direct legal effect such that individuals and enterprises can claim Treaty-based rights in member state courts, prevailing over contrary national rules. This doctrine meant that individuals and enterprises did not have to wait for the European Commission to challenge contrary state rules—they could take action themselves in their own national courts.

Under the doctrine of supremacy, Treaty law took primacy over national law. This doctrine leveraged off the doctrine of direct effect. In Van Gend en Loos, the Court ruled that member states had "limited their sovereign rights", and effected a permanent transfer of power to the "new legal order" of the Community. The Court then relied on this point in establishing the doctrine of supremacy in Costa v. ENEL. As noted by Persaud and Goebel (1997), this was at the core of all other Court doctrines, because it achieved the binding nature of the Court's own judgments.

The Van Gend en Loos judgment laid down certain criteria for Treaty provisions to have direct effect (the provisions needed to be clear, precise, and absolute in their terms, aimed at achieving individual rights, and did not necessarily require Community or member state legislation for their effective application). Over time, the Court has found that Treaty provisions having direct effect include those that define three of the four freedoms—Article 30 on the free movement of goods; Article 48 on free movement of workers and Article 49 on the right of establishment; and Article 56 on the freedom to provide services. Other Treaty provisions have been found also to have

[9] As noted above, the interpretation of violations became broader in the sense that it moved away from the notion of discrimination to one based on impediments to free movement. But in another respect, the interpretation of violations became narrower, because judicial interpretations of allowable derogations also became broader (Barnard 2010).

"horizontal" direct effect, meaning that an individual or enterprise can appeal to EU law in a case against another individual or enterprise, not just against a member government. Treaty provisions in this category include Articles 101 and 102 on competition law, and Article 157 on the right of equal pay for equal work between men and women.

The doctrine of direct effect has allowed individuals and enterprises to challenge a wide variety of national measures in their own courts or in the courts of other member states. As noted above, in trade matters these dispute settlement proceedings tended to be aimed initially at rules that discriminated on the basis of nationality. Over time, the Court's interpretations of what constituted a Treaty violation widened to include a range of rules that could not be objectively justified on grounds of compelling state interests (Persaud and Goebel 1997).[10]

The reason that we know so much about the power of this appeal mechanism is that national judges can send questions—preliminary references—to the European Court of Justice so as to obtain an interpretation of EU law when this is relevant to the resolution of a dispute in the national court.[11] The European Court of Justice responds with a preliminary ruling that the national judge is expected to apply to resolve the case. The vast majority of preliminary references involve an allegation on the part of an individual or enterprise that a specific national law or practice in the same country is incompatible with EU law (McNaughton 2011; Stone Sweet and Brunell 2011). So even if dispute settlement takes place in a decentralized manner in national courts, it leaves a shadow at the Community level in the form of preliminary references, and centralized data on these are available. The data show that the number of such cases has grown steadily, from 147 between 1961 and 1970, to 1,084 from 1991 to 1995 (Stone Sweet and Brunell 1998). The subject matter of these cases has also broadened, as was noted earlier. Furthermore, the preliminary ruling mechanism has been the key mechanisms through which the interpretation of what constitutes a Treaty violation has evolved over time.

In what way does this mechanism differ from the standard dispute settlement mechanisms embodied in trade agreements (either regional or through the WTO)? Stone Sweet, one of the pre-eminent legal scholars in the field, gives a legal perspective on this issue (Stone Sweet 2010; Stone Sweet and Brunell 2011).

He argues that the European Court of Justice and the WTO Appellate Body are in fact similar, in that both are more than mere agents of the contracting states in a principal-agent relationship. They are what he calls Trustee Courts of their respective treaty systems. He defines a Trustee Court according to three criteria:

- the court is the authoritative interpreter of the regime's law, and has the authority to review the legality of acts taken by the contracting States under the regime's law;
- the court's jurisdiction with regard to the contracting States is compulsory; and
- it is difficult, or impossible as a practical manner, for the contracting States, as principals, to reverse the court's important rulings on Treaty law.

He notes that unlike a simple agent, a Trustee Court has the authority to govern the principals themselves. It also has the power to expand or contract its own "zone of discretion". Classic examples of the use of these powers in the EU context are the doctrines of supremacy and direct effect. Also in an EU context, Stone Sweet argues that the member states conferred such

[10] The doctrine of direct effect has also been extended beyond Treaty provisions, and also applies to certain Community directives.

