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## The status of East Asian free trade agreements

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## **ADB Working Paper Series**

### **The Status of East Asian Free Trade Agreements**

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**Abstract**

Free trade agreements (FTAs) have become a prominent feature of the multilateral trading system and an important instrument of trade policy for members of the World Trade Organization (WTO). The proliferation of FTAs is the result of a number of factors, from the economic to the political. East Asia is with no exception involved in the process and witnessing the establishment of multilayered FTAs. Pioneered by the Association of Southeast Asian Nations (ASEAN) in 1992 when it initiated the ASEAN FTA (AFTA), and encouraged by ASEAN+1 (ASEAN plus one country) FTAs, more and more economies in east Asia are involved in FTAs, although the characteristics of these FTAs differ according to their background and circumstances. When the proliferation of FTAs in east Asia benefits the regional trade and economic growth, questions have been raised about “Asian noodle bowl” effect, pointing out multi-layered FTAs in east Asia have created new trade barriers and raised the cost of business in the region. To this end, east Asia needs to progress from the proliferation of multilayered FTAs to a region-wide FTA with wider participation and broader coverage.

**JEL Classification:** F10, F13, F15

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# 1. INTRODUCTION

Regional trade arrangements (RTAs) have become a prominent feature of the multilateral trading system and an important instrument of trade policy for members of the World Trade Organization (WTO). The proliferation of RTAs is the result of a number of factors, from the economic to the political. They may be considered an integral part of the regional movement toward integration and cooperation, or a political motivation for closer relations between countries. They may be viewed as supplementing multilateral arrangements—a “WTO plus” formula (i.e., faster, or beyond WTO arrangements). They may be seen as an alternative approach when multilateral negotiations stall, or as a regional response to globalization. They may also be a policy option to facilitate domestic reform. The principal component of an RTA is negotiation of a free trade agreement (FTA). Compared with multilateral arrangements, an FTA has broader coverage, although its principal content is liberalization and facilitation of trade and investment (Fiorentino, Verdeja, and Toqueboeuf 2006).

East Asia is witnessing the establishment of multilayered FTAs. Pioneered by the Association of Southeast Asian Nations (ASEAN) in 1992 when it initiated the ASEAN FTA (AFTA), and encouraged by ASEAN+1 (ASEAN plus one country) FTAs, more and more economies are involved in RTAs. While the characteristics of FTAs differ according to their background and circumstances, all are committed to be harmonious with WTO. FTA partners can benefit from liberalization of markets and trade, facilitation of investment, and from enhancement of economic cooperation. However, questions have been raised about the potential for negative effects of FTAs because of the complexity and inconsistency of some regulations, and the “noodle bowl” (or “spaghetti bowl”) effect arising from different rules of origin (ROOs).

While recognizing the importance of FTAs, the business community in east Asia has warned that their proliferation has created barriers and raised the cost of business in the region. At the second East Asia Summit (EAS) in January 2007, the leaders of ASEAN, Australia, the People’s Republic of China (PRC), India, Japan, the Republic of Korea (hereafter Korea), and New Zealand, agreed to launch the track II studies of the problems of FTAs and the feasibility of an integrated east Asian FTA. East Asian economies are highly integrated and interdependent. With their high levels of foreign direct investment (FDI) and an intra-regional trade and production network, east Asia needs to progress from the proliferation of multilayered FTAs to a regional FTA with wider participation and broader coverage.

## 2. FREE TRADE AGREEMENTS IN EAST ASIA

### 2.1 Proliferation of Free Trade Agreements

East Asian economies benefited from the advance of multilateralism following the Second World War because most adopted an export-led economic growth model. As the wave of regionalism emerged worldwide, east Asia economies began establishing RTAs. ASEAN, one of the early regional organizations, took the lead in forming FTAs. AFTA, established in 1992, was clearly inspired by the development dynamism of the coming European Union (EU) and the North American Free Trade Agreement.

ASEAN's role is unique in east Asia. On one hand, ASEAN seeks to benefit from FTAs with itself as the hub, creating a hub-spoke structure with its ASEAN+1 FTAs. On the other hand, as an integrated regional market, ASEAN is attractive to other regional groups, leading the latter to seek FTAs with ASEAN.

The PRC, after its emergence as an economic power and accession to WTO in 2000, showed interest in formulating FTAs in order to gain broader access to the markets of both members and nonmembers of WTO. The PRC's first FTA initiative was with ASEAN, and was aimed at establishing ASEAN as both a regional market and a close geographic partner. The PRC initiative was received favorably by ASEAN as an effective strategy for engaging a rising economic power.

The PRC's FTA with ASEAN aroused quick responses from other countries, particularly Japan and Korea, leading to several parallel ASEAN+1 FTAs in east Asia. Japan had previously focused on multilateralism, but its subsequent interest in RTAs was understandable because it was a major player in the east Asian production network. East Asian FTAs excluding Japan would impair the interests of Japanese companies with well developed business networks in the region. Korea, an emerging power in trade and investment, also began to negotiate an FTA with ASEAN. Korean negotiations followed with India, and Australia and New Zealand because of their existing or potential economic links with ASEAN.

Few economies restricted the pursuit of FTAs to east Asia as the search for FTA partners assumed a global reach. For east Asian economies, however, FTAs had clearly become a significant new strategy. How did the FTA become such an important policy instrument and trade strategy for these economies?

In general, the slow progress of the WTO Doha Development Agenda (DDA) negotiations encouraged WTO members to concentrate more on regional efforts. The FTA was embraced by WTO members as an effective instrument for exploiting regional as well as global markets. The FTA initiatives of east Asian economies are thus just one aspect of a global phenomenon.

From a regional perspective, east Asian economies have been encouraged to turn to practicable bilateral or subregional approaches by the failure of Asia-Pacific Economic Cooperation (APEC) to realize its Bogor Goal—i.e., free trade and investment in Asia and the Pacific by 2010 for developed members, and by 2020 for developing members. In 1997, APEC initiated an Early Voluntary Sector Liberalization program by selecting 15 sectors for liberalization. The program, however, failed due to its voluntary approach and the subsequent Asian financial crisis (Feridhanusetyawan 2005). The slow progress of APEC after the 1997 financial crisis encouraged its members turn to other strategies centering on FTAs.

In east Asia, FTAs are also considered part of a strategy of defense against globalization and regionalism in other regions. However, almost all countries are pursuing FTAs. European integration has deepened greatly since the 1990s—notably through the creation of a single market and the successful launch of the euro. The EU also admitted transitional economies in Central and eastern Europe as part of its continued enlargement. In addition to the North American Free Trade Agreement, the United States (US) has pursued FTAs around the world. East Asian economies understandably feel compelled to conclude their own agreements with critical markets (Asian Development Bank 2008). They fear that unless they develop their own regional trade arrangements, they will be disadvantaged in global competition and multilateral negotiations. In addition, they increasingly realize the importance of uniting themselves

to strengthen their bargaining power vis-à-vis the EU, the US, and other regional groupings (Bergsten 2000, 2001).

The push toward regionalism in east Asia strengthened considerably after the financial crisis in 1997. The crisis helped create a sense of east Asian economic identity because of the highly integrated nature of these economies (Kawai 2005). This led to the ASEAN+3 (ASEAN plus the PRC, Japan and Korea) dialogue and cooperation framework and other regional cooperation mechanisms.

FTAs can enhance market access. Compared with a multilateral approach, a regional agreement is much more flexible and can be concluded faster. Problems that may take years to resolve in global negotiations can be dealt with more quickly through an FTA (Zhang 2006). The small number of parties involved in a regional agreement—compared with a WTO agreement—facilitates agreement and the tailoring of agreements to the needs of the participants. Many FTAs in the region cover areas not covered or covered poorly by WTO arrangements, and are thus seen as elements of the WTO-plus formula. Included are FTAs dealing with liberalization of trade in services, investment, standards, intellectual property rights, capacity building, economic cooperation, and labor mobility (Feridhanusetyawan 2005).

Apart from economic considerations, RTAs may be used to cement political relationships between countries. For example, ASEAN began as politico-security institution with limited attention devoted to economic issues. The formation of AFTA in 1992 provided an effective platform for ASEAN countries to intensify cooperation. ASEAN has become an integrated framework for uniting all countries in southeast Asia, and the goal of an ASEAN Community by 2015 has been established. Similarly, the ASEAN-PRC Comprehensive Economic Cooperation Agreement (ACCEC) was regarded as contributing to the process of building political confidence when the PRC emerged as regional power. ASEAN+1 FTAs, with ASEAN as the hub, are viewed as strategic initiatives as well as instruments for community-building within ASEAN.

