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**Regional Trade Policy Cooperation
and Architecture in East Asia**

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Abstract

The global financial and economic crisis has affected East Asia mainly through the trade channel. The region remains heavily dependent on export markets in Europe and North America through both direct exports to these destinations and indirect exports via the export of parts and components to other East Asian countries, particularly the People's Republic of China, which are then assembled and exported as final goods to Europe and North America. The need to rebalance growth in East Asia in the post-crisis era requires measures to strengthen domestic demand and emphasize intra-regional demand. Production networks have been integrating East Asia and this integration process is being hastened by the rapid growth of regional and bilateral trade and economic agreements since the late 1990s. The trigger point for regionalism in East Asia appears to be the 1997–1998 Asian financial crisis, and regionalism is being accelerated by the dismal outlook for the Doha Development Round, the economic rise of the People's Republic of China and India, and the ongoing global financial crisis. Proposals on regional trade architecture include Association of Southeast Asian Nations (ASEAN)+3 and ASEAN+6 for East Asia, the Free Trade Area of the Asia Pacific, and an extension of the Trans-Pacific Strategic Economic Partnership. The case for a new regional trade architecture includes improved competitiveness and economic dynamism from a large integrated market; increased intra-regional flows of trade, investment, and human resources; expansion and deepening of production networks; a rebalancing of growth towards regional demand; and a stronger and cohesive voice in international fora and organizations. Challenges include the pressures of protectionism in an economic recession, the question of whether there is a common political vision, the existence of multiple and overlapping free trade agreements with the accompanying problem of the *noodle bowl*, and the wide development gap among the region's economies.

JEL Classification: F13, F15

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1. INTRODUCTION

East Asia includes some of the world's most export dependent economies. They are confronted with a heavy dependence on the European (i.e., European Union [EU]) and United States (US) markets, the challenges of the stalled Doha Development Round (referred to as the Doha Round), and the fall-out effects of the 2008–2009 global financial and economic crisis that began in the US and swept across Western Europe and Asia.

World trade is forecast to contract by 9% in 2009, driven lower by the collapse in global demand and a shortage of trade financing for many developing countries. In East Asia, responses to the global financial and economic crisis have included fiscal stimuli to offset the sharp falls in export demand; rebalancing economic growth to focus more on domestic demand generation; economic and structural reforms to prepare for a post-crisis world; and the pursuit of regional economic cooperation and integration, particularly in trade and financial cooperation, to maintain regional financial stability, resilience, and growth momentum.

The dismal outlook for the World Trade Organization's (WTO) Doha Round and the ongoing global financial and economic crisis are creating a need for regional trade and investment integration in East Asia to provide a fallback position for the stalled Doha Round, and to provide new growth stimuli in the absence of a rapid recovery of the North American and European markets.

The economic integration literature has two definitions of East Asia, one referring to ASEAN, PRC, Japan, and Korea (ASEAN+3) and the other referring to ASEAN, PRC, Japan, and Korea as well as Australia, New Zealand, and India (ASEAN+6). This paper adopts the broader definition. Section 2 looks at the issues that caused the Doha Round to stall, examines its prospects, and builds a case for regional economic integration. Section 3 examines the fall-out of the global crisis in East Asia, looking mainly at the trade channel and the unraveling of the decoupling thesis, the threat of rising protectionism, and the need to rebalance growth. Section 4 analyses the role that East Asian regional and bilateral free trade agreements (FTAs) can play in the restructuring of East Asia in response to the global crisis. Section 5 examines the case for a region-wide FTA and the various proposals on hand. Section 6 concludes.

2. BACKGROUND: THE DOHA DEVELOPMENT ROUND OUTLOOK

The stalled Doha Round has provided momentum for the pursuit of FTAs in East Asia. It can be safely argued that, whatever the outcome of the Doha Round, the momentum is likely to continue.

2.1 Key Issues in the Doha Round¹

The Doha Round was launched in November 2001 and has since run into trouble. At the December 2005 ministerial meeting in Hong Kong, China, WTO members agreed to undertake liberalization negotiations under four pillars: agriculture, non-agricultural market access (NAMA), services, and rules (including anti-dumping and countervailing duties, and regional trading arrangements [RTAs]). Key areas of the market access negotiations are industrial products, agriculture, and services. The July 2008 Doha Round meeting in Geneva, Switzerland, collapsed because of differences between the US and big emerging countries such as India, over a proposed safeguard to help farmers in poorer countries

¹ This section draws heavily on the *Asian Development Outlook 2006* (ADB 2006).

withstand surges in imports. The next WTO Ministerial Conference is scheduled for 30 November–2 December 2009.

Agriculture: Agriculture has traditionally been one of the most difficult sectors to liberalize due to various politico-economic issues. Agricultural negotiations in the Doha Round are taking place under three pillars: Rules on export subsidies, Rules on domestic support, and Tariff cuts. Complicating the negotiations is the asymmetrical use of the three pillars—while most members of the Organisation for Economic Co-operation and Development use all of them, developing countries primarily use tariff protection. At the ministerial meeting in Hong Kong, China, it was agreed to eliminate farm export subsidies by 2013 (2006 for cotton export subsidies), and in December 2005 it also proposed complicated modalities for tariff cuts, with four ranges of tariffs, each being subjected to a different percentage cut.

Non-agricultural market access: Despite the success of previous rounds in bringing down the tariffs of developed countries, they still remain quite high. There is considerable asymmetry in tariff levels between countries and across sectors within countries. Doha Round negotiators have focused on bound tariffs and have agreed to adopt the *Swiss formula* for liberalization and harmonization. A compromise would have the developed countries offering more in agriculture, services, and rules, and would include flexible provisions to take account of the special needs and interests of developing countries (such as the possibility of excluding a certain percentage of total import value and/or percentage of tariff lines from the formula cuts).

Trade in services: Negotiations regarding services have been deadlocked for several reasons. The first problem is measurement. For example, how to balance the number of licenses granted to foreign insurance companies with the number of visas obtained for domestic nurses willing to work outside the country. The second is that earlier negotiations were exclusively based on bilateral offers and requests, and this cumbersome procedure has complicated negotiations. The third problem is that substantial services liberalization requires behind the border regulation changes, while the fourth problem is that services negotiations in the past have focused on national treatment for foreign service-providers. To allow for deeper integration in the services, it was decided at the ministerial meeting in Hong Kong, China that countries could pursue service negotiations on a plurilateral rather than the usual bilateral basis, a result that would be extended on a most favored nation (MFN) basis.

Rules: Doha Round discussion on rules focus on several issues. The most important are contingent protection (anti-dumping and countervailing duties), RTAs, special and differential treatment, and aid for trade (including trade facilitation). There has been increased use of contingent protection, especially anti-dumping measures; applications are firm or country specific and enforcement of rules has been relatively lax. RTAs violate the MFN principle, but Article XXIV allows for RTAs provided they meet certain general criteria. The WTO has been discussing the need for more definitive criteria; under Doha, further revisions of the interpretation of Article XXIV were to be part of its *single undertaking*. There is also intense debate on whether and how developing countries should be granted special and differential treatment. Since the 1970s, special and differential treatment has mainly taken the form of unilateral preferential tariffs by developed countries for selected developing countries under the Generalized System of Preferences scheme. However, with falling MFN tariff rates, the margin of preference has been seriously eroded. At the ministerial meeting in Hong Kong, China, developed countries agreed to end tariffs and quotas on 97% (tariff lines) of exports from the least developed countries by 2008.

Aid for Trade: Aid for trade relates to issues of governance as well as issues of trade facilitation (such as customs and logistics procedures). The Doha Round has a program of negotiations regarding trade facilitation intended to buttress the capacity of developing countries to implement trade liberalization and structural change. It could potentially be extended to all activities involved in the international movement of goods and services, such

as building transport infrastructure and facilities, operating trade-related services such as telecommunications, and providing specialized legal and insurance services.

2.2 Uncertain Prospects for the Doha Round

The ongoing global financial and economic crisis has posed a serious challenge for the Doha Round. Governments have been too pre-occupied with responding to the global economic crisis to prevent sinking into deep recession. Although governments continue to make political statements on resisting protectionism in various international and regional fora (such as Group of Twenty [G20] and Asia-Pacific Economic Cooperation [APEC]), there has been a rise of so-called murky protectionism (Baldwin and Evenett 2009) in the form of an increased use of anti-dumping measures, the misuse of technical barriers to trade, and the promotion of *buy local* provisions in national stimulus packages. The WTO reported that the number of new anti-dumping investigations rose 17% year-on-year in the second half of 2008, but in a report dated 17 November 2008, the number of such investigations was said to have decreased.

Additional difficulties in the Doha Round negotiations are summarized below:

- First, early General Agreement on Tariffs and Trade (GATT) rounds were successful in considerably reducing tariffs on non-sensitive manufactured goods, leaving the most difficult items to be tackled in the Doha Round. These items include agricultural export subsidies, domestic support for agriculture, agricultural tariff reductions, trade in services, anti-dumping duties, and the rules governing RTAs. Also, the non-uniformity of cuts in tariffs and non-tariff barriers to trade (NTBs) resulting from compromises in earlier rounds has been problematic because it can create its own distortions. Hence, the Doha Round has been particularly difficult.
- Second, developing countries are diverse and often have different priorities and interests and insist that the Doha Round delivers on the development agenda.
- Third, the US and other developed countries are looking for voluntary sector-specific agreements to open markets in important advanced developing economies. These voluntary sector-specific deals would include chemicals, electronics, and industrial machinery, and they would result in major tariff reductions in major developing countries such as Argentina, Brazil, PRC, India, and South Africa. At issue is whether by participating in sector-specific negotiations, developing countries are then committed to industry-specific agreements before knowing all the details.
- Fourth, there is disagreement over the special safeguard mechanism used to protect domestic farmers in developing countries from agricultural import surges. WTO members have agreed that developing countries will have a special safeguard mechanism, and more or less agreed on how big the import increase would be to trigger a temporary tariff rise. The WTO members also agreed on how high the rise should be in general. The blockage is about the situation where the special safeguard mechanism raises tariffs above commitments countries made in their MFN bound rates. India has demanded that developing countries be allowed to apply high, temporary tariffs in excess of existing bound rates to stem imports above a threshold level that could harm local producers.
- Fifth, concern over the trade policy direction of the Obama Administration.

According to the *Asian Development Outlook 2006* (ADB 2006), a successful, comprehensive Doha package would comprise the following: a balanced Swiss formula applied to both NAMA and agriculture with as few excluded sectors as possible; some progress in services, especially Mode 3 and Mode 4; fairer and more transparent rules on

contingent protection; better definitions and rules on RTA transparency, as well as commitments to develop means to ensure the consistency of Article XXIV agreements with multilateralism; and generous offers in terms of *aid for trade* and *trade facilitation plus*. Economists and analysts, however, would agree that many of these are unachievable, and if the US pulls back on the 2008 package then disaster looms. However, since a complete failure of the Doha Round is unthinkable, it is likely that the round would be concluded with lightweight results (Doha Lite), leaving the most contentious issues unresolved. Conclusion of the Doha Round would unlikely plug the loopholes in the existing rules regarding protectionism and RTAs and they could remain as major challenges post-Doha.

3. IMPACT OF THE GLOBAL FINANCIAL AND ECONOMIC CRISIS ON EAST ASIAN TRADE

3.1 Impact of the Global Crisis

The global crisis affects East Asia less with regards to its financial systems and more with its economic growth through export and investment channels. Table 1 shows that economic growth for most East Asian economies slowed considerably in 2008 and 2009. Singapore appears to be worst off, with gross domestic product (GDP) growth plunging from 7.8% in 2007 to only 1.1% in 2008. Economic growth in 2009 is forecast to be substantially worse than in 2008, pulled down by decreases in the export of manufactures and the subsequent knock-on effects on income and investment. For 2010, ADB (2009) forecasts recovery, as signs of recovering economies started to appear in the second half of 2009 in response to stimulus packages and some recovery in global trade.

Table 1: East Asia—GDP and Merchandise Exports Growth Rates

	2006	2007	2008	2009	2010 projected
Annual GDP Growth (%)					
Indonesia	5.5	6.3	6.1	3.6	5.0
Malaysia	5.8	6.3	4.6	(0.2)	4.4
Philippines	5.4	7.2	4.6	2.5	3.5
Singapore	8.4	7.8	1.1	(5.0)	3.0
Thailand	5.2	4.9	2.6	(2.0)	3.0
Viet Nam	8.2	8.5	6.2	4.5	6.2
Southeast Asia	6.0	6.4	4.3	0.7	4.2
People's Republic of China	11.6	13.0	9.0	7.0	8.0
Hong Kong, China	7.0	6.4	2.5	(2.0)	3.0
Republic of Korea	5.1	5.0	2.5	(3.0)	4.0
India	9.7	9.0	7.1	5.0	6.5
Annual Merchandise Exports Growth (%)					
Indonesia	19.0	14.0	18.0	(25.0)	14.6
Malaysia	12.9	9.6	12.8	(13.3)	5.8
Philippines	15.6	6.4	(2.6)	(8.4)	14.6
Singapore	18.1	10.5	13.1	(16.0)	5.0
Thailand	17.0	17.3	16.8	(18.0)	8.0
Brunei Darussalam	22.1	2.3	28.5	(14.5)	3.3
Cambodia	26.9	10.7	—	—	—
Lao People's Democratic Republic	67.1	5.2	21.2	(20.0)	—
Myanmar	47.4	22.3	—	—	—
Viet Nam	22.7	21.9	29.1	(31.8)	8.1
Southeast Asia	17.1	12.2	14.5	(17.7)	7.6
People's Republic of China	27.2	25.8	17.3	(4.3)	8.0
Hong Kong, China	9.7	8.9	5.6	(5.0)	8.0
Republic of Korea	14.8	14.2	14.3	(15.0)	10.0
India	22.6	28.9	11.9	(9.1)	8.9

GDP = gross domestic product.

Source: ADB (2009).