[11] Lower national courts can refer such questions at their discretion; national courts of last resort are required to request the assistance of the European Court of Justice.

authority on the European Court of Justice "in order to help them overcome acute commitment problems associated with market and political integration" (Stone Sweet and Brunell 2011, p. 4).

While Stone Sweet and Brunell (2011) claim that the WTO Appellate Body has similar powers, Pauwelyn (2005) argues that there are notable checks and balances on its behavior. The Dispute Settlement Understanding explicitly guards against judicial activism, by prohibiting panels and the Appellate Body from adding to or diminishing the rights and obligations of WTO Members. Pauwelyn (2005) also argues that the Dispute Settlement Body exercises political control over dispute settlement: "As the umbilical cord between the political and judicial branch, it is a crucial interface and forum of contestation or voice to which both panels and the Appellate Body are most receptive". (Pauwelyn 2005, p. 49).

Van den Broek (2009) also notes that current WTO dispute remedies are less than ideal. Compensation is often unrealistic because the defendant WTO member has to agree to it. Retaliation (raising levels of protection against imports from the defendant WTO member) involves shooting oneself in the foot. He argues that these aspects of WTO dispute settlement penalize the least developed WTO members in particular, a conjecture borne out by statistics on who uses the WTO dispute settlement process.[12]

Stone Sweet and Brunell (2011) consider how the European Court of Justice has dealt with the issue of legitimacy that its Trustee status creates. They argue that one strategy it uses to establish and maintain legitimacy is "majority activism"—the Court's rulings tend to line up with the actual practice found in the majority of member states. The Court also has a clear mandate—to construct and consolidate a transnational, European identity, in part in opposition to nationalism. Its majority activism clearly serves that purpose. The authors argue that because the WTO has no comparable identity construction mandate, it has not developed a variant of majority activism as a way of securing its legitimacy, though they argue that perhaps it should.

The impression that one gets from reading this legal literature is that the differences between the European Court of Justice and the WTO Appellate Body are differences of degree rather than kind. To the extent that there are analytically identifiable differences, they tend to support the more popular notion that more has been possible in the EU because the ultimate goal has been not just the furthering of prosperity, but the prevention of world wars. Pauwelyn (2005) also notes differences in the degree of judicial activism. But here it is important to recall the distinction between a negative list agreement (such as the EU Treaty) and a positive list agreement (such as the GATS). There may have been more judicial activism in the EU because the nature of the agreement allowed more scope for it.

Nevertheless, there is a significant political economy difference between dispute settlement in the EU and the WTO that has received little attention in most of the legal literature. The doctrine of direct effect empowered a whole new set of domestic interests in favor of reform. As Burley and Mattli (1993) note, importers who objected to paying customs duties on their imports could invoke the Treaty of Rome to force their governments to remove them.

According to the standard political economy argument for regional rather than unilateral action, the interests of a country's exporters (in opening up foreign markets) need to be pitted against those of its import-competing industries (in keeping protection at home). The presumption is that the interests of consumers do not count politically because of the collective action problem of mobilizing large numbers of consumers with individually small stakes in the outcome.

[12] Of the 356 complaints brought between 1995 and 2006, 227 were brought by high income WTO members and only one was brought by a least developed country.

At an economic level, this argument fails to recognize that exports are not per se "good" in an economic sense (the mercantilist fallacy)—it depends on the price at which they can be sold.[13] At a political level, this argument fails to recognize that there can be powerful domestic business interests that align with those of consumers—importers who sell directly to consumers, businesses that use imports as intermediate inputs and are equally hurt by import protection, or exporters who are hurt indirectly by the real currency appreciation that import protection tends to generate.[14]

The doctrine of direct effect empowered at least some of those domestic pro-reform business interests. The significance can be illustrated in the context of the example developed by Krugman (1997: 118):

> When the United States recently imposed utterly indefensible restrictions on Mexican tomato exports, an Administration official remarked off the record that Florida has a lot of electoral votes while Mexico has none. The economically correct rebuttal to this sort of thing is to point out that the other 49 states contain a lot of pizza lovers: the politically effective answer is to subject U.S.–Mexican trade to a set of rules and arbitration procedures in which the Mexicans do too have a vote.