## **2.2 Current Status of Free Trade Agreements**

The first non-ASEAN FTA proposal in east Asia, for a Japan-Korea FTA, was put forward in 1998. That proposal remains stalled, but more FTA initiatives were subsequently proposed, with some successfully concluded and some still under negotiation. These FTAs include some restricted to east Asian countries as well as some between east Asian countries and countries in other regions (Appendix Tables 1 and 2).

The Japan-Singapore Economic Partnership Agreement (JSEPA) was considered an innovative FTA in the region when it was concluded in 2002 because it covers more than the conventional areas of liberalization. Trade, investment, and services are covered, as are a mechanism for dispute settlement, and economic and technical cooperation at various functional levels.

The PRC took the lead in concluding a large-scale FTA with ASEAN. Signed in 2002, the ASEAN-PRC Comprehensive Economic Cooperation Agreement began with an early harvest program focusing on liberalization of trade in major agricultural products and an agreement on agricultural cooperation. ACCEC, for liberalization of trade in goods, was signed in November 2004 with implementation beginning in July 2005. ACCEC was followed in 2007 with an FTA for liberalization of trade in services, and an agreement for liberalization of investment was signed in August 2009.



In 2003, Japan signed the ASEAN-Japan Comprehensive Economic Partnership framework agreement with ASEAN and concluded six bilateral FTAs with individual ASEAN countries (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand). Negotiation of the ASEAN-Japan Comprehensive Economic Partnership (AJCEP) was concluded in 2008. Korea accelerated negotiations with ASEAN and the ASEAN-Korea Comprehensive Economic Cooperation Agreement (AKCEC), covering both goods and services, was concluded in November 2007.

Including FTAs with economies in other regions, east Asian economies had concluded 50 FTAs by July 2010, with 43 more under negotiation and an additional 32 proposed (Table 1 and Table 2). Singapore had concluded the most FTAs (35), with 10 under negotiation and 4 proposed. Korea, the PRC, and Thailand followed with 26, 25, and 24 FTA initiatives, respectively. Of these, 6 were being implemented by Korea, 10 by the PRC, and 11 by Thailand. In general, the more developed economies were more active in negotiating FTAs because they often possess stronger negotiating capacities. The less developed economies (e.g., Cambodia, the Lao People's Democratic Republic, and Myanmar) tended to rely more heavily on FTAs based on AFTA and ASEAN+1. Most (102) of the 125 FTAs concluded or initiated by east Asian economies were with countries outside of east Asia.

**Table 1: East Asian Free Trade Agreements (ASEAN+3 Countries)**

Negotiating Body	Under Implementation	Signed	Under Negotiation	Proposed	Total	Partners	
						Inside EA	Outside EA
ASEAN	6	0	1	2	9	5	4
Brunei Darussalam	8	0	2	4	14	6	8
Cambodia	6	0	1	2	9	5	4
China, People's Republic of	10	1	6	8	25	9	16
Indonesia	7	1	2	7	17	6	11
Japan	11	0	5	6	21	11	10
Korea, Republic of	6	1	9	10	26	8	18
Lao People's Dem. Rep.	8	0	1	2	11	6	5
Malaysia	8	2	6	3	19	7	12
Myanmar	6	1	2	2	10	5	5
Philippines	7	0	1	4	12	6	6
Singapore	18	3	10	4	35	8	27
Thailand	11	0	7	6	24	9	15
Viet Nam	7	0	3	3	13	6	7
<b>Total</b>	<b>40</b>	<b>10</b>	<b>43</b>	<b>32</b>	<b>125</b>	<b>23</b>	<b>102</b>
Under implementation						16	24
Signed						1	9
Under negotiation						1	42
Proposed						5	27

ASEAN = Association of Southeast Asian Nations, Dem. = Democratic, EA = East Asia (ASEAN+3), Rep. = Republic.

Notes:

1. ASEAN = Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, Viet Nam.

2. The total avoids double counting and does not correspond to the vertical sum of agreements by status.

3. Status of free trade agreements: (i) under negotiation = under negotiation with or without a signed framework agreement; (ii) proposed = involved parties are considering creating an agreement, establishing joint study groups or joint task forces, and/or conducting feasibility studies for an agreement; and (iii) Concluded = negotiations are completed and parties have signed an agreement and/or begun to implement provisions of an FTA (for example, tariff cuts have begun).

Source: Asia Regional Integration Center. FTA Database. <http://www.aric.adb.org> (accessed July 2010).

**Table 2: Free Trade Agreements involving Countries in East Asia (ASEAN+6 Countries)**

	Japan	Rep. of Korea	PRC	ASEAN	India	Australia	New Zealand
Japan		⊙		☑	⊙	⊙	⊙
Rep. of Korea	⊙		⊙	☑	☑	⊙	⊙
PRC		⊙		☑	⊙	⊙	☑
ASEAN	☑	☑	☑	☑	☑	☑	☑
India	⊙	☑	⊙	☑			
Australia	⊙	⊙	⊙	☑			☑
New Zealand	⊙	⊙	☑	☑		☑	

ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China, Rep. = Republic.

Notes:

1. ASEAN = Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, Viet Nam.

2. ☑ = concluded, ⊙ = under negotiation, and ⊙ = under consideration.

Source: Asia Regional Integration Center. FTA Database. <http://www.aric.adb.org> (accessed July 2010).

As FTAs proliferate, the question naturally arises: could greater benefits be achieved by integrating them. The consolidation of east Asian bilateral and regional FTAs has been explored in both the ASEAN+3 (EAFTA—East Asia FTA) framework and the ASEAN+6 (CEPEA—Comprehensive Economic Partnership for East Asia) framework. While no decision has been reached, interest in these efforts remains strong. Consolidation in a larger framework, such as in the context of APEC and encompassing all APEC members, was proposed under the Free Trade Agreement of the Asia-Pacific (FTAAP) (Asian Development Bank 2008).

### 3. MAIN FEATURES OF FREE TRADE AGREEMENTS IN EAST ASIA

#### 3.1 General Characteristics

AFTA started with the Common Effective Preferential Tariff (CEPT) agreement, which covers only trade in goods. Agreements covering trade in services and investment were concluded later. This gradual approach differs from the inclusive approach to agreement, which is formulated from the outset as a comprehensive agreement covering investment, services, property rights, customs harmonization, and other areas. The latter approach is considered practical in view of the development of ASEAN and most economies in east Asia.

FTAs in east Asia vary extensively in terms of institutional arrangements. AFTA followed a regional approach by adopting a CEPT with different time schedules for old members and new members of ASEAN. Additionally, AFTA may be adjusted during implementation.<sup>2</sup> The ASEAN-PRC framework agreement specifies a regional approach to negotiations while providing for the possibility of bilateral negotiations—e.g., in determining the lists of exemptions and fast track implementation (Feridhanusetyawan 2005). A separate services and investment agreement was also negotiated. In contrast, Japan followed both bilateral and regional approaches in negotiating its agreement with ASEAN.<sup>3</sup>

FTAs in east Asia use the term “comprehensive economic partnership”, which encompasses not only liberalization of trade, investment, and services, but also many other areas, such as intellectual property rights, standards, competition policy, procurement, labor mobility, and economic cooperation. Economic cooperation in this context goes beyond traditional economic assistance, covering infrastructure, human resource development, capacity building, technical assistance, and subregional development. Comprehensive economic partnership agreements cover areas not yet covered or covered inadequately by WTO, and are thus commonly known as WTO plus. The following areas are usually included in these agreements.

**Liberalization.** This covers elimination of tariffs and nontariff barriers, national treatment of imports, market access for trade in services, investment liberalization through national treatment, and national treatment in government procurement. Time schedules are incorporated for liberalization, exclusion and negative lists, and accelerated liberalization through early harvest programs.

**Facilitation.** Included are customs valuation and procedures, standards and conformance measures dealing with technical barriers to trade, and sanitary and phytosanitary measures. Also included are rules of origin as criteria to preferential treatment, transparency of laws and regulations, movement of professional and business people, and improvements in logistics and transportation.

**Protection.** This includes safeguard measures for disruptive imports, fair competition between imports and domestically produced goods, protection of intellectual property rights, investment guarantees, and dispute settlement mechanisms.

**Cooperation.** Included under this broad category are macroeconomic dialogue and surveillance mechanisms, financial and monetary cooperation, infrastructure development, and subregional development. Cooperation in human resource development and capacity building, development of small and medium enterprises (SMEs), science and technology development, and research and development are also included.

**Differential treatment.** This provides for flexible and special treatment for the less developed countries of Cambodia, the Lao People's Democratic Republic, Myanmar, and Viet Nam. Such treatment can take the form of longer time frames for fulfillment of commitments, larger sensitive and exclusion lists, and special assistance in capacity

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<sup>2</sup> AFTA has undergone several changes. In 1996 the time frame was changed from 15 years to 10 years and the tariff reduction target from 0-5% to zero. In 1999 the time frame was changed again—for old members, to 2010, and for new members, to 2015 (except for a few sensitive goods).