The global crisis has been mainly transmitted to East Asia through the trade channel. The drop in developing East Asia's export growth has been huge as import demand from the Group of Three (G3) countries (the US, EU, and Japan) contracted sharply. Table 1 shows the sharp decline in export growth rate in 2007 for Malaysia, Philippines, and Singapore, turning into expected negative growth rates in 2009 for all East Asian economies. Table 2 shows negative export growth appearing in the third quarter of 2008 for most economies. For Singapore, non-oil domestic exports declined from the second quarter onwards. Another indicator of the shrinkage in trade is the falling Baltic Dry Index (an index of the cost of chartering bulk cargo ships) that reflected the sudden and sharp contraction in global demand for bulk raw materials following the decline in industrial production. The fall in incomes in G3 also reduced demand for consumer electronic products, automobiles, and all other durable goods that feature prominently in East Asian exports. The plunge in export demand has been aggravated by the disappearance of trade finance through letters of credit as the global financial crisis deepened. The shrinking demand for East Asia's exports have led to factory closures and rising job losses, negative consumer sentiment discouraging household spending, and negative business sentiment discouraging investment. Falling commodity prices, having peaked in mid-2008, have contributed to the woes of commodity exporting countries in Southeast Asia.

Table 2: East Asia—Monthly Changes in Export Growth (%)

	Indonesia	Malaysia	Philippines	Singapore	Singapore (non-oil domestic exports)*	Thailand	People's Republic of China	Hong Kong, China	Republic of Korea	India
Jan-07	10.1	19.2	13.0	22.3	—	17.6	33.3	8.4	20.8	19.0
Feb-07	10.8	3.0	7.9	(0.8)	—	17.5	51.7	10.8	10.3	16.3
Mar-07	20.9	1.9	7.5	8.4	—	16.5	6.9	6.2	13.2	11.3
Apr-07	16.6	6.9	5.3	14.1	—	18.1	26.6	11.6	17.0	27.5
May-07	17.2	9.8	6.2	4.2	—	18.0	28.7	11.3	11.1	21.6
Jun-07	13.0	6.3	2.3	4.0	1.5	16.9	27.0	10.5	14.5	14.1
Jul-07	13.0	5.7	5.8	13.9	—	6.0	34.1	7.9	17.2	18.2
Aug-07	7.7	5.8	(3.6)	6.1	—	17.1	22.7	7.2	13.6	18.2
Sep-07	7.6	9.9	5.0	5.5	6.1	10.5	22.8	8.7	(1.1)	16.1
Oct-07	18.2	24.7	10.7	20.0	—	26.6	22.2	10.2	22.9	48.8
Nov-07	10.4	14.1	(1.6)	11.9	—	23.2	22.7	6.4	17.0	30.3
Dec-07	13.9	10.1	21.4	12.7	(0.4)	19.0	21.6	7.8	14.8	20.9
Jan-08	34.5	19.5	6.0	22.2	—	36.3	26.6	15.8	14.9	34.9
Feb-08	28.7	25.9	10.5	28.0	—	18.8	6.4	8.0	18.9	43.6
Mar-08	32.5	14.4	(6.6)	14.9	0.6	16.5	30.6	7.9	18.4	34.1
Apr-08	22.5	31.0	4.9	29.3	—	30.1	21.8	14.9	26.4	45.7
May-08	31.6	29.0	2.3	25.3	—	24.7	28.1	10.4	26.9	27.4
Jun-08	34.1	25.4	8.8	24.6	(5.5)	30.4	17.7	(0.5)	16.4	39.2
Jul-08	24.8	32.7	4.4	28.5	—	47.4	26.9	11.4	35.6	37.1
Aug-08	29.9	14.4	6.6	16.9	—	17.7	21.1	1.9	18.1	27.8
Sep-08	29.0	13.7	1.1	17.9	(8.6)	22.6	21.3	3.6	27.6	10.4
Oct-08	4.7	(8.6)	(14.8)	(5.0)	—	5.2	19.1	9.4	7.8	(12.1)
Nov-08	(1.8)	(11.7)	(11.4)	(15.4)	—	(18.6)	(2.2)	(4.8)	(19.5)	(9.9)
Dec-08	(20.6)	(18.8)	(40.3)	(22.0)	(17.8)	(12.5)	(2.8)	(10.8)	(17.9)	(1.1)
Jan-09	(36.1)	(37.3)	—	(40.2)	—	(26.5)	(17.5)	(21.3)	(34.2)	(15.9)
Feb-09	—	—	—	—	—	—	(25.7)	—	(18.3)	—
Mar-09	—	—	—	—	(25.6)	—	—	—	—	—
Apr-09	—	—	—	—	—	—	—	—	—	—
May-09	—	—	—	—	—	—	—	—	—	—
Jun-09	—	—	—	—	(14.3)	—	—	—	—	—

*From Singapore official statistics. Non-oil domestic exports exclude both entrepot exports and oil exports. Singapore's export data from international databases include re-exports.

Source: ADB (2009).

3.2 Rising Threat of Protectionism

Asian Development Outlook 2009 (ADB 2009) cautions that the growing specter of protectionism will complicate the development of Asia's efforts to achieve a more balanced trade structure, which ultimately depends on a robust domestic economy and a healthy appetite for imported capital and consumer goods. It notes that most of the world's major economies have already put various forms of protectionism into effect. This includes the substantial amount of aid given to automobile manufacturers around the world, which totals about US\$48 billion. In East Asia, Indonesia has restricted the import of certain goods to just a few ports and airports and India has increased tax rebates for exporters.

G20 leaders made a "no protectionism" pledge at their November 2008 Summit. A September 2009 report from Global Trade Alert (Evenett 2009), however, revealed that at least 121 protectionist measures have been implemented by G20 governments since

November 2008 and another 134 measures are pending. The report noted that in each quarter of 2009, about 70 harmful measures were implemented and fewer than 5% of the product categories escaped being affected by some protectionist measure. In the goods sectors, the bulk of protectionist measures affect agriculture and lower-productivity manufacturing. The report noted that the “overwhelming picture is one of planned and implemented state initiatives that reduce foreign commercial opportunities and reverse the 25-year trend towards open borders...these findings imply that any notion that protectionism is abating should be set to one side” (Evenett 2009: 3). The report urges G20 leaders to take steps to halt the protectionist dynamics.

3.3 East Asia’s Export Structure and Direction

Trade statistics show that East Asia is becoming increasingly integrated through merchandise trade. As noted by Athukorala and Kohpaiboon (2009), the share of intra-regional trade (import and export) in total non-oil trade ranged between 48% and 52% (with a slight uptrend in recent years), a share that is higher than the North American Free Trade Agreement (NAFTA) and is approaching that of the EU15.² However:

- *Intra-regional trade embodies double counting:* Calculated trade shares misinform regarding the relative importance of intra-regional trade as a source of East Asia’s growth. In view of widespread production fragmentation, the trade data contains serious double counting, as goods in process cross multiple international borders before being embodied in the final product. Even in the absence of product fragmentation, double-counting of intra-regional trade arises because of the entrepot role of Singapore (in Southeast Asia) and Hong Kong, China (in the PRC).
- *Asymmetry of intra-regional trade:* There is significant asymmetry in East Asia’s regional import and export trade patterns. Growth in the intra-regional trade ratio has come largely from intra-regional imports rather than from intra-regional exports. From 1995 to 2007, the intra-regional share of imports increased from 56% to 63%, while the intra-regional share of exports decreased from about 46% to 36%, indicating that East Asia’s dependence on markets in the rest of the world has increased.
- *Variations among sectors:* Electronics is probably the sector most dependent on G3 markets, and the products of this industry have high income elasticity. Hence, the economic slowdown in G3 countries is likely to have a relatively larger effect on the electronics industry and on the economies where the sector is relatively important such as Korea, Malaysia, Philippines, and Singapore. For exports of labor intensive products such as textiles and clothing, developing Asia has become even more dependent on the North American and European markets, which accounts for 42% of the region’s textile and clothing exports in 2006; this is up from 35% in 1994–1995. The PRC was the main source of this increase in market share; in Southeast Asia more than 70% of total textile and clothing products were exported to NAFTA and EU15 in 2005–2006, up from 65% in 1994–1995.
- *Trade in parts and components:* ADB (2009) notes that the share of parts and components in developing Asia’s total manufacturing trade has increased continuously since the early 1990s (on the export side, the share increased from 16% in 1992 to 25% in 2006). Trade in these goods is concentrated in information and communication technology products and electrical machinery. In the Philippines, the share of parts and components in total manufacturing exports doubled from 1992 to almost 70% in 2006; in the PRC it rose from 4% in 1992 to 19% in 2006. Parts and components account for a growing share of developing

² EU15 countries before EU enlargement in 2004 included: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and United Kingdom.

Asia's total imports as well, rising from 22% in 1992 to 36% in 2006. In the PRC, parts and components account for a much larger share of imports than exports; in other Asian countries the opposite holds true. Since the mid-1990s, the PRC has become the centre of final assembly for electronics and electrical goods as well as for other global industries based on parts and components imported from other countries in the region. The share of parts and components in the PRC's total manufacturing imports from East Asia rose from 18.5% in 1994–1995 to over 44% in 2006–2007. Hence, the PRC is playing an increasingly important role in final product assembly using parts and components procured from other countries in the region.

Table 3 shows the direction of East Asia's exports. It shows a declining dependence on the European and US markets. In 2007 total export shares to Europe and the US ranged from a high of 62.5% for Cambodia, 32.8% for the Philippines, 31.0% for the PRC, 30.0% for Viet Nam, and 29.9% for India; to less than 10% for Brunei Darussalam, Lao People's Democratic Republic (Lao PDR), and Myanmar. In contrast, the shares to Asia (PRC + Developing Asia + Japan) show a rising trend between 2000 and 2007 except for Cambodia and Viet Nam. In 2007, Asia's share ranged from over 80% for Myanmar; over 70% for Brunei Darussalam; over 60% for Indonesia; Philippines; Singapore; Lao PDR; and Hong Kong, China; to over 50% for Malaysia and Thailand.

**Table 3: East Asia—Direction of Exports
(percent of total)**

a.

	United States		Europe		Japan		Developing Asia		People's Republic of China		Others	
	2000	2007	2000	2007	2000	2007	2000	2007	2000	2007	2000	2007
From:												
Indonesia	13.0	9.4	13.7	10.0	22.1	18.1	33.1	37.1	4.2	8.1	13.7	17.3
Malaysia	19.5	16.6	13.3	11.2	12.3	7.8	40.3	40.9	2.9	8.5	11.7	15.0
Philippines	27.3	16.3	16.5	16.5	13.4	14.7	30.5	34.6	1.6	10.9	10.7	7.0
Singapore	16.7	9.1	13.5	10.1	7.3	4.9	44.1	51.2	3.8	9.5	14.7	15.2
Thailand	20.5	12.6	15.7	11.5	14.2	10.6	30.8	33.5	3.9	9.5	15.0	22.3
Brunei Darussalam	12.0	7.5	3.6	1.9	40.7	29.8	36.2	41.3	1.8	3.2	5.8	16.4
Cambodia	65.4	46.6	20.5	15.9	0.9	0.8	8.2	8.9	2.1	1.1	2.9	26.6
Lao People's Democratic Republic	2.2	0.6	26.0	8.8	2.8	0.8	43.4	55.5	1.5	5.7	24.1	28.5
Myanmar	22.0	0.0	16.4	6.7	5.4	4.7	35.2	70.0	5.6	7.0	15.5	11.6
Viet Nam	4.9	15.8	20.0	14.2	17.2	10.6	25.8	21.9	10.3	6.8	21.9	30.7
Southeast Asia	18.2	12.2	14.4	11.1	12.6	9.4	37.4	41.2	3.7	8.9	13.7	17.2
People's Republic of China	20.4	16.4	16.1	14.6	16.3	7.4	32.9	33.1			14.3	28.6
Hong Kong, China	23.0	13.8	15.5	12.8	5.5	4.5	10.2	10.7	34.1	48.4	11.8	10.3
Republic of Korea	20.9	11.2	13.7	12.6	11.3	6.9	23.8	21.4	10.2	21.2	20.2	26.8
India	21.1	13.4	24.1	16.5	4.1	2.4	19.2	21.2	1.8	8.6	29.8	37.9

b.

	United States+Europe		United States+Europe+Japan		Japan+Developing Asia+People's Republic of China	
	2000	2007	2000	2007	2000	2007
From:						
Indonesia	26.7	19.4	48.8	37.5	59.4	63.3
Malaysia	32.8	27.8	45.1	35.6	55.5	57.2
Philippines	43.8	32.8	57.2	47.5	45.5	60.2
Singapore	30.2	19.2	37.5	24.1	55.2	65.6
Thailand	36.2	24.1	50.4	34.7	48.9	53.6
Brunei Darussalam	15.6	9.4	56.3	39.2	78.7	74.3
Cambodia	85.9	62.5	86.8	63.3	11.2	10.8
Lao People's Democratic Republic	28.2	9.4	31.0	10.2	47.7	62.0
Myanmar	38.4	6.7	43.8	11.4	46.2	81.7
Viet Nam	24.9	30.0	42.1	40.6	53.3	39.3
Southeast Asia	32.6	23.3	45.2	32.7	53.7	59.5
People's Republic of China	36.5	31.0	52.8	38.4	49.2	40.5
Hong Kong, China	38.5	26.6	44.0	31.1	49.8	63.6
Republic of Korea	34.6	23.8	45.9	30.7	45.3	49.5
India	45.2	29.9	49.3	32.3	25.1	32.2

Source: ADB (2009).

In recent years many East Asian economies have leveraged on the PRC's rapid economic growth by supplying raw materials, parts, and components (intermediate goods). The global crisis has highlighted that, notwithstanding the growing economic importance of the PRC, East Asia is still heavily dependent on markets in Europe and North America.