What the doctrine of direct effect does is give the pizza lovers in the other 49 states a voice by proxy, by empowering tomato importers, who make money by selling to pizza shops, to complain about the actions of the administration officials. So the politics of fighting protection is internalized, and no longer subject to concerns about loss of sovereignty.

Burley and Mattli (1993) note that this empowerment in turn contributed to the legitimacy of the European Court of Justice. The Court was seen as siding with the "little guy" against state bureaucracies, the "people" against the "power elites". And this was a powerful antidote to charges of antidemocratic activism.

Burley and Mattli (1993) also point out the more general benefits of depoliticizing a reform debate by framing it according to non-political criteria. In the case of the EU, with the forum being the European Court of Justice, the external frame of reference for debate was often the rule of law. In other forums (some of which will be discussed shortly), the external frame of reference may be economic growth and efficiency. Even when the politics of reform is entirely internal, it is useful to have a forum that can provide and safeguard such a non-political frame of reference. Burley and Mattli (1993: 72) describe the process as follows:

> Even an economic decision that has acquired political significance is not the same as a "purely" political decision and cannot be attacked as such. It retains an independent "non-political" rationale, which must be met by a counterargument on its own terms. Within this domain, then, contending political interests must do battle by proxy. The chances of victory are affected by the strength of that proxy measured by independent non-political criteria.

The argument so far suggests that the unique feature of the EU that helped it to promote economic reform in sensitive, behind-the-border areas was that it overcame the problem of loss of sovereignty by internalizing the political battle to domestic interests, and yet still provided a non-political frame of reference for the debate.

Dee (2010) provides a number of case studies from the East Asian region to demonstrate that this has been a common feature of institutional arrangements that have proved effective at promoting

[13] Multilateral action can nevertheless help to overcome terms of trade externalities, as noted earlier.

[14] See Banks and Wonder (2010) for evidence that both latter groups have played a public role in pushing for reforms in Australia.

structural reform in that region. When it comes to structural reform, the vested interests with the strongest stakes in the outcomes are primarily domestic—very often the interests of incumbent producers against potential new entrants (domestic as well as foreign), consumers, and upstream and downstream industries. The key to promoting reform is to mobilize domestic pro-reform champions to act as a countervailing force against vested interests. One way to do this is to provide an independent, non-political forum and a frame of reference that stresses economy-wide benefits. A further characteristic stressed by Dee (2010) is that the forum should be transparent, in the sense of making public the arguments of the respective interests, and also making public any recommendations to government. In this way, the special pleading of vested interests can be revealed for what it is. Equally importantly, the pro-reform champions can also self-select on any particular issue.[15]

Examples of institutions that have promoted reforms in this way include the Productivity Commission and its predecessors in Australia (Banks and Wonder 2010) and the Council on Economic and Fiscal Policy in Japan (Hosen 2010). McNaughton (2011) shows, for example, that the concerns that the EU Services Directive are intended to address are being dealt with domestically in Australia by the Council of Australian Governments and the research and recommendations of the Productivity Commission. Institutional examples from the Philippines (Llanto 2010) and Indonesia (Soesastro, Aswicahyono, and Narjoko 2010) illustrate how useful work to support structural reform could potentially take place within a medium-term economic planning framework. Old-fashioned economic planning is often seen as outmoded in an era of open markets and outward-oriented growth strategies, but a medium-term planning process can also provide a useful forum for detailed ex ante reviews of policy options, providing a lead in the policy development process. Such a medium-term focus can then bind successive governments and guard against excessive “short-termism” in policy development.

Many East Asian economies also have influential think tanks that conduct impartial policy reviews and analysis, and therefore provide an open, independent forum in which the views of vested interests are subject to scrutiny using an economy-wide frame of reference. Regional examples are the Philippines Institute of Development Studies, the Centre for Strategic and Independent Studies in Indonesia, the Thai Development Research Institute, the Fiscal Policy Research Institute in Thailand, the Malaysian Institute of Economic Research, the Central Institute for Economic Management in Viet Nam, and the Chinese Academy of Social Sciences. These organizations vary in the extent to which they sit inside or outside formal government structures, and the extent to which their contributions are used in the policy development process. But all have at least some of the characteristics of effective policy review institutions—independence, an economy-wide view, and transparent processes.