<sup>3</sup> An interesting aspect of the Japan-Philippines agreement is the provision for entry and temporary stay in Japan of nurses and certified care workers from the Philippines.

building—e.g., development of human resources and infrastructure (see Joint Expert Group on Feasibility Study of EAFTA 2006).

The objectives of FTAs in east Asia are oriented more toward liberalizing trade and investment than toward real economic integration. East Asia needs to build on FTAs by improving the business environment through further liberalization and closer cooperation. Even the goals of the proposed EAFTA and CEPEA still focus more on opening markets than on economic cohesion. ASEAN has decided to establish an ASEAN Economic Community (AEC) by 2015 with the aim of creating a unified market and production base. However, the primary goal of the AEC—at least in the design stage—still appears to be a highly liberalized market rather than a high level of economic integration based on integrated economic policies and institutions.<sup>4</sup>

### 3.2 Tariff Reduction

Tariff reduction is an important and essential chapter in most FTAs in east Asia. However, there seems to be no common practice or widely accepted model to guide tariff reduction initiatives. Some agreements—such as AFTA, ACCEC, AKCEC, the Singapore-New Zealand Closer Economic Partnership (SNZCEP), and the Singapore-Australia FTA—pursue a negative-list approach, by which tariffs for all items are generally reduced and sensitive goods are listed in “sensitive track” and subject to specific arrangements. In contrast, AJCEP, JSEPA, and some other FTAs take a positive-list approach, whereby tariffs of all items, including specific commodities on the list, are reduced according to a detailed schedule for tariff reductions (see Table 3).

In all these agreements, the common practice is for participants to agree on base tariff rates—to which reductions will apply—before tariff reduction schedules are adopted. The base rate is usually the most favored nation (MFN) applied rate at the beginning of the negotiation period.

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<sup>4</sup> The objectives of the AEC are a single market and production base, and a region that is highly competitive, fully integrated into the global economy, and characterized by equitable development.

**Table 3: Tariff Reduction in Selected East Asian Free Trade Agreements**

AFTA	ACCEC	AJCEP	AKCEC	JSEPA	CNZFTA
Negative list approach, 0% target. The CEPT scheme allows countries to maintain a temporary exclusion list (TEL), sensitive list (SL), and general exclusion list (EL). Commodities are phased into inclusion list (IL) gradually, and there is a longer time frame for ASEAN4 countries. ASEAN6 reached 0–5 % tariff in 2003, Viet Nam in 2006, Lao PDR and Myanmar in 2008, and Cambodia in 2010.	Negative list approach. Under the normal track, tariff will be eliminated by 2010 for ASEAN6 and the PRC. Under the sensitive track, tariff reduction will start in 2012, to reach 0–5% tariff levels by 2018. ASEAN4 is given 5 more years after ASEAN6 to follow a similar tariff reduction scheme. Tariff on goods under the Early Harvest Program, which includes agricultural products (Chapters 01 to 08 of the HS code), will be reduced to zero for ASEAN6 and the PRC.	Positive list approach. Japan formulated different agreements with ASEAN members. Most of tariff will be eliminated immediately or reduced to 0–5% in 11 years for ASEAN6. ASEAN4 is subject to 18 years to follow a similar scheme by 2026. (But Viet Nam must adhere to a relatively serious schedule). Japan has a 16-year scheme to eliminate tariff to 0 or reduce to a low line less than 20%. There are also some specific items in the list which are excluded from any tariff commitment.	Negative list approach. Under the normal track, tariff will be eliminated by 2010 for ASEAN6 and the PRC. ASEAN4 is given 8 more years after ASEAN6 to follow a similar tariff reduction scheme. (Viet Nam is given 6 more years) Under the sensitive track, tariff reduction will start in 2012, to reach 0–5% tariff levels by 2016 for ASEAN6 and the Republic of Korea, by 2021 for Viet Nam, and by 2024 for ASEAN3.	Positive list approach. Tariff on Singapore's imports from Japan will be 0 immediately. To complete tariff elimination in Japan with 10-year transition period by 2010. Japan maintains some exceptions, including meat and meat products, fruit and vegetables, dairy products, and cane and beet sugar.	Positive list approach. Tariff on New Zealand imports from the PRC will be 0% no later than 2016. The PRC has 3 more years to commit to the scheme by 2019. The PRC maintains some exceptions, including greasy wool, carbonized wool, carded wool, and other six items. The tariffs on the products in Chapters 44, 48, and 49 of the HS code, for which rates shall be applied in accordance with PRC's WTO commitments. There is an Accelerated Tariff Elimination clause of Article 8 in the agreement.

AFTA = ASEAN Free Trade Agreement, ACCEC = ASEAN-PRC Comprehensive Economic Cooperation Agreement, AJCEP = ASEAN-Japan Comprehensive Economic Partnership, AKCEC = ASEAN-Korea Comprehensive Economic Cooperation Agreement, ASEAN = Association of Southeast Asian Nations, CEPT = Common Effective Preferential Tariff, PRC = People's Republic of China, CNZFTA = PRC-New Zealand Free Trade Agreement, HS = Harmonized System (tariff code), JSEPA = Japan-Singapore Economic Partnership Agreement, Korea = Republic of Korea, Lao PDR = Lao People's Democratic Republic, WTO = World Trade Organization.

ASEAN = Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, Viet Nam.

ASEAN3 = ASEAN = ASEAN, PRC, Japan, and Korea.

ASEAN4 = ASEAN members Indonesia, Malaysia, Philippines, and Thailand.

ASEAN6 = ASEAN members Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand.

Source: FTA agreements.

When the negative-list approach is used, specific goods are usually listed under sensitive track or “highly sensitive track,” with explicit tariff reduction schedules—comprising a transitional period or a particular tariff rate—applicable to a specified good or goods. There may often be an exception list of some items—or even a sector or sectors—which are exempt from tariff commitments. The positive list approach, while differing in methodology, also incorporates tariff exemptions in the agreement.

In most FTAs, transitional periods usually apply to less developed countries. Even when the participants of an FTA are developed economies, special arrangements for specific items or sectors may be included. In JSEPA, for example, Japan enjoyed a transitional period and a gradual reduction of tariffs before fully liberalized access to the Japanese market was available to Singapore. ACCEC started with an early harvest program, whereby tariffs for 600 agricultural products were eliminated ahead of an FTA, and the PRC did not request a reciprocal reduction from the new members of ASEAN.

### 3.3 Rules of Origin

Rules of origin (ROOs) vary from a local or regional content approach (value added criterion [VC], satisfying minimum local or regional value content), to a change in tariff code classification rule (CTC, defined at a detailed Harmonized System (HS) tariff code level), to a specific process rule (SP, requiring a specific production process for an item) (Tables 4 and 5). Most agreements allow for cumulative ROOs to determine the total bilateral or regional local content of a product. For example, the criterion of 40% VC was first introduced by AFTA when the CEPT scheme was agreed upon in 1992. During negotiations between the PRC and ASEAN for ACCEC, PRC accepted the AFTA ROOs.

JSEPA specifies a “wholly obtained or produced entirely” rule, which requires that products undergo sufficient transformation in the member country in order to receive preferential treatment under the FTA. Cumulation and de minimis are accepted, but the agreement specifies different shares of de minimis—set at 8%–10%. Heading changes are required for HS01-24, HS38 (chemical products), and HS85 (machinery), with subheading changes or regional contents requirements (for liquor and cordials). A regional contents requirement of 60% (with a combination of subheading changes) is required for other chapters of HS. For textile fabrics and articles (HS59), fabric should be made with yarn from an FTA member country (Cheong and Cho 2006).

**Table 4: Overview of Rules of Origin in Selected East Asian Free Trade Agreements**

	<i>AFTA</i>	<i>ACCEC</i>	<i>AJCEP</i>	<i>AKCEC</i>	<i>JSEPA</i>	<i>CNZFTA</i>
<b>CTC</b>	Yes, but not necessary	Yes, but not necessary	Yes	Yes	Yes	Yes
<b>RVC Ratio</b>	40%	40%	40%	60-40%	60-40%	50-30%
<b>SP</b>	Chapter 50–63	Chapter 50–63	Chapter 50–63	Not mentioned	Chapter 28–40, 50–63	Chapter 28–40, 50–63
<b>Cumulation</b>	Yes	Yes	Yes	Yes	Yes	Yes
<b>De minimis</b>	Not mentioned	Not mentioned	7–10%	10%	8–10%	Not mentioned

AFTA = ASEAN Free Trade Agreement, ACCEC = ASEAN-China Comprehensive Economic Cooperation Agreement, AJCEP = ASEAN-Japan Comprehensive Economic Partnership Agreement, AKCEC = ASEAN-Korea Comprehensive Economic Cooperation Agreement, ASEAN = Association of Southeast Asian Nations, JSEPA = Japan-Singapore Economic Partnership Agreement, Korea = Republic of Korea, CNZFTA = PRC-New Zealand Free Trade Agreement.