- **ADB (2007)** estimated that 61% of Asia's total exports were eventually consumed in the G3 economies (Europe, Japan, and the US), while only 6.4% went to meet final demand in the PRC.
- **The Hong Kong Monetary Authority (2007)** estimated that a 10% decline in US imports could lead to a 2.9% decline in total exports of four newly industrialized economies (Hong Kong, China; Taipei, China; Korea; and Singapore) and a 3.0% decline in the total exports of ASEAN, reflecting the vulnerability of emerging Asia to fluctuations in US demand.
- **The European Central Bank (2009)** found that final demand in the PRC only accounted for 7.2% of value added in Korea; Singapore; Taipei, China; and ASEAN4 (Indonesia, Malaysia, Philippines, and Thailand).
- **The Singapore Ministry of Trade and Industry (2009)** found that a significant portion of East Asia's exports to the PRC is used as intermediate inputs to be assembled into final goods in the PRC and subsequently shipped to the G3. Hence, the indirect export exposure to G3 via the PRC was significant for most economies. The total direct and indirect export exposure to G3 is over 40% for Hong Kong, China; Korea; Philippines; Malaysia; Thailand; and Indonesia. Singapore appears to have a lower exposure (although the large volume of entrepot export trade through Singapore probably distorts this figure), especially given that a significant part of such trade is in oil and electronic component products, which are used in outward processing activities in other parts of Asia. When only Singapore's non-oil domestic exports are considered, Singapore's total direct and indirect export exposure to G3 is comparable to other East Asian economies. Thus, the PRC is not a key source of final demand for the exports of many East Asian economies and the region is still very much dependent on demand from G3 countries.

- **ADB (2009)** used a computer general equilibrium (CGE) model to estimate how the recession in Organisation for Economic Co-operation and Development member countries and the attendant drop in consumption and imports will affect developing Asia's trade and growth. The impact was simulated by comparing projected growth in 2009 and 2010 with what growth would have been without the financial crisis. By the end of 2010, most Asian economies will experience real GDPs of 6.0–10.2% less due to the financial crisis, with the PRC having the largest absolute loss.

3.4 Need for Rebalancing Growth

Export-led growth has delivered enormous benefits to East Asia and will continue to do so. However, the current global crisis underlines the risks of excessive dependence on external demand and the unsustainable nature of overproduction in developing Asia that is sustained by overconsumption in the US.

- There is a need for East Asia, particularly the PRC, to put more emphasis on domestic demand, take steps to re-orient trade in final goods within the region, and strongly resist protectionist measures in the region. The PRC's export dependence is unusually high for a large continental economy.
- Rebalancing growth could give a large boost to intra-regional trade. A more robust domestic demand for final goods within regional countries will allow for more substantive intra-regional trade of differentiated products.
- The imbalance between what the region produces and what it consumes will not be resolved quickly as there are many structural reasons for the imbalances, including lack of social insurance, underdevelopment and incomplete financial markets, and limited competition among service products. A key development that bodes well for rebalancing is the emergence of a large and rapidly growing urban middle class.
- Rebalancing growth is fundamentally in East Asia's self interest—increased domestic consumption will raise consumer welfare and increased investments will improve productivity. Bolstering domestic demand in response to weakened external demand requires a combination of policy measures. The optimal mix differs by country, but effective rebalancing requires both policies that reinforce domestic demand and policies that revitalize the domestic economy.
- Strengthening domestic consumption requires policies that transfer more corporate savings to households and reduce the precautionary motive for savings among households.
- The fact that private domestic demand cannot be mechanically increased in the short-term implies that the government must take the lead in rebalancing demand through an activist fiscal policy stimulus package. A more active fiscal policy is needed to mitigate weak external demand in the short-term and to lay the foundation for a more robust domestic demand in the medium–long term.
- Governments should give priority to enhancing the investment climate.
- Supply side policies that promote small and medium enterprises and service industries will bolster production from firms that cater to domestic demand.
- Policies pertaining to financial development and adjustment of the exchange rate can promote a better balance between domestic supply and demand.

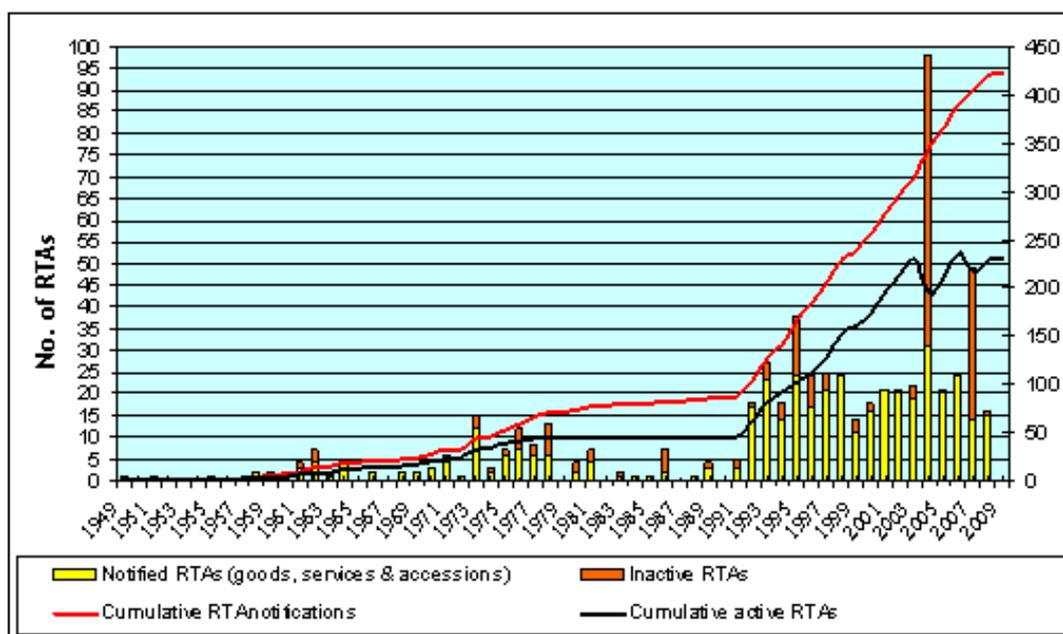
3.5 Need to Strengthen Regional Cooperation

- A larger regional market is conducive to economies of scale and specialization, and thus, to intra-industry trade in differentiated products.
- Greater regional cooperation and FTAs can also promote a more balanced trade structure. Intra-Asian trade is still largely based on intermediate rather than final goods, and trade in final goods remains heavily dependent on demand from Europe and the US. Removing trade barriers and trade facilitation among countries in East Asia would help stimulate intra-regional trade in final goods as well as re-direct export demand from Europe and the US towards the region itself.
- Strengthened regional cooperation can provide developing Asia with additional resilience against large external shocks.
- Intra-regional exchange rate policy dialogue or coordination could also promote intra-regional trade and investment by maintaining stability among regional currencies.

4. SURGE OF PLURILATERAL AND BILATERAL FTAs

Figure 1 shows RTAs notified to the GATT/WTO up to the end of 2008. There has been a surge in the number of notified RTAs since the early 1990s. It should be noted, however, that the surge is in part due to the number of RTAs in services reported under General Agreement on Trade and Services (GATS) V since January 1995.

Figure 1: RTAs Notified to the GATT/WTO (1948–2008), Including Inactive RTAs, by Year of Entry into Force



Source: WTO website (http://www.wto.org/english/tratop_e/region_e/regfac_e.htm).

4.1 Recent Surge in FTAs in East Asia

Before 1992, East Asia had no FTAs,³ unlike the situation in Africa, the Americas, and Western Europe. The ASEAN Free Trade Area (AFTA) came into force in January 1993 and since the late 1990s the number of FTAs has rapidly increased.

Several factors have been at play in the growth of regional, plurilateral, and bilateral FTAs.

- First, there has been a thawing of political relations among East Asian countries with the end of ⁴ the Cold War, particularly between the PRC and the rest of East Asia. Increasingly, entering into FTAs with countries inside and outside the region has become common foreign policy.
- Second, East Asia will eventually require a policy framework to support and further the deepening of market-driven economic integration. Properly designed FTAs could expand trade and foreign direct investment (FDI) and deepen production networks and supply chains; eliminate cross-border barriers; facilitate trade and FDI; and harmonize various trade-related rules, standards, and procedures.
- Third, Asian governments and business firms are concerned about emerging European and North American blocs that discriminate against Asian exporters and investors. Businesses in Japan and other East Asian countries lobby their governments to enter into plurilateral and bilateral FTAs to improve market access. The success of the EU and NAFTA economic integration also had a demonstration effect on East Asia. At the political and policy level, there is also a demand for a stronger and cohesive Asian voice in international fora and in international negotiations.
- Fourth, the Asian financial crisis of 1997–1998 highlighted the need for East Asia to strengthen regional economic cooperation for resilience, sustainable economic growth, and stability. This led to the ASEAN+3 (ASEAN plus the PRC, Japan, and Korea) financial and monetary cooperation that resulted in the Chiang Mai Initiative, with central bank swap arrangements, a regional surveillance mechanism, and the Asian Bond Market Initiative.
- Fifth, the slow progress in Doha Round negotiations and the APEC liberalization process is pressuring Asian governments to seek plurilateral and bilateral FTAs as an insurance policy.
- Sixth, some countries, such as Japan, seek FTAs to promote domestic reforms (as is the case of Mexico joining NAFTA).
- Seventh, a *domino effect* is also evident. The economic rivalry between the PRC and Japan led both countries into FTAs with ASEAN and the individual ASEAN countries as well as with other trading partners. Other countries also rushed into FTAs for fear of being left out of FTA markets. Thus, Korea signed an FTA with ASEAN and some individual ASEAN countries, and then when Singapore pursued bilateral FTAs with a number of regional and extra-regional countries (including India and the US) it put pressure on competing ASEAN countries to do likewise.
- Finally, it appears easier to achieve plurilateral and bilateral agreements among likeminded countries on various WTO and WTO-Plus issues than to achieve consensus within the WTO.

³ There was the 1977 ASEAN Preferential Trading Arrangement and the Bangkok Agreement, but they were selective tariff liberalization and not FTAs.

⁴ For example, on 9 April 2009, the *Japan Times* reported that Keidanren wants the Japan-EU FTA to be negotiated.

Table 4 shows the number of FTAs in East Asia as of January 2009.⁵ Singapore⁶ led with 32 agreements, followed closely by India (31), Thailand (24), PRC (23), and Korea (23). The Cambodia, Lao PDR, Myanmar, and Viet Nam (CLMV) sub-group has the least agreements.⁷

Table 4: FTA Status in East Asia* by Country, as of January 2009

	Concluded, signed, or implemented	Under negotiation	Proposed	Total
Brunei Darussalam	6	3	4	13
Cambodia	4	3	2	9
Indonesia	6	4	6	16
Lao People's Democratic Republic	6	3	2	11
Malaysia	7	9	3	19
Myanmar	4	4	2	10
Philippines	5	3	4	12
Singapore	17	11	4	32
Thailand	9	9	6	24
Viet Nam	5	4	2	11
Subtotal ASEAN	69	53	35	157
People's Republic of China	9	4	10	23
Japan	10	5	4	19
Republic of Korea	6	7	10	23
Australia	7	7	4	18
New Zealand	6	5	3	14
India	9	13	9	31
Subtotal ASEAN + 6	47	41	40	128
Total East Asia*	116	94	75	285

*East Asia is defined as ASEAN+6.

Source: Author's compilation from the ADB Asia Regional Integration Center database (<http://aric.adb.org/indicator.php>).

Table 5 is a matrix of plurilateral FTAs by country and status. The ASEAN countries have the largest number of plurilateral FTAs, as they are members of ASEAN (AFTA/ASEAN Framework Agreement on Services [AFAS]/ASEAN Investment Area [AIA] and ASEAN Economic Community [AEC]) as well as the ASEAN-Plus agreements with PRC, India, Japan, Korea, Australia-New Zealand, and EU. In addition, Brunei Darussalam, New Zealand, and Singapore are members of the Trans-Pacific Strategic Economic Partnership (also known as TPP or P4); PRC, India, Lao PDR, and Korea are members of the Asia Pacific Trade Agreement; India, Myanmar, and Thailand are members of the Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation; and India is a member of the South Asian Free Trade Area.

⁵ Proposed refers to where countries are considering an FTA, establishing a joint study group or task force, or conducting feasibility study.

⁶ The large number of FTAs in Singapore reflects its need to secure market access because of its extreme dependence on export markets. Singapore's high success rate in negotiations reflects its lack of agricultural exports and its willingness to completely open up its goods sectors and rapidly open up its services sectors to foreign competition.

⁷ The lack of bilateral FTAs in the CLMV countries reflects their reluctance to open up to international competition as well as the lack of interest in their markets by large economies. CLMV FTAs are mainly ASEAN-centric and entered into upon provisions for regional cooperation and capacity building.

Table 5: Matrix of Plurilateral FTAs of the ASEAN+6 Countries**a.**

	ASEAN	ASEAN+ People's Republic of China	ASEAN+ Japan	ASEAN+ Republic of Korea	ASEAN + CER	ASEAN + India	ASEAN + Europe	ASEAN +3	ASEAN +6
Brunei									
Darussalam	I	I	I	I	N	N	N	P	P
Indonesia	I	I	I	I	N	N	N	P	P
Malaysia	I	I	I	I	N	N	N	P	P
Philippines	I	I	I	I	N	N	N	P	P
Singapore	I	I	I	I	N	N	N	P	P
Thailand	I	I	I	I	N	N	N	P	P
Cambodia	I	I	I	I	N	N	N	P	P
Lao									
People's Democratic Republic	I	I	I	I	N	N	N	P	P
Myanmar	I	I	I	I	N	N	N	P	P
Viet Nam	I	I	I	I	N	N	N	P	P
People's Republic of China		I						P	P
Japan			I					P	P
Republic of Korea				I				P	P
Australia					I				P
New Zealand					I				P
India						N			P

b.

	CJK	P4	SAFTA	APTAD	BIMSTEC	APEC	I+N Total
Brunei Darussalam		I				I	9
Indonesia						I	8
Malaysia						I	8
Philippines						I	8
Singapore		I				I	9
Thailand					N	I	9
Cambodia							7
Lao People's Democratic Republic				I			8
Myanmar					N		8
Viet Nam						I	8
People's Republic of China	P			I		I	3
Japan	P					I	2
Republic of Korea	P			I		I	3
Australia						I	2
New Zealand						I	2
India			I	I	N		4

I = implemented; N = under negotiation; P = proposed/under study/consultation.