The problem of developing a mandate for structural reform is not confined to democratically elected governments. The PRC and Viet Nam also face the problem of managing vested interests. One strategy that Viet Nam has tried is a taskforce approach—putting together groups of experts from within and outside government to consider one particular area of reform (Vo and Nguyen 2010). According to Fan (2010), the PRC too is at the stage where reforms can potentially create losers as well as winners, and so it requires new strategies to deal with vested interests.

In none of these East Asian examples has an institution been given the powers of a Trustee Court to bind the actions of the government. This is the essence of the East Asian aversion to supranational institutions—no East Asian government would be willing to limit its sovereign rights in this fashion. But this does not mean that institutions with only advisory powers cannot influence policy outcomes. The country case studies in Dee (2010) demonstrate that they can, because

[15] Note that under the processes of the European Court of Justice, even the issues self-select.

ideas have influence by shaping debates, and transparent processes have influence by marshalling the winners as well as the losers from reform.

6. HOW TO SHAPE REGIONAL INSTITUTIONS TO PROMOTE DOMESTIC REFORM?

The preponderance of evidence is that signing more PTAs will not promote domestic reform. The chapters may be written and the agreements signed, but the content will continue to be relatively empty so long as governments feel that such agreements impinge unduly on their sovereignty and their right to regulate. One key reason that governments will continue to feel this way is that there is very little in PTAs to help governments deal with the domestic politics of reform.

Nor can great hope be placed in current WTO processes. Pauwelyn (2005: 58) gives a careful examination of the likelihood of ongoing WTO success, particularly given its ever broader agenda. He concludes that:

> The so-called bicycle club of trade must be disbanded. It takes exporters and producers as the core constituency of the system and assumes that, to keep their support, the world trade system requires ever more liberalization; otherwise, the bicycle will fall over. To survive as a legitimate organization, the WTO must extend its base to include consumers and citizens. It must, in other words, play out its strongest card: that genuine free trade benefits the masses, not the few. … The proxy of exporters/producers allegedly representing majority interests is no longer needed and can, in any event, no longer suffice.

It is instructive to look at recent proposals for how to restructure and revitalize the WTO. The immediate issues include whether to break away from a "single undertaking" (the decision-making rule that nothing is agreed until everything is agreed), the consensus rule, or to allow more plurilateral rather than multilateral agreements.[16] Examples of these kinds of proposals are found in the Sutherland Report (2004) and the Warwick Commission (2007).

The proposals also include the idea that WTO members should grant direct effect to WTO treaty obligations, so that individuals and enterprises can take action in national courts in the event of non-compliance by a WTO member. On the face of it, this looks like a promising move, since the doctrine of direct effect was instrumental in the EU's success in achieving domestic reform. To date, not even the EU has granted direct effect to WTO obligations, on the grounds that unless all other WTO members gave direct effect in the same way to the same provisions, the EU might put itself at a disadvantage vis-à-vis the other WTO members (for example, Van den Broek 2009). The move may well also create uncertainty for EU traders, because EU courts might have to give preference to WTO measures at the expense of EU measures. The general granting of direct effect by all WTO members would overcome the EU's first objection.

But Trachtman (1999) disagrees with the proposition that WTO members should grant direct effect to WTO obligations. He argues that the currently weak enforcement mechanisms help the WTO to achieve democratic legitimacy—something that the Stone Sweet and Brunell (2011) argument is currently lacking. Trachtman (1999, p. 678) argues that "direct effect without more direct democratic participation in formulation of the directly effective law raises as many issues as it resolves."

Pauwelyn (2005) makes a similar argument. He argues that the current WTO does not allow sufficient democratic participation (not just of the members states, but also of the various private

[16] The current WTO agreement on Government Procurement is plurilateral.

interests within them) to ensure the loyalty required for members to put up with the more legalistic system that the WTO has become. This is in contrast to the EU, where progress was slow and incremental, but where loyalty was more or less maintained (see also the seminal analysis of the EU by Weiler 1991).[17] Giving direct effect to WTO obligations would be a mistake, because it would achieve efficiency without loyalty.