Notes:

1. CTC: change in tariff classification rule.
2. RVC: regional value content rule.
3. SP: specific process rule.

Source: Individual FTA agreements.



**Table 5: Rules Origin in Selected Bilateral Free Trade Agreements in East Asia (ASEAN+6)**

<b>Value Added Criterion (VC)</b>	
Singapore-New Zealand	Cumulative local content >40%
Singapore-Australia	Cumulative local content >50%
Australia-New Zealand	Cumulative local content >50%
<b>Change of Tariff Code Classification (CTC)</b>	
Japan-Malaysia	HS 4 digit
Thailand-Australia	HS 4 digit or HS 6 digit
Thailand-New Zealand	HS 4 digit or HS 6 digit
Singapore-Rep. of Korea	HS 4 digit or HS 6 digit
<b>Alternative</b>	
Japan-Singapore	Cumulative local content >40%, or CTC HS 4 digit
<b>Requirement of VC and CTC</b>	
Thailand-India	Cumulative local content >40%, and CTC HS 4 digit
Singapore-India	Cumulative local content >40%, and CTC HS 4 digit

ASEAN = Association of Southeast Asian Nations, HS = Harmonized System (tariff code), Rep. = Republic.

ASEAN+6 = ASEAN plus the People's Republic of China, Japan, the Republic of Korea, India, Australia, and New Zealand.

Source: Preliminary report on Soesasto, Hadi, ed. 2008. *Developing a Roadmap toward East Asian Economic Integration*. Economic Research Institute for ASEAN and East Asia (ERIA) Research Project Report 2007, No. 1-1. Chiba: Institute of Developing Economies-Japan External Trade Organization.

### 3.4 Economic Cooperation

FTAs in east Asia incorporate a variety of commitments to economic cooperation in a number of areas. Cooperation agreements are typically popular as general statements or as part of framework agreements. Many cooperation agreements, however, have no specific work plan, time schedule, or review mechanism. Economic cooperation may be seen as representing a commitment to deepening bilateral relations and to narrowing development gaps between FTA participants, thus contributing to regional economic integration.

AFTA includes cooperation in its Framework Agreements on Enhancing ASEAN Economic Cooperation, concluded in 1992. ASEAN members reached a consensus on four broad areas of cooperation—i.e., trade; industry, minerals, and energy; finance and banking; and transportation and communications. They also agreed to increase cooperation in research and development, technology transfer, tourism promotion, human resource development, and other economic areas (Banda and Whalley 2005).

The ASEAN-PRC framework agreement incorporates wide ranging commitments to cooperation, with five key sectors identified: agriculture, information and communication technology, human resource development, investment, and Mekong River Basin

development. Concrete measures were also included to promote and facilitate trade in goods and services as well as investment (i.e., standards and conformity assessment, technical barriers to trade, nontariff measures, and customs cooperation); enhance the competitiveness of SMEs; and promote electronic commerce, capacity building, and technology transfers.

AJCEP details many areas of cooperation, including trade facilitation, business environment enhancement, energy, information and communications technology, human resource development, tourism and hospitality, transportation and logistics, standards conformity, and mutual recognition. AKCEC targets 19 areas of cooperation, including customs procedures, trade and investment promotion, financial services, SMEs, standards and conformity assessment, sanitary and phytosanitary measures, broadcasting, and film making.

Singapore attaches limited significance to the chapter on cooperation in its FTAs. Cooperation is not included in the framework agreement of JSEPA. The PRC followed her tradition in terms of the importance attached to a cooperation clause again in the measures for cooperation incorporated in the PRC-New Zealand FTA (CNZFTA). The scenario for cooperation envisaged there is wide ranging, from economic cooperation, to cooperation on SMEs, to labor and environmental cooperation. In pursuit of such cooperation, the two countries pledge to encourage and facilitate policy dialogue and regular exchanges of information with the aim of expanding trade and investment; assistance and amenities for visiting business persons and trade missions; dialogue and exchanges on experience; and economic activities in both the public sector and private sector. Particular importance is attached to cooperation in support of SMEs with the promotion of cooperation and information exchange between government institutions, business groups, and industrial associations; trade fairs and investment marts; training and personnel exchange; and support for financial assistance and intermediary services to SMEs.<sup>5</sup>

### 3.5 Commitments Beyond Tariff Reduction

In most east Asian FTAs, specific chapters address technical barriers to trade—including elimination of quantitative trade restrictions and other nontariff barriers, but the extent and depth of coverage vary. Singapore tends to have fewer technical barriers to trade than other economies in east Asia. The SNZCEP, JSEPA, and the Singapore-Australia FTA, for example, all state that quantitative restrictions are either not permitted or subject to WTO criteria. In contrast, AFTA, an FTA including economies ranging from the most developed to the least developed, retained technical barriers as a “safeguard” for the less-developed economies. Technical barriers to trade are a concern for most economies in the region (Feridhanusetyawan 2005) (Tables 6 and 7).

Like its commitment to reducing technical barriers to trade, Singapore tends to have liberal safeguard content in its FTAs, with no safeguards permitted in the Singapore-New Zealand CEP and the Singapore-Australia FTA. However, JSEPA, ACCEC, AKCEC, AJCEP, and the PRC-New Zealand FTA all reference in varying ways the right of members to initiate a safeguard for a good within the transition period. AFTA makes no mention of safeguard content. Most east Asian FTAs contain chapters on antidumping and countervailing duty management, but the bulk of these do not go beyond the commitments of WTO.

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<sup>5</sup> See PRC-New Zealand Free Trade Agreement, 2008.

All FTAs in east Asia cover liberalization of trade in services, although the extent of commitment and implementation vary. Many agreements include liberalization of trade in services in their agenda, but contain few provisions beyond the commitments of the General Agreement on Trade in Services (GATS). The ASEAN Framework Agreement on Services follows the GATS positive list approach and pledges to go beyond GATS in terms of liberalization, but progress has been slow. JSEPA and the Singapore-New Zealand agreement follow a similar approach as well as wider provisions, including market access, national treatment, or MFN treatment. FTA agreements on services sometimes adopt a negative list approach like the Singapore-Australia FTA, although liberalization content differs. The ASEAN+1 framework agreements, such as those under ACCEC, AJCEP, and AKCEC, clearly note that each party is committed to liberalize trade in services beyond its GATS commitments. ACCEC and AKCEC formulated a detailed agreement covering trade in services. AJCEP postponed liberalization of trade in services, and discussion and negotiations of these provisions continue. Like commitments to tariff reduction, agreements covering trade in services contain a general list and an exemption list incorporating specific sectors.

The scope of each FTA must be examined in order to understand its primary characteristics. Accordingly, it is essential to first define the scope of one standard FTA. The standard scope of a potential FTA can be defined easily since most economies involved in FTAs are members of WTO. In practice, the framework of an FTA differs due to WTO plus contents from liberalization of service/investment, intellectual property, government procurement, competition policy, to institutional provision and so on (Korea Institute International Economic Policy 2008).