Source: Author's compilation from the ADB Asia Regional Integration Center database (<http://aric.adb.org/indicator.php>).

4.2 Content and Scope of AFTA and AEC

Analysis of ASEAN and AFTA usually makes a distinction between the older members, known as ASEAN6 (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand) and the newer members known as CLMV (Cambodia, Laos PDR, Myanmar, and Viet Nam). This distinction is important in FTAs, which generally accord special and differential treatment to the CLMV countries.

Trade in Goods: AFTA was implemented in January 1993 to cover the trade in goods and it has the following main provisions:

- Sectoral and product coverage applies to all manufactured products (including capital goods and processed agricultural products) but excludes unprocessed agricultural products. Coverage was subsequently extended to unprocessed agricultural products. Remaining exceptions are contained in the Temporary Exclusion List, Sensitive List, and General Exclusion List.
- Initially, tariffs were to be reduced to 0–5% over a period of 15 years. These were subsequently amended—tariff reductions to the 0–5% level were progressively brought forward to 2002 for ASEAN+6 and Viet Nam, 2008 for the Lao PDR and Myanmar, and 2010 for Cambodia; tariff reductions to zero level were set with completion dates of 2010 for ASEAN+6 and 2015 for CLMV. Allowance is made for member countries to provisionally suspend the Common Effective Preferential Tariff preferences when an import surge causes damage to a domestic industry. However, some ASEAN members have sought to suspend CEPT preferences to pre-empt an import surge.
- The AFTA rules of origin state that “a product shall be deemed to be originating from ASEAN Member States if at least 40% of its content originates from any Member State.”⁸ This gives rise to difficulties in interpretation and implementation.
- Member states are to eliminate quantitative restrictions upon enjoyment of tariff concessions on products and eliminate other NTBs within five years. This has proved difficult to implement as there has been no agreed list of NTBs in ASEAN for many years.
- Eleven priority sectors (later extended to 12) were identified for accelerated integration by coordinating integration measures such as zero tariffs, rapid customs clearance, and harmonization of product standards and technical regulations.
- An ASEAN Industrial Cooperation scheme was introduced to enhance ASEAN’s industrial competitiveness and investment competitiveness by promoting joint manufacturing between ASEAN-based companies. ASEAN Industrial Cooperation products enjoy immediate tariff preferences under AFTA as well as local content accreditation and investment incentives.

Trade in Services: Services liberalization is under the 1995 AFAS. Seven packages of commitments were reached through five rounds of negotiations and seven mutual recognition arrangements on qualifications of professional service suppliers. Priority service sectors identified for liberalization and cooperation are financial services, maritime transport, air transport, telecommunications, tourism, business services, and construction.

Investment: Investment provisions are contained in the 1998 ASEAN Framework Agreement on the AIA, which aims to provide an environment that will facilitate free flow of investment, technology, and skills, as well as promote inclusion in regional and global

⁸ The ASEAN rules of origin document is available in full on the ASEAN Secretariat’s website (www.aseansec.org).

production networks. AIA grants national treatment to ASEAN investors by 2010 and to non-ASEAN investors by 2020, with some exceptions specified in the Temporary Exclusion List and Sensitive List. This discriminatory treatment makes no economic sense as most FDI in ASEAN countries originates from non-ASEAN sources. AIA also promises to provide a greater transparency to investment policies, rules, procedures, and administrative processes; a more streamlined and simplified investment process; more liberal and competitive investment regimes; and lower transaction costs for business operations.

In February 2009, ASEAN adopted an enhanced version of the AIA called the ASEAN Comprehensive Investment Agreement. It incorporates the four pillars of liberalization, facilitation, protection, and promotion. Investment liberalization is to be achieved by 2015, providing national treatment and MFN treatment for all investors with limited exceptions; removing of restrictions to entry for investments in the priority integration goods sectors; and reducing/removing (where possible) restrictive investment measures and other impediments. Investment facilitation covers more transparent, consistent, and predictable investment rules, regulations, policies, and procedures. Investment protection is accorded to all investors and investments, regardless of nationality.⁹ ASEAN also agreed to promote the following: ASEAN as an integrated investment area and production network; intra-ASEAN investments, especially from ASEAN6 (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand) to CLMV; industrial complementation and production networks among multinational corporations in ASEAN; joint investment missions that focus on regional clusters and production networks; and a network of bilateral agreements on avoidance of double taxation among ASEAN countries.

ASEAN Economic Community: In 2003, in response to the challenges of globalization and the economic rise of the PRC and India, ASEAN agreed to establish the AEC¹⁰ by 2020. This was later brought forward to 2015. The AEC aims to transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy. The AEC Blueprint of November 2007 sets out a strategic schedule of timelines up to 2015 for the implementation of various integration measures. The plan of action has four components:

- First, regarding existing economic integration programs, clear timelines to remove all NTBs by 2005 were adopted, including harmonization of product standards and technical regulations, and mutual recognition agreements in five priority sectors. Although tariff reductions and eliminations are nearing completion, removing NTBs has been a slower process. For example, the ASEAN Single Window was only established in 2008.
- Second, new initiatives for the AEC include fast-track vertical integration in 12 priority sectors identified as agro-based products, fisheries, wood-based products, rubber-based products, automotives, textiles and apparel, electronics, e-ASEAN, medical equipment and instruments, aviation services, tourism, and logistics services.
- Third, measures will be taken to strengthen institutions, streamline decision-making processes, and ensure the effective implementation of all ASEAN initiatives. A unit will be established to provide legal advice on trade disputes and oversee an enhanced ASEAN Dispute Settlement Mechanism.¹¹
- Fourth, ASEAN6 will continue to help the less developed CLMV in capacity building and technical and development cooperation to narrow the development gap.

⁹ This supersedes the 1987 ASEAN Agreement for the Promotion and Protection of Investments and its 1996 protocol.

¹⁰ ASEAN also agreed to form the ASEAN Security Community and the ASEAN Socio-cultural Community.

¹¹ The ASEAN Charter came into force in December 2008 as the constitution of ASEAN.

4.2.1 PRC–Japan–Korea FTA?

The PRC has proposed an FTA among the PRC, Japan, and Korea. Considering the high concentration of intra-regional trade among the three countries and the complementarities of their industrial structure and geographic proximity, there is high probability of an emerging trade agreement—barring political constraints. Japan and Korea could take advantage of the huge market and low-priced natural and human resources of the PRC, while the PRC could benefit from the transfer of technology and FDI from Japan and Korea. However, the PRC's applied tariffs on imports from Japan and Korea are still high, so there is currently little interest in this option. Overcoming historical animosity and securing public consensus remains a challenge. Urata¹² notes that if Japan opened market access to the PRC, and the PRC opened FDI access to Japan, it would be a win–win situation for both countries.

4.2.2 ASEAN-Plus Agreements

An integrated ASEAN has a smaller nominal gross national product (GNP) than either the EU or NAFTA. Hence, ASEAN has to be outward looking and readily accept proposals for FTAs from major and rising economic powers. ASEAN is currently engaged in ASEAN+1 agreements with Australia–New Zealand, the PRC, India, Japan, Korea, and EU, making ASEAN a de facto FTA hub. There is no ASEAN–US agreement, as the US has preferred to pursue bilateral FTAs and trade and investment framework agreements with individual countries under its Enterprise for ASEAN Initiative.

Table 6 shows the comparative sizes of ASEAN and its ASEAN-Plus FTA partners, and the possible future ASEAN–US agreement. The agreements vary widely in size. In terms of population size, ASEAN–PRC is the largest with 1.8 billion, ASEAN–India is next with 1.6 billion, while ASEAN–CER is the smallest. However, by market size (GNP), ASEAN–US is the largest, followed by ASEAN–Japan and ASEAN–PRC. The PRC, Japan, and US have larger economies than the collective ASEAN+10, while the economies of India, Korea, and Australia–New Zealand CER are smaller. By volume of trade, ASEAN–US is largest. The trade volume of Japan is comparable to ASEAN, but the trade volumes of India, Korea, and Australia–New Zealand CER are considerably smaller.

A domino effect is evident. The PRC's proposal for an agreement with ASEAN was rapidly followed by similar offers from India, Japan, Korea, Australia–New Zealand CER, and EU, with the latest being the EU. Japan chose both an ASEAN-wide framework umbrella and bilateral FTAs with selected ASEAN countries. India and Korea embarked on bilateral FTAs with Singapore prior to their ASEAN-wide initiatives. The PRC embarked on a limited bilateral FTA with Thailand after initiating the ASEAN-wide agreement and has since negotiated a bilateral FTA with Singapore. The US has concluded a bilateral FTA with Singapore and has ongoing negotiations with a few others.

¹² Shujiro Urata in a verbal commentary on the author's draft paper.

Table 6: ASEAN's FTA Partners

	Population 2007 (million)	GNI Size 2007 (US\$ billion)	GNI per Capita 2007 (US\$)	Exports 2007 (US\$ billion)	Imports 2007 (US\$ billion)	Total Trade 2007 (US\$ billion)
ASEAN	564	1,144.6	2,029.0	863.3	773.2	1,636.5
PRC	1,320	3,120.9	2,360.0	1,217.9	955.8	2,173.7
ASEAN–PRC	1,884	4,265.5	2,264.0	2,081.2	1,729.0	3,810.2
ASEAN percentage share	29.9	26.8	89.6	41.5	44.7	43.0
Japan	128	4,813.3	37,670.0	712.8	621.0	1,333.8
ASEAN–Japan	692	5,957.9	8,610.0	1,576.1	1,394.2	2,970.3
ASEAN percentage share	82	19.2	23.6	54.8	55.5	55.1
Republic of Korea	49	955.8	19,690.0	371.6	356.6	728.2
ASEAN–Republic of Korea	613	2,100.4	3,426.0	1,234.9	1,129.8	2,364.7
ASEAN percentage share	92	54.5	59.2	69.9	68.4	69.2
PRC–Japan–Republic of Korea	1,497	8,890.0	5,939.0	2,302.3	1,933.4	4,235.7
ASEAN	564	1,144.6	2,029.0	863.3	773.2	1,636.5
ASEAN percentage share	37.7	12.9	34.2	37.5	40.0	38.6
Australia–New Zealand Closer Economic Partnership (CER ¹)	25	877.5	35,100.0	168.1	196.2	194.1
ASEAN–CER	589	2,022.1	3,433.0	1,031.4	969.4	1,830.6
ASEAN percentage share	96	56.6	59.1	83.7	79.8	89.4
India	1,123	1,069.4	950.0	145.2	216.7	361.9
ASEAN–India	1,687	2,214.0	1,312.0	1,008.5	989.9	1,998.4
ASEAN percentage share	33	51.7	154.6	85.6	78.1	81.9
United States	302	13,886.5	42,740.0	1,163.2	2,017.0	3,180.2
ASEAN–US	866	15,031.1	17,357.0	2,026.5	2,790.2	4,816.7
ASEAN percentage share	65	7.6	11.7	42.6	27.7	34.0

ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China, US = United States.

Source: Compiled by author from World Development Report 2008 tables (<http://go.worldbank.org/ZJIAOSUFU0>).

All the ASEAN+1 agreements are comprehensive and have been dubbed FTA-Plus and WTO-Plus. The scope of these comprehensive economic partnerships (CEP) and comprehensive economic cooperation (CEC) agreements extend beyond trade liberalization in goods to include liberalization of trade in services and investment, trade and investment facilitation, government procurement, intellectual property rights, competition policy, and wide-ranging economic and technical cooperation (such as the development of agriculture, industry, fishery, forestry, and energy; human resources; infrastructure; small and medium enterprises; science and technology; and information and communication technologies; and labor and environment). Additionally, they include special and differential treatment, flexibility, and capacity building for the CLMV. Framework agreements were reached prior to negotiations on the various components of the CEP/CEC. Only ASEAN–PRC has implemented an Early Harvest Program. Trade in goods agreements are usually negotiated and implemented first, followed by agreements on services and investment, although some ASEAN+1 agreements are single undertakings.

Table 7 shows the different time frames for the ASEAN and ASEAN+1 agreements. The time frames for the elimination of tariffs, with built-in flexibility allowing for some countries or some sectors to be realized later, are shown below:

- AFTA: Start: January 1993; End: 2010 for ASEAN6 (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand) and 2015 for CLMV
- AEC: Start: October 2003; End: 2015
- ASEAN–PRC: Start: June 2005; End: 2010 for ASEAN6 and PRC, and 2015 for CLMV
- ASEAN–India: Start: 2009; End: 2011 for ASEAN5 (that is, ASEAN6 minus the Philippines) and India, 2016 for the Philippines and CLMV
- ASEAN–Japan: Start: January 2009; End 2012 for ASEAN6 and Japan, 2017 for CLMV
- ASEAN–Korea: Start: July 2006; End: 2010 for ASEAN6 and Korea, no end-date indicated for CLMV

The rules of origin (ROO) for the various ASEAN and ASEAN+1 agreements are

- AFTA: 40% value added; amended to include change of tariff classification (CTC); product specific
- ASEAN–PRC: 40% value added (same as AFTA)
- ASEAN–India: 35% value added plus CTC
- ASEAN–Japan: depends on bilateral negotiations, some still ongoing
- ASEAN–Korea: product specific

A common template for the various ASEAN+1 agreements would make it easier for them to become building blocks or to be amalgamated into a region-wide arrangement. For ASEAN to become a production base, it needs to minimize business transaction costs by having similar schedules of tariff reduction and rules to ensure use of the most efficient supplier. A common ROO could facilitate the spread of full cumulation and the development of regional production networks.