Pauwelyn (2005) reviews the other major proposals that have been put forward to reform the WTO, not just in terms of the compliance it achieves, but more broadly. If a lack of democratic participation is the problem at the moment, then the solution is not to divorce trade negotiations even more from the "rough and tumble" of representative democracy (for example, Weiler 2001; Bhala 2001), nor is it to dispense with the current consensus rule (for example, Sutherland Report 2004). But nor does he think that the current dispute settlement process should be weakened (for example, Barfield 2001). As a legal scholar and former legal officer with the WTO Secretariat, the lesson he draws from the history of the WTO is that to be effective, it needed an independent and automatic enforcement mechanism—particularly once it started dealing with nontariff barriers and behind-the-border measures.

As noted above, Pauwelyn (2005) argues that the problem of the WTO is that it remains focused primarily on non-discrimination instead of economic efficiency, and on the interests of producers instead of the interests of consumers. As such, it has been ripe for exploitation by special interests. Examples cited by Pauwelyn are the protectionist agreements on agriculture, antidumping and the former agreement on textiles, and win-lose agreements (which benefit some countries at the expense of others) such as that on trade-related intellectual property rights (TRIPS).

So Pauwelyn's solution is to propose more politics and participation in the WTO, not less. And he gives a number of concrete WTO-specific proposals to provide more capital city input into Geneva processes, and to give a broader range of actors a voice in WTO issues, if not a seat at the table. Van den Broek (2009) also urges a greater role for non-state actors in bringing pressure for WTO compliance via the "mobilization of shame". Pauwelyn also proposes a slight weakening of discipline (and more options for exit) by dispensing with the single undertaking and by not requiring a consensus of all WTO members that a new plurilateral agreement can be added to the WTO system.

If the current configuration of exporter and import-competing producer interests can no longer secure further trade liberalization in the WTO, as the current fate of the Doha Round suggests, then it is even less likely to secure deeper domestic reforms in either the WTO or in regional trade negotiating forums. These current forums are simply not equipped to help governments fight the necessary domestic political battles. The above proposals are worth considering if the WTO is to make progress on its current agenda. But in the context of a much broader agenda—domestic reform—a key question is whether it would be sufficient to give a greater range of domestic interests a voice in a forum in which other governments also sit, or whether it would be even better to remove the other government(s) from the table.

[17] When the doctrines of direct effect and supremacy were first developed, there were only six member states of what is now the EU, and the legislative voting pattern in the Council of Ministers was by unanimity. Since then, there have been changes in the voting patterns in the Council, with the introduction and then modification of Qualified Majority Voting. In addition, a "co-decision" procedure has been introduced for legislation, under which both the EU Parliament and the Council of Ministers must consent to a measure for it to be adopted. These changes have contributed to the further/deeper integration of the EU legal system, and to further reforms at the domestic level in EU member states.

The above economic arguments suggest that a reciprocity mechanism is weak or ineffective in achieving behind-the-border reform. So it does not help to have another government at the negotiating table, especially when this raises concerns about loss of sovereignty, to compound the problem of lack of democratic legitimacy. But this does not mean that regional institutions, or even the WTO for that matter, cannot assist domestic governments to push a domestic reform agenda.

This has been recognized recently by Hoekman and Mattoo (2011) in the context of services trade liberalization. They argue that a concerted, international effort to pursue regulatory cooperation could help to push the reform process along both unilaterally and in market access negotiations. They argue that two types of cooperation are needed. The first is international assistance with diagnosing prevailing policies (or the lack of them) and using this analysis to devise strategies for reform. This process could help to identify a menu of regulatory options for countries to consider. Aid for trade initiatives could also help with the implementation. A second type of cooperation is between regulators, explicitly focused on addressing regulatory externalities that impede trade. An example would be initiatives to improve the international mobility of workers, as international experience suggests that this requires the regulatory cooperation of both the home and host countries.

Dee and Findlay (2008) proposed a similar agenda, but also noted that further progress would be needed on domestic reform before progress could be expected in market access negotiations. This would be the only way to overcome the quite legitimate concerns of developing countries that they were not yet ready for services trade liberalization.