**Table 6: Services and Investment Liberalization in Selected East Asian Free Trade Agreements**

	<i>AFTA</i>	<i>ACCEC</i>	<i>AJCEP</i>	<i>AKCEC</i>	<i>JSEPA</i>	<i>CNZFTA</i>
<b>Services</b>	Services liberalization is covered under AFAS, signed in 1995. The objective of AFAS is to enhance cooperation in services, eliminate substantially restrictions to trade in services, and liberalize trade in services by expanding the depth and scope of liberalization beyond GATS commitment. AFAS follows a positive list approach.	The parties agree to enter into negotiation to progressively eliminate all discriminatory measures with respect to trade in services, expand the depth and scope of services liberalization under GATS, and enhance cooperation in services to improve efficiency and competitiveness.	Liberalization is directed toward progressive elimination of substantially all discrimination, expansion in depth and scope of services liberalization, facilitation of entry and temporary movement of businesspeople, and enhanced cooperation in services.	The parties agree to enter into negotiation to progressively liberalize trade in services among the parties with substantial sectoral coverage in conformity with Article V of GATS. Such liberalization shall be directed to elimination of discriminatory measures, expansion in the depth and scope of liberalization of trade in services, enhanced cooperation in services among the parties in order to improve efficiency and competitiveness.	Positive list approach based on GATS. Mainly agreement on national treatment and improvement of market access. Safeguard provision not included. Government procurement and investments are covered separately. The right of nonestablishment is not included. Maritime and aviation services are generally excluded, while telecommunications services are covered under a separate chapter.	Mainly agreement on national treatment, most favored nation (MFN) treatment, and improvement of market access. Air traffic rights, and services directly related to the exercise of air traffic rights are generally excluded. Government procurement not included.
<b>Investment</b>	Covered under the Framework Agreement on the ASEAN Investment Area (AIA), signed in 1998, to establish the ASEAN competitive investment area by 2010 and free flow of investment by 2020. AIA provides national treatment to ASEAN investors by 2010 and other investors by 2020, and opens all industries to ASEAN investors by 2010 and others by 2020.	The parties agree to enter into negotiation to progressively liberalize the investment regime, strengthen cooperation in investment, facilitate investment, improve transparency of investment rules and regulations, and provide protection for investment.	ASEAN and Japan agreed to create a liberal and competitive environment, strengthen cooperation in investment, facilitate investment, improve transparency, and provide protection for investors and investment.	The parties agree to enter into negotiation to progressively liberalize the investment regime, strengthen cooperation in investment, facilitate investment, improve transparency of investment rules and regulations, and provide protection for investment.	Provision of national treatment to investors and equal access to justice to pursue or defend investors' rights. No performance-related requirement as a condition for establishment and expansion of operation. Temporary safeguard measures are possible in the case of serious balance of payment difficulties. Neither party shall expropriate or nationalize investment or pursue other similar measures, except for public purposes, and the expropriation shall be conducted based on nondiscriminatory bases and upon the payment of compensation.	National treatment and MFN treatment are included. Free transfer of all payments relating to an investment. Neither party shall expropriate or nationalize investment or undertake other equivalent measures. Investors are protected against expropriation, and fair market value of the expropriated investment is compensated immediately should expropriation occur. Government procurement excluded. Providing investor dispute settlement mechanism.

AFAS = ASEAN Framework Agreement on Services, AFTA = ASEAN Free Trade Agreement, ACCEC = ASEAN-China Comprehensive Economic Cooperation Agreement, AJCEP = ASEAN-Japan Comprehensive Economic Partnership Agreement, AKCEC = ASEAN-Korea Comprehensive Economic Cooperation Agreement, ASEAN = Association of Southeast Asian Nations, GATS = General Agreement on Trade in Services, JSEPA = Japan-Singapore Economic Partnership Agreement, CNAFTA = PRC-New Zealand Free Trade Agreement .

Source: Individual FTA agreements.

**Table 7: Comparison of Regulations Incorporated in Free Trade Agreements Concluded by the People's Republic of China and the Republic of Korea**

	People's Republic of China with:					Republic of Korea with:				
	ASEAN	Pakistan	Chile	N.Z.	CEPAs	Chile	Singapore	EFTA	ASEAN	US
<b>Market access for goods</b>	○	○	○	○	○	○	○	○	○	○
MFN treatment	○	○	○	○	○	×	×	○	○	○
National treatment	○	○	○	○	○	○	○	○	○	○
Tariff concession	○	○	○	○	○	○	○	○	○	○
Rule of origin	○	○	○	○	○	○	○	○	○	○
Customs procedure	○	○	○	○	○	○	○	○	×	○
Technical barriers to trade	○	○	○	○	○	○	○	○	○	○
Sanitation and phytosanitary measures	○	○	○	○	○	○	○	○	○	○
Safeguard management	○	○	○	○	○	○	○	○	○	○
Antidumping/countervailing duty management	○	○	○	○	○	○	○	○	○	○
<b>Service trade sector</b>	○	×	○	○	○	○	○	○	○	○
Regulation of specific service	○	×	○	○	○	○	○	○	○	○
Movement of a natural person	○	×	○	○	○	○	○	○	×	×
<b>Investment</b>	×	○	×	○	○	○	○	○	×	○
<b>Intellectual property</b>	×	×	○	○	○	○	○	○	○	○
<b>Government procurement</b>	×	×	×	×	×	○	○	○	×	○
<b>Others</b>										
Competition policy	×	×	×	×	×	○	○	○	×	○
Environment	×	×	○	×	×	×	×	×	×	○
Labor	×	×	○	×	×	×	×	×	×	○
Electronic commerce	×	×	×	×	○	×	○	×	×	○

	Transparency	○	○	○	○	○	○	○	○	○	○
	<b>Institutional provisions</b>										
	FTA operation organization	○	○	○	○	○	○	○	○	○	○
	Dispute settlement policy	○	○	○	○	X	○	○	○	○	○

ASEAN = Association of Southeast Asian Nations, CEPA = Hong Kong/Macao Closer Economic Partnership Arrangement, EFTA = European Free Trade Association, FTA = free trade agreement, MFN = most favored nation, N.Z. = New Zealand, US = United States.

Note: O = included, X = not included.

Source: Development Research Center of the State Council (DRC), Korea Institute for International Economic Policy (KIEP). 2008. *Papers presented for the International Symposium on Possible Roadmap to a CJK FTA: Obstacles and Expectations*. 1 August. Beijing: DRC.

**Table 8: Comparison of Regulations Incorporated in Economic Partnership Agreements Concluded by Japan**

	With Japan								
	Singapore	Mexico	Malaysia	Philippines	Thailand	Indonesia	Chile	Brunei	ASEAN
<b>Market access for goods</b>	○	○	○	○	○	○	○	○	○
Tariff concession	○	○	○	○	○	○	○	○	○
Rules of Origin	○	○	○	○	○	○	○	○	○
Customs procedure	○	○	○	○	○	○	○	○	×
Technical barriers to trade	×	○	○	×	×	×	○	×	○
Sanitation and phytosanitary measures	×	○	○	×	×	×	○	×	○
Mutual recognition	○	×	×	○	○	×	×	×	×
<b>Service trade sector</b>	○	×	○	○	○	○	○	○	○
Movement of a natural person	○	○	×	○	○	○	○	×	×
<b>Investment</b>	○	○	○	○	○	○	○	○	○
<b>Intellectual property</b>	○	×	○	○	○	○	○	*2	*3
<b>Government procurement</b>	○	○	×	○	○	○	○	*4	×
<b>Others</b>									
Competition policy	○	○	○	○	○	○	○	×	*5
Environment	×	○	○	○	*1	○	○	○	×
Cooperation	○	○	○	○	○	○	×	○	○
Paperless Trading	○	×	×	○	○	×	×	×	×
<b>Institutional provisions</b>									
Dispute settlement policy	○	○	○	○	○	○	○	○	○

ASEAN = Association of Southeast Asian Nations, Brunei = Brunei Darussalam.

Notes:

○ = included , × = not included.

\*1: as part of "Cooperation".

\*2: as part of "Cooperation" and "Improvement of Business Environment".

\*3: as part of "Improvement of Business Environment".

\*4: as part of "Cooperation".

\*5: as part of "Cooperation".

Source: National Institute for Research Advancement of Japan (NIRA):. 2008. Papers presented for the International Symposium on Possible Roadmap to a CJK FTA: Obstacles and Expectations. 1 August. Beijing: DRC.



## 4. NEED FOR A WIDER REGIONAL FREE TRADE AGREEMENT

### 4.1 New Challenges

#### *Noodle Bowl Effects*

East Asian economies are highly interdependent through a regional production network. This network functions through the division of a product production chain into components and the allocation of individual components to the most cost-efficient location in east Asia. Production processes are thus fragmented into multiple slices and located in different countries. For some products, individual steps may be the responsibility of a single firm (or firms in the same group) that has operations in different countries, while others may involve transactions between different firms in several countries.

How does this production network function well without a regional free trade agreement? Two factors are crucial. One is the liberal policy adopted unilaterally by individual countries with a focus on attracting FDI and participating in the division of production. Another is the intra-firm network (or networks) of multinational corporations that benefits from the FDI-friendly policy of the host countries. Supported by appropriate policy and market arrangements, the production network facilitates exploration of market conditions with the aim of maximizing benefits among producers. While the production network is not without shortcomings and restraints, it does facilitate appropriate adjustments to changes in market conditions. FTAs, initiated and negotiated by east Asian governments, aim to produce more benefits than the production network dominated by multinational corporations. However, they may in fact create barriers for the production network due to their complex regulations and rules, which were formulated and approved with few consultations with the business community.

East Asian FTAs started with a multilayered approach. This approach can provide incentives for individual countries and a regional group like ASEAN to pursue maximum gains. However, it may also create barriers in regional trade and investment and fragment the regional market because of the variety of arrangements, thus reducing gains. Business costs may increase due to complicated or contradicting regulations (e.g., ROOs) which are counterproductive in the context of economic integration based on the production network (Zhang 2006).