4.2.3 ASEAN–PRC Framework Agreement and Comprehensive Economic Cooperation:

The PRC first proposed an FTA with ASEAN in November 2000 as part of a process to build confidence and allay ASEAN concerns over the PRC's challenge in export markets and in attracting FDI. The PRC offered an Early Harvest Program, special and differential treatment, and flexibility for the CLMV as incentives. In turn, ASEAN began to view the PRC as a rapidly growing market for its products and services (including tourism), and as a new engine for growth. Major components of the CEC are:

- An Early Harvest Program of tariff reduction and elimination, primarily in agricultural goods, was implemented in January 2004 and lasted for three years. There was an Exclusion List and different time frames for ASEAN6 and for the CLMV.
- The Agreement on Trade in Goods was implemented in June 2005. It provides for tariff reduction and elimination along two tracks. For products on the normal track, tariff reductions will be completed by 2010 for ASEAN6 and the PRC, and by 2015 for CLMV. For products on the sensitive track, the tariff reduction schedule is determined by mutual agreement. ROO are based on 40% value added. Countries are committed to abide by provisions on WTO disciplines on non-tariff measures, technical barriers to trade, and sanitary and phytosanitary measures subsidies and countervailing measures; anti-dumping measures; intellectual property; and safeguards. In addition, ASEAN member states agree to recognize the PRC as a full market economy.

- The Agreement on Services was implemented in July 2007, while the Agreement on Investment was signed in August 2009.

4.2.4 ASEAN–Japan Framework Agreement and Comprehensive Economic Partnership

Japan proposed an economic partnership agreement with ASEAN in January 2002, soon after the ASEAN–PRC CEC proposal. The formalized partnership will anchor Japanese economic interests in ASEAN and balance the rise of the PRC. In turn, ASEAN recognizes Japan as the second largest economy in the world and recognizes Japan's roles as the regional growth engine in recent decades, a major source of FDI and technology transfer, and the largest source of technical and development assistance.

The Framework Agreement was signed in October 2003 with the following principles and provisions: comprehensive coverage of countries and sectors; special and differential treatment for ASEAN states and greater flexibility for CLMV; flexibility for sensitive sectors of ASEAN and Japan; early implementation of cooperation in areas that could provide more immediate benefits such as technical assistance and capacity building for ASEAN, especially for CLMV; trade and investment promotion and facilitation; trade and investment policy dialogue; business sector dialogue; mobility of business people; trade data compilation and exchange; and facilitation and cooperation programs covering a wide field. A big obstacle in the negotiations is Japan's protectionist stance towards its agricultural and labor markets. Japan wants the CEP to be a single undertaking but negotiations on services and investment are not yet completed. Both sides agreed to incorporate common features of Japan's bilateral FTAs with ASEAN economies into the ASEAN-wide CEP; this will essentially be an umbrella agreement. The CEP should be realized by 2012 for ASEAN6 and 2017 for CLMV. A notable feature of the bilateral economic partnership agreements is the capped entry into Japan of certain categories of professionals from Indonesia, Philippines, and Thailand. This is seen as a major concession from Japan's normally strict restrictions on labor inflows.

4.2.5 ASEAN–Korea Comprehensive Economic Partnership

Korea proposed a comprehensive partnership with an FTA. The Framework Agreement came into force in July 2006. Korea and ASEAN6 started cutting tariffs from July 2006 and aim to be completed by 2010. The target date for CLMV is to be determined at a later date. Korea and individual ASEAN countries may choose up to 40 items that could be excluded from tariff reductions. Talks became ensnared over tariffs on food products for ASEAN; and automobiles, steel, and mobile phones for Korea. Tariffs on 97% of about 4000 categories of goods will be cut by 2010 with the rest being cut by 2016. ASEAN agreed to treat goods produced at the Kaesong Industrial Complex in North Korea as made-in-Korea. Disagreements between Korea and Thailand on agricultural products led to a delay by Thailand in ratifying the agreement. Negotiations on trade in services and investments have been concluded.

Table 7: Timeframes for ASEAN and ASEAN Plus Agreements

Group/Free Trade Agreement	Phasing	Under Negotiation	Concluded/ Signed	Implementation	Completion Date of Tariff Commitments		
					Partner	ASEAN+6	CLMV
ASEAN–AFTA (0–5% tariff target)	Goods		1992	Jan 1993		2003	2006–2010
ASEAN–AFTA (0% tariff target)	Goods					2010	2015
ASEAN–AFAS (services)	Services						
ASEAN–AIA (investment)	Investment						
ASEAN–AEC	Single undertaking		Oct 2003			2015	2018
ASEAN+PRC (goods)	Goods		2004	July 2005	PRC 2010	2010	2015
-Services agreement	Services			July 2007			
-Investment agreement	Investment		Aug 2009				
-PRC–Thailand bilateral				x			
-PRC–Singapore bilateral		X					
ASEAN+Japan	Single undertaking		Apr 2008	Jan 2009*	Japan 2012	2012	2017
ASEAN+Republic of Korea (goods)	Goods		Aug 2006	Jun 2007**			
-Services agreement	Services		Nov 2007	May 2009***			
-Investment agreement	Investment		Jun 2009	Pending ratification			
ASEAN+India	Single undertaking		Apr 2008				
ASEAN+Australia/New Zealand	Single undertaking		Feb 2009	Pending ratification			
Trans-Pacific Strategic Economic Partnership (TPP)	Single undertaking		Jun 2005	May 2006			

AFAS = ASEAN Framework Agreement on Services; AFTA = ASEAN Free Trade Agreement; AIA = ASEAN Investment Area; ASEAN = Association of Southeast Asian Nations; CLMV = Cambodia, Lao People's Democratic Republic, Myanmar, and Viet Nam; PRC = People's Republic of China.

*Implemented by Brunei Darussalam, Japan, Lao People's Democratic Republic, Malaysia, Singapore, Lao People's Democratic Republic, Myanmar, and Viet Nam.

**Thailand has yet to sign and implement the goods agreement.

***Covers only Brunei Darussalam and Korea, Malaysia, Myanmar, Philippines, Singapore and Viet Nam; pending ratification in Cambodia, Indonesia, Lao People's Democratic Republic, and Thailand.

Source: Author's compilation from press releases and media reports on the various agreements.

4.2.6 ASEAN–India Comprehensive Economic Cooperation

India offered ASEAN a trade pact in November 2002, presumably as part of its Look East strategy. ASEAN welcomed the initiative as India is a rising economic power in the region. The Framework Agreement was signed in October 2003 and entered into force in July 2004. It was envisaged that tariff concessions in the FTA should cover at least 80% of trade between ASEAN and India. India, with high agricultural tariffs of 70–100%, and many small and marginal farmers, resisted tariff cuts on a range of products of strong export interest to some ASEAN members, especially rice, palm oil, plantation crops such as coffee and tea, and spices such as pepper. At the same time, India was worried about imports of manufactures from Thailand. Initially, India presented an exclusion list of 1,414 products (including textiles, rice, vegetable oil, and petroleum products) that represented 44% of ASEAN's total exports to India in 2004, of which vegetable oil and petroleum products accounted for 27%. In particular, the exclusion of palm oil, tea, pepper, and textiles would affect 80% of Malaysian exports to India. Subsequently, India's negative list was reduced to 850. Considerable differences also existed over the ROO; the eventual compromise agreed on is at least 35% domestic value added plus CTC. The FTA on goods was signed in August 2009. Negotiations on services and investment are ongoing.

4.3 Bilateral FTAs

There is a dense network of plurilateral and bilateral FTAs among the East Asian (ASEAN+6) countries. Table 8 shows FTAs that are under negotiation, have been implemented, or have been concluded. The FTAs have been classified into plurilateral and bilateral FTAs, and either intra-regional (among ASEAN+6 countries) or cross-regional (with other regions). The incidence (number of members x number of FTAs) of intra-regional bilateral FTAs is higher than that of cross-regional bilateral FTAs. While Northeast Asia (PRC, Japan, and Korea) is active in bilateral FTAs with individual ASEAN countries, there are as yet no trilateral or bilateral FTAs among themselves.

Table 9 shows that in addition to ASEAN-wide agreements, Japan has bilateral agreements with seven ASEAN countries (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Viet Nam); Korea has implemented a bilateral agreement with Singapore and proposed bilateral agreements with Malaysia and Thailand; the PRC has bilateral agreements with Singapore and Thailand; Australia has implemented bilateral agreements with Singapore and Thailand, is negotiating with Malaysia, and has proposed a bilateral agreement with Indonesia; New Zealand has implemented a bilateral agreement with Singapore, and is negotiating with Malaysia; while India has implemented a bilateral agreement with Singapore, is negotiating with Malaysia and Thailand, and has proposed a bilateral with Indonesia. Thus, individual ASEAN countries have been entering into bilateral FTAs with the same partners as in the ASEAN+1 agreements. Some of the bilateral agreements preceded the ASEAN+1 agreements, but other bilateral agreements came later. There is no common template between ASEAN+1 and its pair-wise agreements, or among the ASEAN+1 agreements, resulting in an obvious noodle bowl.

Table 8: Plurilateral and Bilateral FTAs of the ASEAN+6 Countries

	Under Negotiation, Concluded, or Implemented									New FTAs Proposed	Total FTAs
	Plurilateral FTAs*			Bilateral FTAs			Total plurilateral & bilateral				
	Intra- regional**	Cross- regional	Total	Intra- regional**	Cross- regional	Total	Intra- regional**	Cross- regional	Total		
Brunei Darussalam	6	2	8	1	0	1	7	2	9	4	13
Indonesia	6	2	8	1	1	2	7	3	10	6	16
Malaysia	6	3	9	4	3	7	10	6	16	3	19
Philippines	6	1	7	1	0	1	7	1	8	4	12
Singapore	6	4	10	6	12	18	12	16	28	4	32
Thailand	6	3	9	6	3	9	12	6	18	6	24
Cambodia	6	1	7	0	0	0	6	1	7	2	9
Lao People's Democratic Republic	6	2	8	1	0	1	7	2	9	2	11
Myanmar	6	2	8	0	0	0	6	2	8	2	10
Viet Nam	6	1	7	1	1	2	7	2	9	2	11
People's Republic of China	1	3	4	6	3	9	7	6	13	10	23
Japan	1	1	2	10	3	13	11	4	15	4	19
Republic of Korea	1	3	4	5	4	9	6	7	13	10	23
Australia	1	2	3	7	4	11	8	6	14	4	18
New Zealand	1	3	4	6	1	7	7	4	11	3	14
India	1	8	9	6	7	13	7	15	22	9	31
FTA incidence	66	41	107	61	42	105	127	83	210	75	285

FTA = free trade agreement.

*Plurilateral refers to FTAs involving more than two countries, including between an FTA grouping of countries and another individual country.

**Intra-regional is defined here as being among the ASEAN+6 group of countries.

** intra-regional defined here as among the ASEAN+6 group of countries

Source: Author's compilation from the ADB Asia Regional Integration Center database (<http://aric.adb.org/indicator.php>).

Table 9: Matrix of Bilateral FTAs Between the ASEAN+6 Countries

a.

	Brunei Darussalam	Indonesia	Malaysia	Philippines	Singapore	Thailand	Cambodia	Lao People's Democratic Republic	Myanmar	Viet Nam
Brunei Darussalam										
Indonesia										
Malaysia										
Philippines										
Singapore										
Thailand								I		
Cambodia										
Lao People's Democratic Republic						I				
Myanmar										
Viet Nam										
People's Republic of China					S	I				
Japan		I	I	I	I	I				S
Republic of Korea			P		I	P				
Australia		P	N		I	I				
New Zealand					I	I				
India		P	N		I	N				

b.

	People's Republic of China	Japan	Republic of Korea	Australia	New Zealand	India	I+S+N Total
Brunei Darussalam		I					1
Indonesia		I		P		P	1
Malaysia		I	P	N	N	N	4
Philippines		I					1
Singapore	S	I	I	I	I	I	5
Thailand	I	I	P	I		N	5
Cambodia							0
Lao People's Democratic Republic							1
Myanmar							0
Viet Nam		I					1
People's Republic of China			P	N	I	P	4
Japan			N			N	7
Republic of Korea	P				P	N	2
Australia	N	N	N		I	P	7
New Zealand	I		N			P	4
India	P	N	N	P	N		6

I = implemented, S = signed/concluded, N = under negotiation, P = proposed/under study/consultation.

Source: Author's compilation from the ADB Asia Regional Integration Center database (<http://aric.adb.org/indicator.php>).

4.4 Scope and Coverage of FTAs/CEPs/CECs in East Asia

Evaluating the impact of FTAs requires consideration of the scope and coverage of the agreements as they extend beyond the tariff barrier of customs union theory. Many of the East Asian FTAs, specifically those of the PRC and Japan, are titled as “economic partnership” and “comprehensive economic cooperation” agreements, of which tariff arrangements are only a part.

Trade in goods: Notification to the WTO under GATT Article XXIV requires coverage of *substantially all trade*, but many developing countries opted for notification under the Enabling Clause. For example, AFTA and the ASEAN–PRC FTA are notified under the Enabling Clause, but the PRC–Singapore FTA as well as many of Singapore’s other bilateral FTAs are notified under GATT XXIV and GATS V. Also the definition of *substantially all trade* has led to varying interpretations.

Trade in services: Notification to the WTO under GATS Article V. FTAs have to provide for substantial sectoral coverage in terms of the number of sectors and modes of supply, the elimination of substantially all discrimination to national treatment, and prevent the raising of barriers against non-members. Developing countries have more flexibility in fulfilling the conditions of substantial sectoral coverage and eliminating discriminatory measures. GATS-type agreements adopt the positive list approach in which national schedules list service sectors and modes of supply that will enjoy market access and national treatment; trade restrictions can be imposed on all non-scheduled sectors. NAFTA-type service agreements adopt the negative list approach, where all services are up for liberalization unless otherwise indicated through lists of reservations, which can be for existing measures as well as for future measures. The GATS positive list approach can be seen in the AFAS, ASEAN–PRC, Australia–Thailand, Korea–EFTA, Singapore–European Free Trade Area, Singapore–India,

Singapore–New Zealand, Japan–Malaysia, Japan–Philippines, and Japan–Singapore agreements. Negative list agreements include those of Singapore–Australia, Singapore–Korea, Singapore–Panama, Singapore–US, Korea–Chile, Japan–Mexico, and the Trans-Pacific Strategic Economic Partnership Agreement. Most of the services agreements provide for liberal ROO along the lines of GATS Article V. Exceptions include domestic ownership and control requirements as in the agreements of Singapore–India and Australia–Thailand; certain foreign policy related carve-outs; and the exclusion of branches as in the agreements of Japan–Malaysia and Japan–Philippines. A majority of the East Asia FTAs call on regulatory bodies to facilitate the recognition of professional qualifications, such as engineering and nursing services (AFAS), engineering services (Singapore–Korea) and legal services (Singapore–US).