Drysdale (2010) addresses more directly the kinds of regional institutions and mechanisms that could best support a domestic reform agenda. He stresses the importance of ownership of the reform agenda, something that is not helped if the reforms are seen to be dictated by outside organizations or by trading partner governments. He proposes regional support for those home-grown institutional mechanisms (such as those cited above) that help to generate successful domestic reforms. The key elements of regional support are capacity building and providing forums for experience sharing. The activities needing such support are domestic efforts to diagnose current policies and develop policy alternatives, in transparent domestic forums that allow the views of vested interests to be met and challenged by domestic pro-reform champions. The evidence above suggests that it was this aspect of the EU that accounts for its success in achieving domestic reform. So this aspect is worth the support of regional institutions.

Which members of the alpha-numeric soup of Asian regional institutions are best placed to carry out this support? Drysdale (2010) and Soesastro (2010) point out that of all the current regional institutions, APEC has the track record of regional experience sharing and mentoring. It has the sanction, through the Leaders' Agenda to Implement Structural Reform (signed in 2004). In addition, it has started to develop the delivery mechanisms, for example through the establishment of the APEC Policy Support Unit. This is not to say that other regional institutions could not also start usefully working in this direction. What is critical is to recognize that the key to achieving domestic reform is to win the domestic political battle. This is what regional institutions need to support.

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APPENDIX

Progress in Reforming Healthcare and Financial Services in ASEAN, 2008–2010

	Brunei Darussalam	Cambodia	Indonesia	Lao People's Democratic Republic	Malaysia
BANKING					
Recent	Since the Ministry of Finance issued clarification on lending in 2009, foreign banks can only lend against local capital.	An amendment was made in September 2009 to liberalize interest rate setting.	None	None	In Nov 2010, the central bank announced several measures to curb property speculation as well as to address the rising household debt problem. Among these, the monetary regulator imposed a maximum loan-to-value ratio of 70%, which will be applicable to the third house financing facility taken out by a borrower.
Prospective	With effect from 1 January 2011, the Monetary Authority Brunei Darussalam was established as a statutory body to regulate the banking, finance and insurance sector, independent of the Ministry of Finance.	None	None	None	The Central Bank of Malaysia is currently preparing a new Financial Sector Masterplan, which will further liberalize the banking and securities markets.

Notes	None	Both the minimum capital requirement and the reserve requirement was changed in 2009 in reponse to the global financial crisis.	Changes to banking industry regulation concerned a few prudential measures.	None	None
INSURANCE					
Recent	None	None	None	New Law on Investment Promotion 2009 means that 100% foreign ownership is allowed, the minimum foreign equity in joint ventures has been reduced from 30% to 10%, and the term of licences has been extended from 50 to 99 years. However, the government does not want to issue new licences because of the small size of the market.	None
Prospective	None	None	None	The Law on Insurance is expected to be amended to be more appropriate to the current situation of a more liberalized and open economy to the world and regional integration. In the coming years, the scope of the compulsory insurance-based social security system will be extended.	None

Notes	None	None	The only change in insurance regulation during 2008-2010 concerned prudential measures.	None	None
MEDICAL PROFESSIONS					
Recent	None	New mutual recognition agreement signed with ASEAN countries in 2009.	Law no. 44/2009 covers medical professionals for hospitals. Hospitals can employ foreign medical professionals, but the employment must be for the purpose of knowledge and technology transfers, ruling out foreigners in unskilled positions. Permenkes no. 028 issued on 4 January 2011 says clinics cannot hire foreign healthcare workers. Foreign equity limits for medical and dental clinincs (specialist only) have been raised from 65% to 67%. Those for nursing have been raised from 49% to 51% in Medan and Surabaya, and from zero to 49% in the rest of Indonesia.	None	None

Prospective	None	None	None	None	The Malaysian National Healthcare Financing Scheme (similar to Australia's Medicare system) may finally be implemented. The government is keen to push telemedicin', and has been promoting medical tourism. It has been promoting the recruitment of foreign doctors and specialists and establishing new medical colleges and twinning programs to raise the ratio of doctors per head of population.