Complex FTAs could disrupt the cross-border production networks which have been central to the region's successful integration. Uncoordinated proliferation of FTAs may lead to inconsistent provisions in FTAs—especially rules of origin—which could hamper the process of production networking across countries (Feridhanusetyawan 2005).

Transaction costs may increase due to FTA procedures for product border crossing, such as documenting products and verifying them prior to crossing. Transactions for product border crossing may be time consuming and counterproductive, even hindering the smooth mechanism aimed for in an FTA. As a result, many businesses prefer paying MFN duties to proving origin as required by FTAs. The latter may cost much more than money.

The noodle bowl effects of FTAs occur for two reasons (Bhagwati 1995; Bhagwati, Greenaway, and Panagariya 1998; Baldwin 2006, 2007). One is the variation in the models and the scope of tariff liberalization arrangements in FTAs. Another is the differences in ROOs in these agreements. FTAs call for different phase-in modalities—i.e., tariff reduction schedules. Exporters may face different tariffs according to product destination. Similarly, several types ROOs are used differently, even in the same FTA (Table 4 and Table 5).

#### *Low Utilization of Free Trade Agreements*

Data showed that AFTA preferential tariff rates were not being widely used, with less than 3% of intra-ASEAN trade, overall, benefiting from these rates (Figure 1). In order to benefit, importers must prove the goods they are importing originated in ASEAN.<sup>6</sup> This requires completion of Form D. The majority of traders found it advantageous to pay the MFN applied rate (and thus avoid the administrative cost and delay of Form D), or to take advantage of other schemes—such as duty drawback programs or duty-free treatment in export processing zones (Baldwin 2007).

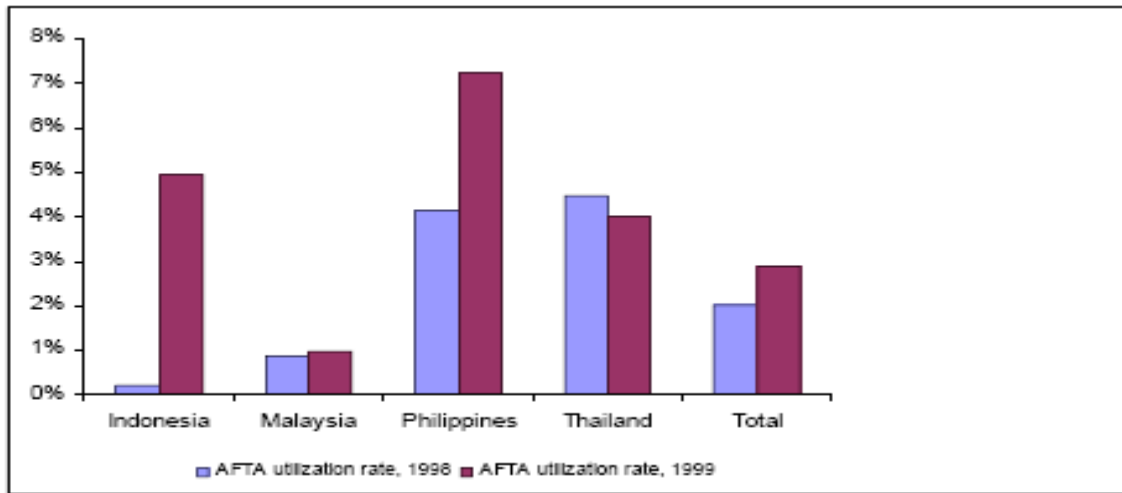
According to a survey by the Japan External Trade Organization (JETRO), only 11.2% of Thailand's imports from AFTA members took advantage of AFTA's CEPT. Malaysian data indicated that only 4.1% of its exports to AFTA members enjoyed CEPT preference rates (JETRO 2003).

Why the low utilization of preferential tariff rates under AFTA? The answer lies in the small margins between AFTA preferential tariffs and MFN tariff rates. For the bulk of intra-AFTA trade, they are too small to compensate for the administrative cost and delay of applying for preferential tariff treatment. Due to the production networks, computer/machinery (HS chapter 84), and electrical goods and electronic parts and components (HS chapter 85), form the bulk of intra-AFTA trade. The MFN tariff rates applicable to the above items are, respectively, 1.9% and 1.5% for US exports, and 2.5% and 2.2%, respectively, for EU exports. The AFTA preferential tariff rates are 1.5% and 1.4%, respectively, for these exports. The AFTA vs MFN margins are thus small—i.e., only 0.4% and 0.1%, respectively, for US exports, and 1.0% and 0.8%, respectively, for EU exports (Harrigan et al. 2007). It is no surprise that ASEAN importers prefer the quick and convenient application of MFN tariff rates given these small margins.

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<sup>6</sup> To avoid tariff fraud, goods from third nations are transshipped through an ASEAN country to gain preferential access.

**Figure 1: Utilization Rates of the ASEAN Free Trade Agreement**  
(% of intra-ASEAN imports)



ASEAN = Association of Southeast Asian Nations, AFTA = ASEAN Free Trade Agreement.

Source: PriceCooperWaterhouse. 2002. *Presentation to the 10th Meeting of the ASEAN Directors-General of Customs*. 24 July.

The proliferation of FTAs in east Asia present challenges. Businesses may feel frustration in the face of the variety of ROOs, regulations, and other complexities. These complexities erode the smoothly functioning mechanisms associated with unilateral liberalization.

According to a recent JETRO survey in 2008 sampling more than 700 Japanese companies, 11.9% utilized FTAs, 15.6% planned to utilize them, and 37.4% had no plan to use them. In fact, the percentage of Japanese firms that replied that they are utilizing the preferential tariff rates is 5.1% in 2006 and this figure increase to 11.9% in 2007 and 18.9% in 2008. (JETRO 2009) Japanese SMEs reported a lower rate of FTA use and planned use, while large Japanese companies tended to report a higher rate of FTA use and planned use. Reasons for low rates of FTA use were:

- knowledge of FTAs was not widespread among sampled firms;
- phase-out tariff schedules made the impact of FTAs small;
- the administrative cost of preparing documents was high, and the VC rule required frequent changes in purchasing sources;
- exporters prepared the required documents, but the benefits went to importers;
- the time required to obtain a certificate did not match “just in time” production;
- use of FTAs was likely only for products with high export volumes and high MFN tariff rates.

An additional reason was that information technology products benefit from the Information Technology Agreement (ITA). Exports of most intermediate goods of this type are exempted from tariffs, resulting in no tariff barriers for much trade in goods in the east Asian production network (Hiratsuka, Isono, and Sato 2007).

According to a survey of 100 firms in Thailand, 45.7% used or planned to use tariff preferences. However, findings differed by sector and firm size. Some 26% of the companies sampled reported nonuse of FTAs—most being SMEs with few connections to the production network. In the textile and garment sector, FTA utilization was 50% for large companies and 37.5% for SMEs. In the electronics sector, the FTA utilization rate for large companies was 85.7% and 32.2% for SMEs. In the auto-auto parts sector, large companies reported a 57.1% FTA utilization rate, while 31% of SMEs reported using FTAs. FTA utilization rates in Thailand were also different for different FTAs. Sampled firms showed more interest in the Thailand-US FTA and the Thailand-Japan Economic Partnership Agreement because these were more applicable to their business activities (Wignaraja and Olfindo 2008).

Data of cross-country surveys organized by ADB indicates that Japanese firms (29%) are the highest users of FTA preferences, followed by Thai firms (25%). In contrast, firms in Korea (21%), the Philippines (20%), and Singapore (17%) make less use of FTAs (Kawai and Wignaraja, 2009). Then the ADB study seeks the views of and experience with FTAs from 841 manufacturing firms based in the PRC, Japan, the ROK, the Philippines, Singapore, and Thailand, the average percentage of surveyed firms utilizing FTA preferences is about 28% (Kawai and Wignaraja, 2010).

A survey of PRC firms found that firms reporting use of FTA preferences for 50% or more of their exports was very low—3.5% in 2008 and 5.6% in 2009. Only 5.2% (in 2008) and 6.5% (in 2009) of firms sampled reported use of FTA preference rates for 20% to 50% of their exports, while 19% reported use of FTA preferences for less than 20% of their exports in both 2008 and 2009. The proportion of PRC firms reporting use of FTA preference rates was 28.9% in 2008 and 35.6% in 2009. More than 40% of firms queried did not answer survey questionnaires. Thus the combined proportion of firms not answering plus those reporting nonuse of FTAs was as high as 70%. It is conjectured that the reason firms did not answer questionnaires was their lack of knowledge about FTAs and their use (Zhang 2010).