Investment: This is covered in ASEAN and ASEAN+1 agreements as well as in developed–developing country bilateral FTAs. There is a commonality in approach, with central commitments being national treatment and/or MFN treatment of foreign investors, typically alongside commitments to create a liberal and competitive environment for investment, to improve transparency of laws and regulations, and to protect investors.

WTO-Plus issues: Many of the CEPs/CECs go beyond the WTO agenda to include provisions on a host of issues such as the four *Singapore issues* of trade facilitation, investment, government procurement, and competition policy; as well as issues such as intellectual property, environment, and labor. FTAs between developed and developing countries usually include such provisions, reflecting the emphasis that developed countries place on these issues. In particular, the US has a standard template for its FTA negotiations. The PRC's agreements, on the other hand, have no standard template and are seemingly customized according to their FTA partners.

The majority of concluded FTAs had WTO-Plus provisions in addition to goods and services provisions. The coverage of WTO-Plus provisions reflects economic interests, relative bargaining power, and negotiating capacity. Table 10 from Kawai and Wignaraja (2008) maps the provisions on the four Singapore issues and various categories of cooperation enhancement in 15 East Asian FTAs. Most of them cover the Singapore issues, while coverage of intellectual property, environment, and standards are less widespread, and coverage of co-operation enhancement is even less common. Many of the FTAs that contain only goods and services trade provisions are between developing countries.

Competition policy: This provision is found in many FTA agreements with developed countries, such those entered into by Australia, EFTA, Japan, New Zealand, and US, but is absent in agreements between developing countries such as in the ASEAN–PRC and ASEAN–India FTAs. In the Singapore–US FTA, there are detailed commitments by both parties. In the Singapore–Australia FTA, both governments commit to apply their competition laws but allow measures or sectors to be exempt from commitments on public interest grounds if executed in a transparent manner.

Temporary movement of natural persons: This is either covered in the Services chapter (Mode 4) or the Investment chapter (intra-corporate transferees) but is sometimes contained in a separate chapter covering movement of business persons, professionals, and intra-corporate transferees. In the light of Japan's strong discouragement of inflow of foreign labor, it is noteworthy that its bilateral agreements with several ASEAN countries have allowed for the limited inflow into Japan of certain categories of professionals.

Commitments on cooperation: Agreements between developed and developing countries usually contain a range of commitments on co-operation. Typically these comprise vague statements of intent, unlike the commitments on liberalization measures. All the ASEAN+1 agreements have various co-operation commitments.

Table 10: Coverage of Selected WTO-Plus East Asian FTAs, 2007

Provisions	Japan– Singapore 2002	Japan– Philippines 2006	Japan– Thailand 2007	Japan– Brunei Darussalam 2007	Japan– Indonesia 2007	US– Republic of Korea 2007	US– Singapore 2004	Singapore– Australia 2003	Singapore– Republic of Korea 2006	P4 2006
GOODS:										
Tariff elimination	X	X	X	x	x	x	X	x	x	x
Rules of origin	X	X	X	x	x	x	X	x	x	x
Trade remedies: antidumping			X	x	x	x			x	x
Trade remedies: subsidies and CV			X	x	x	x			x	x
Trade remedies: bilateral safeguards	X	X	X	x	x	x	X		x	x
Tariff rate quotas										
Early harvest program										
Agriculture covered	X	X	X	x	x	x				
Textiles and apparel	X	X	X	x	x	x	X			
Quarantine & SPS measures						x		x	x	
Other NTBs	X	X	X	x		x				x
Technical barriers to trade	X	X				x	X	x	x	x
Standards and conformance, MR	X	X	X			x	X		x	x
Customs admin. & procedures			X	x	x	x		x		
Paperless trading	X	X	X					x	x	x
SERVICES:										
Telecommunications	X	X	X		x	x	X	x	x	
Financial services	X	X	X		x	x	X	x	x	x
Professional services					x	x			x	
Labor mob/temp entry bus persons	X	X	X	X	x	x	X	x	x	x
SINGAPORE ISSUES:										
Trade facilitation	X	X	X	X		x	X	x	x	x
Investment	X	X	X	X	X	x	X	x	x	x
Government procurement	X	X	X	X	X	x	X	x	x	x
Competition policy	X	X	X		X	x	X	x	x	x
COOPERATION ENHANCEMENT:										
Intellectual property	X	X	X	X	X	x	X	x	x	X

Provisions	Japan– Singapore 2002	Japan– Philippines 2006	Japan– Thailand 2007	Japan– Brunei Darussalam 2007	Japan– Indonesia 2007	US– Republic of Korea 2007	US– Singapore 2004	Singapore– Australia 2003	Singapore– Republic of Korea 2006	P4 2006
E-commerce						x	X	x	x	
Labor standards/move of persons	X	X	X	X	X	x	X			x
Environment		X	X	X	X	x	X		x	x
ECOTECH	X	X	X	X				x	x	x
Strategic partnership					X					x
Capacity building				X	X					
Information exchange			X	X	X					
Energy			X	X	X				x	
Transport and communications	X	X	X	X		x			x	
Construction	X	X							x	
SME	X	X	X	X						
Trade and investment promotion			X	X	X	x				
Transparency			X	X	X	x	X		x	x
State trading enterprises										
Education			X	X				x		
DISPUTE SETTLEMENT:										
Percentage of goods+serv provisions covered	68	68	79	68	68	89	53	47	74	68
Percentage of WTO-Plus provisions covered	50	55	75	75	60	55	45	40	60	50

CV = content value, ECOTECH = economic and technical cooperation;; MR =mutual recognition;; NTB = nontariff barriers, SME = small- and medium-sized enterprises, SPS = sanitary and phytosanitary standards; WTO = World Trade Organization.
Source: Kawai and Wignaraja (2008).

4.5 Evaluating the Benefits and Costs of FTAs in East Asia

In traditional customs union theory, a customs union can contribute to a more efficient allocation of resources within the region, but possibly at the expense of resource allocation between members and non-members, thus making the welfare implications ambiguous. Viner (1950) argued that trade diversion costs take place if the formation of a custom union causes a member to switch imports from a low cost non-member to a higher-cost member; on the other hand, trade creation benefits take place if a member imports more from another member who is also a low cost supplier. Besides the static welfare effects, customs unions also confer several dynamic benefits due to increased competition, economies of scale, stimulus to investment, and better resource utilization. However, the traditional Vinerian focus on trade creation and trade diversion in evaluating their effects often seems irrelevant as the majority of recent CEP/CEC agreements involve many investment liberalization and facilitation, and behind the border liberalization issues.

Whalley (2006) argues that use of gravity or Global Trade Analysis Project models for analysis of the impact of tariff barrier changes may yield little if the agreements are complex and elaborate. Hence, the scope and coverage of agreements raise the following questions—What is the extent of these FTAs on covered trade? What is the utilization rate of the FTA preferential tariffs? How significant are NTBs and the various WTO-Plus provisions?

Coverage of trade: First, what is the extent of these FTAs on covered trade? Measuring the ratio of a country's bilateral trade with its FTA partners against the country's total trade with the world is relatively easy from available trade data. In East Asia, ASEAN countries generally have higher trade shares than the larger Northeast Asian economies, indicating a greater dependence on FTA trade. Both plurilateral and bilateral FTAs show a high degree of extra-regional orientation. It is more difficult to measure the extent of a country's trade that utilizes the FTA preferential tariffs because of various exceptions and exclusions, a lack of data on utilization rates of tariff preferences, and a lack of data on the country direction of services trade. A study by Kawai and Wignaraja (2009) on tariff utilization in a number of East Asian countries showed that utilization rates are generally low, meaning CGE modeling results of tariff reduction/elimination may be overstated.

Margin of preference between MFN and FTA tariffs: Second, what is the margin of preference and utilization rate of the FTA preferential tariffs? A low margin of preference between MFN applied tariffs and FTA preferential tariffs indicate little incentive for businesses to utilize the FTA preferences when set against the administrative costs of obtaining ROO certification. However, for multinational corporations trading in huge volumes, even a small percentage margin could translate into large dollar amounts saved.

Table 11 shows the tariff profiles of ASEAN+6 countries. The simple average MFN applied tariffs are generally much lower than the simple average MFN bound tariffs. There is a wide variation in the average MFN applied tariffs among East Asian countries, ranging from double-digits for Cambodia, India, Korea, and Viet Nam at one extreme, to zero for Singapore at the other extreme. For each country, there are wide variations in individual tariff rates. The percentage share of HS 6-digit subheadings with MFN applied tariffs of zero, range from highs of 100% for Singapore, 79.9% for Brunei Darussalam, and 63.2% for New Zealand, to under 6% for Cambodia, PRC, India, Lao PDR, Myanmar, and Philippines. There are also instances of prohibitive tariffs, with MFN applied tariffs exceeding 1000%. The coefficients of variation of MFN applied tariffs are very high for Brunei Darussalam, Korea, Japan, and Singapore. Hence, simple average MFN applied tariffs give little guidance on margin of preference at the HS 6-digit tariff lines.

Table 11: East Asia—Country Tariff Profiles for All Products

	Binding Coverage (%)	Simple Average MFN		Duty Free MFN		Non ad val. Duties MFN		Duties >15% MFN		Duties >3*AV MFN		Maximum Duty MFN	
		Bound	MFN Applied	Bound	MFN Applied	Bound	MFN Applied	Bound	MFN Applied	Bound	MFN Applied	Bound	MFN Applied
Share of HS 6-digit subheadings (%)													
Brunei Darussalam	95.3	25.3	3.6	0.0	79.9	0.3	0.7	95.2	10.2	0.1	10.8	>1000	>1000
Cambodia	100	19.0	14.2	1.0	5.5	0.0	0.0	44.5	18.9	0.1	0.0	60	35
Indonesia	96.6	37.1	6.9	2.5	22.3	0.0	0.2	90.7	2.7	0.4	1.4	210	150
Lao People's Democratic Republic	—	—	9.7	—	0.0	—	0.2	—	13.4	—	8.1	—	40
Malaysia	83.7	24.5	8.4	5.2	57.3	2.8	0.7	36.4	21.8	1.8	2.3	>1000	>1000
Myanmar	17.4	83.0	5.6	0.9	3.5	0.1	0.0	14.2	5.4	0.5	5.4	550	40
Philippines	66.8	25.6	6.3	2.6	2.8	0.0	0.0	55.8	3.1	0.0	3.1	80	65
Singapore	69.2	12.1	0	15.9	100	0.5	0.0	0.5	0.0	0.5	0.0	>1000	112
Thailand	74.7	28.1	10.0	2.8	18.3	18.7	21.9	65.9	22.6	1.0	3.1	252	215
Viet Nam People's Republic of China	100	11.4	16.8	14.3	32.6	0.0	0.0	27.4	40.7	3.6	0.8	200	150
Japan	99.6	5.1	5.1	55.1	52.3	3.5	3.7	3.7	3.6	3.7	3.6	648	648
Republic of Korea	94.6	17.0	12.2	14.1	15.4	0.5	0.4	20.1	8.3	2.5	2.7	887	887
Australia	97.0	9.9	3.5	20.9	48.8	0.5	0.2	13.4	4.1	6.0	4.1	55	245
India	73.8	50.2	14.5	2.8	3.9	5.3	5.0	70.5	18.2	0.8	3.7	372	289
New Zealand	99.9	9.9	3.0	47.7	63.2	1.9	0.4	30.9	5.0	7.4	6.8	183	17
United States	100	3.5	3.5	45.7	47.1	8.2	8.2	2.7	2.8	7.5	7.5	350	350

MFN = most favored nation.

Source: Author's compilation from WTO World Tariff Profiles (<http://stat.wto.org/TariffProfile/WSDBTariffPFHome.aspx?Language=E>).

Table 12a shows the MFN applied tariffs and imports by product groups for five ASEAN countries (Indonesia, Malaysia, Philippines, Thailand, and Viet Nam). These countries all have moderate average MFN applied tariffs, except for Viet Nam. Also, Thailand and Viet Nam still have a highly protectionist agricultural sector, with average agricultural tariffs of over 20%. The other high average tariff groups are found in beverages and tobacco (except Philippines), clothing, textiles (Viet Nam), and transport equipment (except Philippines). Electrical machinery (including electronics), which is a major import of Malaysia, Philippines, and Thailand, has low average tariffs. Table 12b shows the MFN applied tariffs and imports by product groups of ASEAN's partners in the ASEAN + 1 agreements. The PRC has an average MFN applied tariff of 9.9%, with 15.8% in agriculture and highs of 16.0% in clothing, 13.5% in leather and footwear, and 11.5% in transport equipment. Major import groups are minerals and metals, petroleum, chemicals, non-electrical machinery, and electrical machinery with average tariffs of under 10%. Australia and New Zealand have very low average MFN applied tariffs, both in agriculture and in manufactures. Japan has a low average MFN applied tariff but a very high average agricultural tariff (21.8%) and 11.2% in leather and footwear. Korea has a relatively high average MFN applied tariff (12.2%), but an extremely high average tariff for agriculture (49.0%), as well as a high average tariff of 12.6% for clothing. India has a high average MFN applied tariff (14.5%), the highest among ASEAN's partners, a very high average agricultural applied tariff of 34.4% and very high tariffs of over 20% on textiles, clothing and transport equipment. However, as qualified above in the ASEAN tariffs, simple average tariffs of FTA partners may give little indication of the prohibitive heights of some individual tariffs at the HS 6-digit level.