HEALTH SERVICES					
Recent	None	None	Law no. 36/2009 on health requires all foreign healthcare facilities to obtain operating license. Law no 44/2009 on hospitals regulates their establishment and management and introduces mandatory accreditation every 3 years. Foreign equity limits for hospitals and medical laboratories have been raised from 65% to 67%. The minimum size of foreign hospitals has been lowered from 300 to 200 beds for ASEAN investors, though the hospitals still have to be specialist. Foreign medical professionals can be employed in hospitals and medical laboratories, but this must be for the purpose of knowledge and technology transfer, now ruling out foreigners in unskilled positions. Universal services obligations have been spelt out in law.	None	None
Prospective	None	None	None	None	None

HORIZONTAL					
Recent	None	None	None	None	None
Prospective	None	None	None	None	None
BANKING					
Recent	None	None	None	The Bank of Thailand has permitted commercial banks to employ personnel of ASEAN nationality with unlimited numbers in any position, but foreign institutions face consideration on a case-by-case basis. This policy change implements commitments under AFAS. A foreign bank with branches in Thailand is allowed to establish up to two additional branches with the approval of the Bank of Thailand. This implements commitments under the GATS.	In mid 2010, the government removed the control over the lending interest rate (commercial banks could arrange the lending interest rate with customers), but the State Bank used some administrative procedures to impose the borrowing rate below 14% (the rate that commercial banks in the Viet Nam Banking Association have committed). Circular 09 sets out stricter requirements for shareholders, especially founding shareholders, who wish to establish a joint stock commercial bank, and new longer timeframes of the application process for a license. Prior to 2010, foreign bank branches could lend against the parent capital but from 2010, branches have to lend against their own chartered capital, not

					their parent capital.
Prospective	None	None	None	None	Under the Law on Credit Institutions which will take effect on 1 January 2011, the prime interest rate structure is abolished. The prime rate was eliminated as unreflective of the supply-demand relationship on the market and was viewed as interventionist by financial markets.
Notes	None	None	None	None	Certain prudential requirements have been raised, including the minimum capital adequacy ratio.
INSURANCE					
Recent	Myanma Insurance can supply insurance services including quasi-medical insurance for expatriates going abroad. In 2008 quasi-medical insurance did not exist.	None	None	None	None
Prospective	None	None	None	None	The draft amendment and supplement to the Law on Insurance Business will recognize the cross-border provision of insurance services by foreign insurance organizations

					and individuals. It will also recognize the right to set up branches of foreign non-life insurance enterprises in Viet Nam. It would also abolish ceding percentages. All are in accordance with Viet Nam's WTO commitments. It would expand the range of recognized insurance products and insurance enterprises.
Notes	None	None	None	None	None
MEDICAL PROFESSIONS					
Recent	Same as for health services.	The process for issuing employment permits to foreign nationals has been extended from 1 to 3 working days. Otherwise, the lack of progress in liberalization stems from the constitutional provision that the practice of all professions in the Philippines shall be limited to Filipino citizens.	None	None	None
Prospective	None	None	None	None	None

HEALTH SERVICES

Recent	Some easing of cross-border trade. Some joint venture hospitals have been established since 2008.	A major policy change is the suspension for one year of the need to obtain a Certificate of Need, the only restriction on new entry of private hospitals. The DOH Administrative Order No. 2007-0027 created the improved quality assurance and monitoring program for clinical laboratories in the Philippines and rendered the DOH-BHFS Circular No. 3 Series of 2003 that suspends issuance of permits to new entry of laboratories, obsolete. The process for issuing employment permits to foreign nationals has been extended from 1 to 3 working days. In 2009, the Health and Wellness Alliance of the Philippines was established to organize industry and government	None	None	The Health Insurance Law took effect on 1 July 2009, aiming to ease the load on provincial and central hospitals, and expand policyholder categories to include drug addicts and people with congenital defects who were previously excluded.

		stakeholders involved with global healthcare and wellness services, tourism, and retirement.			
Prospective	None	There are emerging demands for the amendment of the Republic Act 4226 or the Hospital Licensure Act to expand the coverage of the law to include health facilities other than hospitals.	None	None	None
HORIZONTAL					
Recent	None	None	None	One distinctive change is the replacement of the Working of Alien Act 1978 by the new act, Working of Alien Act 2008. Among other things, it extends the validity period of the work permit from not exceeding one year to not exceeding two years. However, non-immigrants visas are normally granted for one year.	None
Prospective	None	None	None	None	None