## **4.2 Benefits of a Wider and Broader Regional Free Trade Agreement**

In general, FTAs contribute to the development of rules and legal mechanisms in east Asia. These agreements and arrangements—at both bilateral and subregional levels—focus on principles of international standards, or WTO-consistent standards. They have a profound significance in east Asian relations by strengthening both the rule of standards and the rule of law, thus contributing to improvements in the national systems of countries in the region and strengthening the foundation for regional cooperation. These regional arrangements contribute to the development of a new regional system based on interests and rules that are increasingly common and shared among all parties. This is in effect regional institution building, to all intents and purposes creating public property that can be used by countries in the region to advance their interests.

From a dynamic perspective, the gains under FTAs from facilitating trade, investment, and economic cooperation will be much greater than the gains created by lower tariffs. Regional economic cooperation of this kind will improve the long-term environment for economic development in east Asia (Zhang 2006).

However, the complexity of east Asian FTAs contributes to the cost of doing business in the region. The competitive efforts of these countries to negotiate more FTAs may

damage the regional production network, which is essential for east Asian economic dynamism. A regional FTA with wider participation and broader coverage would help overcome most challenges, including the negative noodle bowl effects. Estimates based on computable general equilibrium (CGE) modeling show that the larger the size of an FTA, the larger the gains. The economic gains are significant when moving toward EAFTA (ASEAN+3), or CEPEA (ASEAN+6) from current bilateral FTAs and ASEAN+1 FTAs.<sup>7</sup> Of course, a wider regional FTA does not mean simply combining current ASEAN+1 FTAs. New negotiations would be required, but provisions in existing east Asian FTAs could provide useful inputs for a wider regional FTA.

## 5. THOUGHTS ON DEEPER REGIONAL INTEGRATION

### 5.1 Toward an Integrated Regional Free Trade Agreement

Recognizing the problems created by the overlap of FTAs in east Asia, the need to move toward an integrated regional FTA has been emphasized. A preliminary political consensus in this direction was reached by ASEAN+3 Economic Ministers in 2004 when it was recognized that study of the feasibility of an EAFTA was needed. Initiated by the PRC, a joint expert group of experts from the 13 ASEAN+3 countries—ASEAN plus the PRC, Japan, and Korea—was set up in 2005. The group presented a report to the ASEAN+3 Economic Ministers in September 2006 which asserted that the rationale for an EAFTA was consistent with the interests of east Asian countries. The economic benefits from EAFTA would exceed AFTA, any ASEAN+1 FTA, or other bilateral and subregional arrangements. The report recommended that an EAFTA should be comprehensive, of high standard, and negotiated and implemented as a single undertaking. It recommended that an EAFTA go beyond existing east Asian FTAs, be formed among ASEAN+3 countries first, and then to be extended to other countries in the region. The group urged east Asian leaders to start the process of forming an EAFTA soon (Joint Expert Group for Feasibility Study on EAFTA 2006). The recommendations were not immediately accepted by ASEAN+3 leaders. The phase II study of EAFTA is ongoing and led by Korea. In near term, ASEAN+3 is a more feasible framework for establishing a wider regional FTA in east Asia.

Japan proposed an alternative approach by calling for a comprehensive economic partnership based on the East Asia Summit (EAS) framework (CEPEA). EAS leaders agreed to conduct a feasibility study of CEPEA in 2006, and a joint expert group was established in 2007. A report was completed in July 2008 and presented to the EAS ministers' meeting. It argued that a wider regional comprehensive economic partnership that included India would create larger gains than any other regional FTA. The report recommended that the CEPEA should provide a broader framework for regional integration and cooperation—with economic cooperation as the priority and an FTA as a core, covering facilitation, liberalization, environment, energy, and information and communication technology (CEPEA Track Two Study Group 2008). However, an EAS-based FTA may be more difficult to form than other smaller frameworks.

In forging a wider regional FTA, the stance of ASEAN and the degree of consensus among its members will be crucial. By establishing parallel ASEAN+1 FTAs, ASEAN

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<sup>7</sup> According to the Global Trade Analysis Project (GTAP) model, EAFTA would result in a 1.93% increase of gross domestic product, while CEPEA would result in a 2.05% increase in gross domestic product (CEPEA Track Two Study Group 2008).

ensured that it was a hub of the agreements and thus able to forcefully pursue its interests. Moving toward an integrated regional FTA, ASEAN may lose its special status as driver and hub. Considering the large economic gaps among its members, ASEAN needs to strengthen its capacity as a group to engage other economies on an equal footing. Under its new Charter, ASEAN has established the goal and agenda to form by 2015 a strengthened community, AEC, incorporating three communities—i.e., Economic, Security, and Social Communities. It thus seems likely that ASEAN will accept an integrated FTA in east Asia only after it succeeds in building the AEC. The best strategy for attaining an east Asian FTA may be support for ASEAN's efforts to first build the AEC.

Three northeast Asian countries—the PRC, Japan, and Korea—will play crucial roles in constructing a wider east Asian FTA because their economic size and position in the region. These three economies are highly integrated through an FDI-trade network. Each has an FTA with ASEAN, but there is no formal arrangement between them. If these three countries could conclude a Northeast Asian FTA ahead of EAFTA or CEPEA, a foundation could be provided for east Asia to move more readily toward a wider regional FTA. Leaders from the PRC, Japan, and Korea agreed to launch a joint study of the feasibility of a Northeast Asian FTA in 2003. The study group supported establishment of a PRC-Japan-Korea FTA (CJK FTA). However, political momentum toward this goal seems difficult to foster due to the concern of Japan and Korea about opening their agricultural markets to the PRC. A CJK FTA appears to be a long-term vision for the region, but a possible path toward it could be through multiple ASEAN+1 FTAs.<sup>8</sup>

The above analysis shows that while an integrated FTA in east Asia may be desirable, it may not be on the agenda of regional leaders in near future. In the meantime, east Asia economies should continue efforts to reduce barriers created by multiple FTAs.

## 5.2 Adopting Guiding Principles and Best Practices

Considering the difficulties of moving toward an integrated FTA in east Asia, an alternative course is to standardize FTAs in the region through the adoption of “guiding principles” and adherence to “best practices.” Standardization of FTAs would mean adherence to the principles of multilateralism—including comprehensive coverage in terms of measures, sectors, and products (with few exemptions)—and incorporation of liberal ROOs and effective mechanisms for monitoring and enforcement to ensure consistent implementation (World Bank 2004). A primary benefit of FTAs derive from adherence to best practices, which are reflected in comprehensive coverage of goods and service, low and symmetrical rules of origin, appropriate customs procedures and related measures, strong trade-related intellectual property rights, national treatment of FDI, transparent and fair antidumping procedures and dispute settlement, open and nondiscriminatory government procurement policies, competition policies that create a level playing field, and nondiscriminatory and transparent technical barriers (Plummer 2007; Asian Development Bank 2008).

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<sup>8</sup> Ahn, H. 2006. FTA Policies of CJK and Prospect of CJK FTA: Korean Perspective. Paper presented at KIEP-NAEAK International Conference, Prospects for Regional FTA in Northeast Asia. Seoul. 14 December. This view also expressed by Motoshige Itoh in his presentation during the same conference: Itoh, M. 2006. FTA Policies of Northeast Asian Countries and Possibilities on Northeast Asian FTA: Japanese Perspective. See the conference proceedings.

APEC (2004) provides guiding principles for FTA best practices. Included are detailed guidelines for all major FTA provisions, such as consistency with APEC's Bogor goals and WTO, commitments beyond WTO, comprehensiveness, transparency, facilitation, dispute settlement, rules of origin, cooperation, sustainable development, accession to the third market, and periodic review. Through the adoption of best practices, differences in FTA modalities may be significantly reduced, and FTAs will be more transparent and disciplined.

### **5.3 Harmonizing Rules of Origin**

Multiple ROOs are a problem for business in east Asia that requires early resolution. ROOs should maximize trade creation and minimize trade distortion. One approach is to simplify ROOs, making them easier to understand and comply with. For each country, the ROOs in all its FTAs should be consistent.

However, simplification of ROOs alone may not be adequate to resolve existing problems. An additional means of enhancing flexibility and reducing the complexities of product origin would be to design coequal rules of origin. This would provide a choice among a standardized tariff shift rule, RVC rule, or specific rule. It could also enhance existing cumulation provisions to full cumulation provisions by creating a regional standard and regional implementation process for cumulation convergence.<sup>9</sup>

### **5.4 Facilitating Business in East Asia**

Considering the difficulties of moving toward a wider regional FTA in east Asia, an agenda could be initiated aimed at facilitating and simplifying business transactions in the region. Aside from the proposed harmonization of ROOs, an immediate step that could reduce regional business costs would be the adoption of a single window program in east Asia. This could be effected by extending ASEAN's single window initiative to other east Asian countries, or by conclusion of a single-window agreement among ASEAN+3 countries, or among EAS countries.