Table 12: ASEAN Countries—Tariffs and Imports by Product Groups

a.

Product groups	Indonesia			Malaysia			Philippines			Thailand			Viet Nam		
	MFN Applied Duty	Imports Share	Imports Duty-free	MFN Applied Duty	Imports Share	Imports Duty-free	MFN Applied Duty	Imports Share	Imports Duty-free	MFN Applied Duty	Imports Share	Imports Duty-free	MFN Applied Duty	Imports Share	Imports Duty-free
	(Avg)	(%)	(%)												
1 Animal products	4.4	0.4	57.0	0.5	0.3	99.5	21.3	0.5	0.0	28.1	0.0	43.0	20.1	0.0	14.6
2 Dairy products	5.5	0.9	0.0	3.4	0.3	86.9	3.9	1.1	0.0	15.8	0.2	0.0	21.9	0.8	0.0
3 Fruits, vegetables, plants	5.9	0.7	0.6	4.2	0.6	80.4	9.4	0.5	0.0	27.6	0.4	0.7	30.6	0.7	7.8
4 Coffee, tea	8.3	0.2	0.0	9.0	0.7	87.4	15.8	0.2	0.0	23.1	0.1	0.0	37.9	0.0	0.0
5 Cereals & preparations	6.3	2.3	62.2	5.1	1.3	64.2	10.9	3.9	0.1	19.4	0.6	0.0	27.4	1.4	24.2
6 Oilseeds, fats & oils	4.0	1.7	55.5	1.7	0.0	74.7	5.6	1.3	0.0	19.1	1.0	0.0	13.4	1.5	65.1
7 Sugars & confectionery	10.4	1.2	0.0	2.8	0.4	92.6	16.0	0.2	0.0	32.3	0.0	0.0	17.7	0.3	10.5
8 Beverages & tobacco	51.8	0.4	0.0	136.6	0.4	2.2	8.2	0.7	0.0	33.4	0.3	0.0	66.6	0.5	0.0
9 Cotton	4.0	1.0	99.5	0.0	0.0	100.0	2.6	0.1	0.0	0.0	0.5	100.0	6.0	0.5	99.4
10 Other agricultural products	4.3	0.7	68.7	0.6	0.3	97.0	3.4	0.5	0.0	10.3	0.4	0.6	7.8	0.9	22.1
11 Fish & fish products	5.8	0.2	57.7	2.2	0.4	91.5	8.0	0.2	0.0	14.5	1.3	0.0	31.3	0.7	0.7
12 Minerals & metals	6.6	13.4	41.3	10.9	13.5	61.1	4.7	10.5	12.9	5.9	23.1	38.4	10.2	19.8	46.8
13 Petroleum	0.5	31.5	100.0	1.1	8.3	89.7	2.9	18.7	0.0	9.4	19.5	96.0	17.5	13.7	0.0
14 Chemicals	5.2	13.5	43.1	3.3	8.4	69.2	3.8	8.9	6.8	3.8	8.9	37.3	5.2	13.5	52.2
15 Wood, paper, etc.	5.0	2.7	66.8	10.7	2.1	58.7	6.9	2.4	2.0	6.8	2.1	34.5	17.2	3.9	37.8
16 Textiles	9.3	1.7	14.6	10.5	1.1	25.9	9.3	2.8	0.9	8.1	2.1	0.0	30.4	10.6	10.7
17 Clothing	14.4	0.1	0.0	16.0	0.2	5.0	14.9	0.2	0.0	24.5	0.2	0.0	49.3	0.7	0.0
18 Leather, footwear, etc.	9.0	1.3	8.2	13.9	1.2	63.1	6.7	0.8	8.4	12.7	1.3	21.1	19.0	3.4	1.2
19 Non-electrical machinery	2.3	14.4	65.3	3.6	15.0	86.5	2.3	13.8	63.2	4.7	13.5	47.4	5.4	12.3	58.9
20 Electrical machinery	5.8	3.5	32.5	6.5	36.0	89.3	3.8	25.2	84.5	8.3	17.9	74.7	12.8	8.0	50.3
21 Transport equipment	11.6	6.7	20.4	11.4	4.4	48.3	9.0	5.2	4.8	20.7	2.2	1.0	22.2	4.5	7.2
22 Manufactures, n.e.s.	6.9	1.3	17.5	4.9	4.2	92.4	4.8	2.3	23.0	11.0	4.3	52.6	15.2	2.5	47.9
Total (simple average MFN rate)	6.9			8.4			6.3			10.0			16.8		
Agriculture	8.6			11.7			9.6			22.0			24.2		
Non-agriculture	6.7			7.9			5.8			8.2			15.7		
Imports (US\$ billion)		55.1			127.4			40.6			125.8			36.6	

b.

Product groups	People's Republic of China			Japan			Republic of Korea			Australia			New Zealand			India		
	MFN Applied Duty	Imports Share	Imports Duty-free	MFN Applied Duty	Imports Share	Imports Duty-free	MFN Applied Duty	Imports Share	Imports Duty-free	MFN Applied Duty	Imports Share	Imports Duty-free	MFN Applied Duty	Imports Share	Imports Duty-free	MFN Applied Duty	Imports Share	Imports Duty-free
	(Avg)	(%)	(%)	(Avg)	(%)	(%)	(Avg)	(%)	(%)	(Avg)	(%)	(%)	(Avg)	(%)	(%)	(Avg)	(%)	(%)
1 Animal products	14.8	0.1	5.7	13.9	1.7	3.8	22.1	0.6	0.5	0.4	0.3	94.2	1.8	0.5	48.6	31.6	0.0	0.0
2 Dairy products	12.2	0.1	0.0	154.7	0.1	21.8	67.5	0.1	0.0	4.1	0.2	25.4	1.5	0.2	74.0	34.5	0.0	0.0
3 Fruits, vegetables, plants	14.9	0.3	4.7	12.3	1.2	11.1	57.8	0.5	0.0	1.6	0.7	55.1	1.4	1.4	80.8	30.8	1.2	20.7
4 Coffee, tea	14.9	0.0	0.0	15.5	0.4	62.1	53.9	0.1	0.0	1.0	0.5	71.7	3.1	0.7	35.5	55.9	0.0	0.0
5 Cereals & preparations	24.5	0.2	11.9	64.3	1.3	62.0	133.7	1.0	4.5	1.3	1.1	24.9	3.5	2.3	21.7	31.1	0.8	0.2
6 Oilseeds, fats & oils	11.2	1.7	14.0	10.9	0.7	79.8	40.0	0.5	2.5	1.6	0.4	81.8	0.8	0.8	87.7	48.8	1.5	0.0
7 Sugars & confectionary	27.4	0.1	0.0	23.2	0.1	66.5	17.8	0.2	0.0	1.9	0.1	9.6	1.7	0.6	65.3	34.4	0.0	0.0
8 Beverages & tobacco	23.0	0.2	2.4	13.9	1.3	62.1	31.7	0.3	0.0	3.6	0.9	26.4	2.9	1.4	74.6	63.3	0.1	0.0
9 Cotton	22.0	0.7	0.0	0.0	0.0	100.0	0.0	0.1	100.0	0.0	0.0	100.0	0.0	0.0	100.0	17.0	0.1	0.0
10 Other agricultural Products	11.7	0.6	2.5	5.3	0.8	71.7	16.6	0.5	12.5	0.3	0.3	93.1	0.7	0.7	48.5	22.0	0.4	0.0
11 Fish & fish products	10.9	0.6	1.1	5.5	2.2	4.4	15.8	0.9	0.7	0.0	0.6	85.6	0.5	0.3	73.3	29.6	0.0	0.0
12 Minerals & metals	7.9	15.2	32.8	1.0	22.1	90.7	4.6	23.5	46.3	2.8	12.3	51.2	2.3	10.2	48.7	8.4	32.0	11.1
13 Petroleum	5.1	11.4	81.0	0.6	21.9	96.8	4.6	21.3	4.2	0.0	13.7	100.0	0.2	15.5	99.7	8.9	28.8	0.0
14 Chemicals	6.9	12.2	1.2	2.5	8.2	44.9	5.9	8.6	17.3	1.8	11.8	59.4	1.0	12.1	63.5	8.0	8.5	0.7
15 Wood, paper, etc.	4.6	2.6	73.0	0.8	3.4	77.2	2.2	2.1	70.7	3.4	4.3	25.2	1.6	5.3	76.4	9.1	2.2	3.7
16 Textiles	9.7	2.2	0.0	5.5	2.1	7.3	9.1	1.7	3.3	6.8	2.2	12.4	3.0	2.8	32.9	20.9	1.3	1.6
17 Clothing	16.0	0.2	0.0	9.2	4.2	0.0	12.6	1.1	0.0	15.4	2.4	2.2	16.3	2.7	0.1	22.2	0.0	0.0
18 Leather, footwear, etc.	13.5	1.7	0.1	11.2	1.8	44.8	7.9	1.1	23.2	5.5	2.6	4.3	4.6	2.1	27.6	10.1	0.0	0.4
19 Non-electrical machinery	8.3	12.8	36.0	0.0	10.3	100.0	6.0	11.1	40.0	3.1	17.7	49.1	4.1	13.5	51.1	7.0	10.9	31.0
20 Electrical machinery	9.0	25.2	81.4	0.2	5.9	98.7	6.2	16.3	72.4	3.2	4.9	27.5	3.5	4.3	33.4	6.5	3.5	48.9
21 Transport equipment	11.5	4.1	0.0	0.0	3.7	100.0	5.5	2.7	42.1	5.9	16.6	21.9	4.6	17.5	89.6	20.8	5.5	0.1
22 Manufactures, n.e.s.	12.2	7.8	13.3	1.2	6.5	94.8	6.7	5.5	33.0	1.4	6.4	77.3	2.3	5.1	61.4	8.7	2.3	24.2
Total (simple avg MFN rate)	9.9			5.1			12.2			3.5			3.0			14.5		
Agriculture	15.8			21.8			49.0			1.3			1.7			34.4		
Non-agriculture	9.0			2.6			6.6			3.8			3.2			11.5		
Imports (US\$ billion)		716.0			521.5			305.9			120.6			24.4			166.3	

MFN = most favored nation, n.e.s. = not elsewhere specified.

Source: Author's compilation from WTO World Tariff Profiles (<http://stat.wto.org/TariffProfile/WSDBTariffPFHome.aspx?Language=E>).

Significance of Non-tariff barriers (NTBs) and WTO-Plus provisions: Third, how significant are the NTBs for trade in goods and in new areas such as services, mutual recognition, investment, intellectual property, competition policy, and movement of persons? As tariffs have fallen over the years, NTBs (such as customs valuation and procedures) have become more prominent; they are less transparent and quantifiable, and often act as a more serious trade barrier than tariffs. Also, trade in goods is only part of the CEP/CEC agreements; of growing importance are the liberalization of services and investments.

Kawai and Wignaraja (2008) proposed criteria and measures to maximize the benefits and minimize the costs of FTAs. These are (i) consistency with Article XXIV and GATS V by adopting lowest tariff rates among members, (ii) a large membership, (iii) comprehensive coverage of liberalization measures (goods, services, and investment), (iv) simple and non-restrictive ROO; and (v) harmonized regulatory and institutional frameworks. Well-designed FTAs can maximize dynamic gains by generating greater trade and FDI through trade and investment liberalization and facilitation for goods, services, and FDI. WTO-Plus provisions in areas such as investment, intellectual property, competition policy, regulatory harmonization, labor mobility, and environment issues can also deepen economic integration. Greater inflow and outflow of FDI allows the transfer of technologies and promotes trade and economic development. The benefits are larger if the FTAs can induce difficult domestic structural reforms; once reforms are pursued it is much easier for the country to provide greater market access to non-members as well.

A good balance must be sought between the breadth of participating countries and the depth of measures to be addressed in an FTA. On the cost side of FTAs, one serious cost relates to discriminatory treatment of non-members, especially small and low-income countries that have little ability to join FTAs. The cost of FTA negotiations could also be large for small, poor economies with limited negotiation capacity. Proliferation of many overlapping FTAs with different ROO and standards can create the risk of noodle bowls, thereby reducing incentives for businesses to use the FTAs.

5. EAST ASIA FTA AND ECONOMIC COOPERATION?

5.1 Rationale and Challenges of a Region-wide FTA and Economic Cooperation

Asia is a huge and diverse economic region, and it would be best to examine an FTA for East Asia first, before embarking on the larger and more ambitious pan-Asia FTA or Asia Pacific FTA.

The region-wide approach is superior to the sub-regional and bilateral approaches in FTA formation, in both the static welfare effects (trade creation and trade diversion) and the dynamic effects from increased competition, economies of scale, and utilization of economic resources.

There are geopolitical and economic reasons for establishing a region-wide FTA and fostering economic cooperation in East Asia:

- *Political gains:* The ASEAN experience has shown the usefulness of economic cooperation and integration in reducing geopolitical tensions and conflicts. A large grouping would also increase the East Asian voice in international organizations and international fora.
- *Modeling results:* Various modeling studies¹³ have shown that a larger region-wide FTA would result in more economic benefits than smaller FTAs. The region-wide

¹³ See for example, Kawai and Wignaraja (2007).

FTA, with the removal of barriers to trade and investment and freer flows of capital and labor, would facilitate regional production networks and supply chains, and incentivize individual countries to undertake reforms and economic restructuring to better meet the challenges of globalization, as well as regionalism and protectionism in the Americas and Europe.

- *Investment effect:* A larger and integrated market, together with lowered investment barriers, would facilitate and incentivize the entry of more foreign investments in resources, manufacturing, services, and infrastructure development, thereby improving regional connectivity.
- *Counter the noodle bowl effect:* A region-wide FTA holds possibilities for establishing compatible ROO, product and technical standards, and conformance requirements, thus, avoiding the fragmentation of markets and the negative noodle bowl effect from the proliferation of multi-layered and overlapping FTAs. It is recognized that establishing compatibility across the large number of plurilateral and bilateral FTAs would be difficult in practice and that it may be necessary to progress step-by-step.