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<sup>9</sup> This recommendation from: Staples, B. 2008. Rules of Origin and Origin Administration in East Asia. Paper presented at ADBI Asian Noodle Bowl Conference. Tokyo. 17–18 July.

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## APPENDIX

**Table A1: Free Trade Agreements among East Asia Economies**

	Under Implementati on	Signed	Under Negotiatio n	Proposed
ASEAN Free Trade Area	○			
ASEAN-PRC Comprehensive Economic Cooperation Agreement	○			
ASEAN-Japan Comprehensive Economic Partnership		○		
ASEAN-Korea Comprehensive Economic Cooperation Agreement	○			
East Asia Free Trade Area (ASEAN+3)				○
Japan-Brunei Free Trade Agreement	○			
PRC-Hong Kong, China Closer Economic Partnership Arrangement	○			
PRC-Japan-Korea Free Trade Agreement				○
PRC-Korea Free Trade Agreement				○
PRC-Macao Closer Economic Partnership Arrangement	○			
PRC-Singapore Free Trade Agreement	○			
PRC-Thailand Free Trade Agreement	○			
Japan-Indonesia Economic Partnership Agreement	○			
Japan-Korea Free Trade Agreement			○	
Japan-Malaysia Economic Partnership Agreement	○			
Japan-Philippines Economic Partnership Agreement	○			
Japan-Singapore Economic Agreement for a New-Age Partnership	○			
Japan-Thailand Economic Partnership Agreement	○			
Japan-Viet Nam Economic Partnership Agreement	○			

Korea-Singapore Free Trade Agreement	○			
Korea-Thailand Free Trade Agreement				○
Malaysia-Korea Free Trade Agreement				○
Laos-Thailand Preferential Trading Arrangement	○			

ASEAN = Association of Southeast Asian Nations, Brunei = Brunei Darussalam, PRC = People's Republic of China, Laos = Lao People's Democratic Republic, Korea = Republic of Korea.

Source: Asia Regional Integration Center. FTA Database. Available: <http://www.aric.adb.org> (accessed July 2010).

**Table A2: Free Trade Agreements between East Asian and Non-East Asian Economies**

	Under Implementati on	Signed	Under Negotiation	Proposed
ASEAN-Australia and New Zealand Free Trade Agreement	○			
ASEAN-EU Free Trade Agreement			○	
ASEAN-India Comprehensive Economic Cooperation Agreement	○			
Comprehensive Economic Partnership for East Asia (CEPEA/ASEAN+6)				○
Trans-Pacific Partnership (TPP)			○	
Pakistan-Brunei Darussalam Free Trade Agreement				○
Trans-Pacific Strategic Economic Partnership Agreement (Brunei Darussalam, Chile, New Zealand and Singapore)	○			
United States-Brunei Free Trade Agreement				○
Asia-Pacific Trade Agreement	○			
Costa Rica-PRC Free Trade Agreement		○		
New Zealand-PRC Free Trade Agreement		○		
PRC-Australia Free Trade Agreement			○	
PRC-Chile Free Trade Agreement	○			
PRC-Gulf Cooperation Council Free Trade Agreement			○	
PRC-Iceland Free Trade Agreement			○	
PRC-India Regional Trading Arrangement				○
PRC-Norway Free Trade Agreement			○	
PRC-Pakistan Free Trade Agreement	○			
PRC-Peru Free Trade Agreement	○			
PRC-South Africa Free Trade Agreement				○
PRC-South African Customs Union Free Trade Agreement			○	

PRC –Switzerland Free Trade Agreement				○
PRC-Taipei,China Economic Cooperation Framework Agreement			○	
Shanghai Cooperation Organization Free Trade Agreement				○
India-Indonesia Comprehensive Economic Cooperation Arrangement				○
Indonesia-Australia Free Trade Agreement				○
Indonesia-Chile Free Trade Agreement				○
Indonesia-European Free Trade Association Free Trade Agreement				○
Pakistan-Indonesia Free Trade Agreement			○	
Preferential Tariff Arrangement-Group of Eight Developing Countries		○		
United States-Indonesia Free Trade Agreement				○
Japan-Australia Economic Partnership Agreement			○	
Japan-Canada Free Trade Agreement				○
Japan-Chile Economic Partnership Agreement	○			
Japan-Gulf Cooperation Council Free Trade Agreement			○	
Japan-India Economic Partnership Agreement			○	
Japan-Mexico Economic Partnership Agreement	○			
Japan-Mongolia Economic Partnership Agreement				○
Japan-New Zealand Free Trade Agreement				○
Japan-Peru Free Trade Agreement			○	
Japan-Switzerland Economic Partnership Agreement	○			
Australia-Korea Free Trade Agreement			○	
India-Korea Comprehensive Economic Partnership Agreement	○			
Korea-Canada Free Trade Agreement			○	
Korea-Chile Free Trade Agreement	○			
Korea-Colombia Free Trade Agreement			○	
Korea-European Free Trade Association Free Trade Agreement	○			
Korea-European Union Free Trade Agreement			○	

Korea-Gulf Cooperation Council Free Trade Agreement			○	
Korea-Israel Free Trade Agreement				○
Korea-MERCOSUR Preferential Trading Agreement				○
Korea-Mexico Strategic Economic Complementarity Agreement			○	
Korea-Peru FTA			○	
Korea-Russia Bilateral Economic Partnership Agreement				○
Korea-South Africa Free Trade Agreement				○
Korea-Turkey Free Trade Agreement			○	
Korea-United States Free Trade Agreement		○		
New Zealand-Korea Closer Economic Partnership			○	
Malaysia-Australia Free Trade Agreement			○	
Malaysia-Chile Free Trade Agreement			○	
Malaysia-India Comprehensive Economic Cooperation Agreement			○	
Malaysia-New Zealand Free Trade Agreement		○		
Malaysia-Pakistan Closer Economic Partnership Agreement	○			
Preferential Tariff Arrangement-Group of Eight Developing Countries		○		
Trade Preferential System of the Organization of the Islamic Conference			○	
United States-Malaysia Free Trade Agreement			○	
Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area			○	
Pakistan-Philippines Free Trade Agreement				○
United States-Philippines Free Trade Agreement				○
Canada-Singapore Free Trade Agreement			○	
Comprehensive Economic Partnership Agreement between Singapore and Sri Lanka				○
European Free Trade Association-Singapore Free Trade Agreement	○			
Gulf Cooperation Council-Singapore Free Trade Agreement		○		
India-Singapore Comprehensive Economic Cooperation Agreement	○			

New Zealand-Singapore Closer Economic Partnership	○			
Pakistan-Singapore Free Trade Agreement			○	
Singapore-Australia Free Trade Agreement	○			
Singapore-Bahrain Free Trade Agreement (now GCC-Singapore Free Trade Agreement)		○		
Singapore-Costa Rica Free Trade Agreement		○		
Singapore-EU Free Trade Agreement			○	
Singapore-Egypt Comprehensive Economic Cooperation Agreement			○	
Singapore-Jordan Free Trade Agreement	○			
Singapore-Kuwait Free Trade Agreement (now GCC-Singapore Free Trade Agreement)			○	
Singapore-Mexico Free Trade Agreement			○	
Singapore-Panama Free Trade Agreement	○			
Singapore-Peru Free Trade Agreement	○			
Singapore-Qatar Free Trade Agreement (now GCC-Singapore Free Trade Agreement)			○	
Singapore-Ukraine Free Trade Agreement			○	
Singapore-United Arab Emirates Free Trade Agreement (now GCC-Singapore Free Trade Agreement)				○
United States-Singapore Free Trade Agreement	○			
India-Thailand Free Trade Area			○	
Pakistan-Thailand Free Trade Agreement				○
Thailand-Australia Free Trade Agreement	○			
Thailand-Bahrain Free Trade Agreement			○	
Thailand-Chile Free Trade Agreement				○
Thailand-European Free Trade Association Free Trade Agreement			○	
Thailand-MERCOSUR Free Trade Agreement				○
Thailand-New Zealand Closer Economic Partnership Agreement	○			



Thailand-Peru Free Trade Agreement			○	
United States-Thailand Free Trade Agreement			○	
Chile-Viet Nam Free Trade Agreement			○	
Viet Nam-European Free Trade Association Free Trade Agreement				○

ASEAN = Association of Southeast Asian Nations, Brunei = Brunei Darussalam, EU = European Union, GCC = Gulf Cooperation Council, Korea = Republic of Korea, MERCOSUR = Mercado Común del Sur, PRC = People's Republic of China, Korea = Republic of Korea.

Note: ASEAN+6 = ASEAN, PRC, India, Japan, Republic of Korea, Australia, and New Zealand.

Source: Asia Regional Integration Center. FTA Database. <http://www.aric.adb.org> (accessed July 2010).