There are also various obstacles in the way of a region-wide FTA and economic cooperation:

- *Is there a common political vision?* Countries in East Asia need to be convinced that there is a common destiny and that the political and economic gains of economic cooperation and integration outweigh the costs of surrendering national sovereignty to build common institutions and common rules and disciplines. One lesson from the failure of the Free Trade Area of the Americas negotiations is the importance of avoiding a lack of common political vision among the larger participants (Stephenson 2007). In East Asia, while ASEAN has gone some way towards the objective of building an ASEAN community, countries in Northeast Asia are still plagued by historical mistrust and current economic rivalry.
- *How to handle the wide development gaps?* A region-wide FTA would encompass a wide mix of economies at different levels of economic development, and industrial and technological competence. It would be difficult to reach a consensus on the scope and speed of achieving a high quality FTA and economic partnership. Among the poorer and less efficient economies, producers, and suppliers, concerns have been raised of marginalization; hence, governments are reluctant to open up their less competitive farm sectors, labor intensive industries, and small- and medium-sized enterprises without adequate safeguards and financial and technical assistance for capacity building. Among the richer and more competitive economies, there is public resistance to financial transfers through taxation in the absence of political and social integration (as in the case of the EU). Still, there are positive aspects to regional diversity. For one, it offers complementarities and prospects of specialization and efficient regional production. It would also enable the smaller and less developed East Asian economies to be part of regional and global production networks and supply chains in East Asia and enjoy the spillover effects from regional dynamism and growth.
- *How deep is intra-regional economic linkage?* East Asian trade and investment activities are oriented towards markets and investors outside the region, particularly towards North America and Western Europe, although there has been rapid growth of intra-regional trade in recent years. Table 13 shows intra-regional trade in 2007. Only Indonesia has intra-regional exports exceeding 50% under the East Asia Free Trade Agreement (EAFTA), and only Australia, Indonesia, Malaysia, and Singapore have intra-regional exports exceeding 50% under the Comprehensive Economic Partnership for East Asia (CEPEA). However, dependence on intra-regional imports is significantly higher. All EAFTA members

except the PRC and Japan have intra-regional imports exceeding 50%, while all CEPEA members except the PRC, India, and Japan have intra-regional imports exceeding 50%. Further, as noted in ADB (2007), product fragmentation in East Asia has resulted in intra-regional trade being dominated by trade in parts and components (72.7%), while trade in final goods is still largely destined for non-regional markets (78.8%).

- The recent quick transmission of the US financial and economic crisis to East Asian economies through the collapse in demand for the region's exports has put paid to the de-coupling thesis. There is a growing realization among East Asian policy makers that the pre-crisis export-led model is unsustainable and that East Asian countries have to rebalance growth towards regional and domestic demand. East Asia appears to be recovering from the current crisis faster than North America and Western Europe and this, together with the rebalancing of growth, should lead to deeper intra-regional trade and investment linkages.

5.2 Possible Roadmaps to a Region-wide FTA

At the minimum, a region-wide FTA would be defined as EAFTA (or ASEAN+3). However, there is the alternative scenario of CEPEA (or ASEAN+6)). There are also proposals for an APEC FTA or an expanded Trans-Pacific Strategic Partnership to prevent a *split down the Pacific*.

EAFTA (East Asia Free Trade Area or ASEAN+3) Option:

ASEAN+3 cooperation started as an initiative for monetary and financial cooperation in the wake of the ASEAN financial crisis. The grouping adopted the Chiang Mai Initiative in 2000, which was aimed at fostering regional financial stability and resilience. On trade and investment cooperation and integration, there was the 2001 Report of the East Asia Vision Group and the 2002 Report of the East Asia Study Group. The latter report was adopted at the ASEAN + 3 Summit in 2002 and contains medium- and long-term measures such as the convening of an East Asia Summit and an expert group to study the feasibility of an East Asia FTA. The East Asia Summit was convened in Kuala Lumpur in December 2005. The expert group was appointed in 2005 and submitted its first report in mid-2006 and its final report in 2009. The final report stressed the need to adopt a common ROO.

EAFTA could be achieved by the following:

- *Merging ASEAN agreements with a Northeast Asia FTA:* ASEAN is in an advanced stage of implementation of AFTA (goods), AFAS (services), and AIA (investment). There is no comparable PRC–Japan– Korea trilateral FTA agreement, while bilateral options are still in the early consultation and feasibility study stage. While the past political relations of PRC, Japan, and Korea constituted a serious barrier, there appears to be a warming of political ties and an increasing willingness to cooperate. The issue of agriculture (which has troubled the Doha Round) between the two sub-regions is difficult to resolve. A merger of the ASEAN bloc with the Northeast Asian bloc would highlight the asymmetric economic power between the two sub-regions.
- *Merging the ASEAN+1 FTAs:* This would be ASEAN-centric since there are FTA agreements linking ASEAN with PRC, Japan, and Korea (as well as Australia–New Zealand CER and India) and key production networks are rooted in ASEAN. On the positive side, these ASEAN + 1 agreements would have an agreed common framework and liberalization schedule, reducing possible areas of divergence and disagreement. A negative scenario is also possible, as the lack of a common template for these agreements would result in a noodle bowl that would be difficult to unravel.

Table 13: Intra-regional Exports and Imports of EAFTA and CEPEA in 2006

Region/Country	Percent of Region/Country Exports to:								
	ASEAN	People's Republic of China	Japan	Republic of Korea	EAFTA	India	Australia	New Zealand	CEPEA
Indonesia	16.72	8.49	20.85	6.71	52.77	4.49	3.08	0.33	60.67
Malaysia	23.69	8.84	9.19	3.81	45.53	3.36	3.39	0.43	52.71
Philippines	11.34	4.88	17.46	3.23	36.91	0.43	1.45	0.36	39.15
Singapore	30.30	10.13	4.90	3.63	48.96	3.41	3.82	0.54	56.73
Thailand	17.31	9.77	11.71	1.94	40.73	1.86	3.80	0.41	46.80
Cambodia	3.56	1.67	3.11	0.20	8.54	0.03	0.37	0.24	9.18
Viet Nam	13.66	6.37	11.96	2.75	34.74	0.30	7.31	0.20	42.55
People's Republic of China	6.60		8.33	4.55	19.48	1.97	1.48	0.18	23.11
Japan	11.14	14.79		7.55	33.48	0.89	2.03	0.34	36.74
Republic of Korea	8.64	21.82	7.08		37.54	1.76	1.25	0.19	40.74
India	7.97	6.39	2.30	1.73	18.39		0.76	0.09	19.24
Australia	9.15	12.16	16.94	7.54	45.79	5.90		5.35	57.04
New Zealand	9.65	5.49	9.49	3.62	28.25	0.72	20.87		49.84
Percent of Region/Country Imports From:									
Region/country	ASEAN	People's Republic of China	Japan	Republic of Korea	EAFTA	India	Australia	New Zealand	CEPEA
Indonesia	43.01	13.84	9.32	6.02	72.19	1.98	2.53	0.63	77.33
Malaysia	39.17	13.65	10.79	4.28	67.89	1.24	1.49	0.37	70.99
Philippines	23.11	13.20	15.90	7.46	59.67	0.99	1.46	0.57	62.69
Singapore	23.32	15.17	9.79	6.16	54.44	2.98	1.65	0.24	59.31
Thailand	22.80	11.30	23.15	4.10	61.35	1.42	3.10	0.39	66.26
Cambodia	48.17	20.93	2.51	6.56	78.17	0.03	0.78	0.03	79.01
Viet Nam	25.70	21.57	9.74	10.12	67.13	0.30	1.68	0.48	69.59
People's Republic of China	12.12		17.38	14.03	43.53	1.58	2.68	0.24	48.03
Japan	15.24	20.21		5.22	40.67	0.65	4.28	0.48	46.08
Republic of Korea	11.09	21.71	20.03		52.83	0.96	3.75	0.36	57.90
India	15.27	15.68	3.94	4.26	39.15		4.88	0.12	44.15
Australia	20.01	13.72	10.43	3.51	47.67	0.82		4.00	52.49
New Zealand	14.14	9.06	9.48	2.92	35.60	0.53	28.35		64.48

ASEAN = Association of Southeast Asian Nations, CEPEA = Comprehensive Economic Partnership in East Asia, EAFTA = East Asia Free Trade Agreement, UNESCAP = United Nations Economic and Social Commission for Asia and the Pacific.

Source: Author's compilation from UNESCAP's Asia-Pacific Research and Training Network on Trade Interactive Trade Indicators database (www.unescap.org/tid/artnet/artnet_app/iti_aptiad.aspx).

CEPEA (Comprehensive Economic Partnership in East Asia or ASEAN+6) Option:

The first East Asia Summit was held in Kuala Lumpur, Malaysia in December 2005¹⁴ followed by summits in Cebu, Philippines in January 2007, and in Singapore in November 2007. The summit was attended by the ASEAN+3 countries as well as by Australia, India, and New Zealand. Japan regards ASEAN+6 as an appropriate group for East Asia's trade and investment cooperation and in April 2006 proposed CEPEA.

¹⁴ Russia was invited to the First East Asia Summit as an observer.

The CEPEA option has several advantages. It would result in a larger trade creation effect than EAFTA. Including Australia, India, and New Zealand would reduce the leadership competition between the PRC and Japan in an East Asia FTA. However, this option would also have difficulties in that most ASEAN countries as well as Australia, PRC, and New Zealand have comparative advantages in agriculture, while India, Japan, and Korea are highly protectionist in agriculture. The less developed ASEAN countries are concerned about opening up their economies to competition from the PRC, Japan, and Korea as well as Australia, New Zealand, and India without prior capacity building to improve their supply-side competitiveness. Hence, the less developed ASEAN countries prefer to argue for cooperation and facilitation measures before committing to liberalization measures.

CGE Modeling Results for EAFTA and CEPEA:

CGE simulation studies are useful in quantifying the income effects of eliminating import tariffs on goods trade and liberalizing cross border trade in services through FTAs.¹⁵ A serious shortcoming in CGE simulation is the inability to incorporate the dynamic investment effects of FTAs. It is common knowledge that all ASEAN countries view the positive investment effects as a major benefit of signing on to FTAs. Another shortcoming of CGE modeling is the inability to incorporate ROO and NTBs that are likely to afford more protection for domestic industries than tariffs. Thus, Kawai and Wignaraja (2007) caution that CGE studies are best used in conjunction with other empirical tools such as analysis of the complex structure of FTAs and enterprise perception studies of the benefits of FTAs. Kawai and Wignaraja's 2007 CGE study incorporates trade in services and trade facilitation. Their scenarios for EAFTA (ASEAN+3) and CEPEA (ASEAN+6) as well as for ASEAN-PRC, ASEAN-Japan and ASEAN-Korea are shown in Table 14.

¹⁵ For a list of CGE studies on ASEAN, ASEAN+1 and ASEAN+3, see Kawai and Wignaraja (2007).

Table 14: Income Effects of Alternative Plurilateral FTA Scenarios

	Compared to 2017 baseline (at constant 2001 US dollar rate)									
	ASEAN+PRC FTA		ASEAN+Japan FTA		ASEAN+Korea FTA		ASEAN+3 FTA		ASEAN+6 FTA	
	Value (US\$ million)	Percentage change	Value (US\$ million)	Percentage change	Value (US\$ million)	Percentage change	Value (US\$ million)	Percentage change	Value (US\$ million)	Percentage change
ASEAN:	44,211	3.72	28,831	2.43	8,088	0.68	62,186	5.23	67,206	5.66
Indonesia	6,924	2.30	2,834	0.94	1,475	0.49	7,884	2.62	8,588	2.86
Malaysia	7,551	4.02	4,453	2.37	1,339	0.71	10,391	5.54	11,869	6.33
Philippines	2,556	2.13	1,915	1.59	630	0.52	3,177	2.64	3,431	2.85
Singapore	6,854	4.13	3,171	1.91	793	0.48	7,943	4.79	9,002	5.43
Thailand	16,324	7.39	14,107	6.39	2,640	1.20	26,728	12.10	28,346	12.84
Cambodia	68	0.75	30	0.33	15	0.16	107	1.20	109	1.21
Viet Nam	3,371	4.68	2,119	2.94	1,136	1.58	5,293	7.35	5,490	7.63
Others	563	0.50	203	0.18	60	0.05	661	0.59	370	0.33
Northeast Asia:	9,756	0.11	18,624	0.21	7,256	0.08	165,720	1.85	172,087	1.93
People's Republic of China	19,103	0.58	(4,475)	(0.14)	(2,351)	(0.07)	41,502	1.26	43,598	1.33
Japan Republic of Korea	(3,965)	(0.08)	24,943	0.51	(1,308)	(0.03)	74,825	1.54	77,137	1.59
East Asia (Other):										
Australia	1,046	0.18	(1,204)	(0.21)	(9)	0.00	(2,376)	(0.41)	22,546	3.91
New Zealand	166	0.21	(73)	(0.09)	12	0.02	(216)	(0.27)	4,136	5.24
India	(809)	(0.10)	(658)	(0.08)	(370)	(0.05)	(2,371)	(0.30)	19,270	2.42
World	81,998	0.17	45,134	0.09	14,173	0.03	213,919	0.45	259,837	0.54

Source: Kawai and Wignaraja (2007).

Among the three ASEAN+1 scenarios, ASEAN–PRC has the largest income effect on ASEAN, while ASEAN–Korea has the smallest. Although all ASEAN countries benefit, there is a wide variance in income effects, with the largest found in Thailand. In the ASEAN–PRC FTA, Japan and Korea suffer from negative trade diversion; in the ASEAN–Japan FTA, the PRC and Korea suffer from negative trade diversion; while in the ASEAN–Korea FTA, the PRC and Japan suffer from trade diversion.

EFTA and CEPEA offer larger gains than the ASEAN+1 scenarios. EFTA gains to FTA members are significant at US\$228 billion, while gains from CEPEA are higher at US\$285 billion. However, the two scenarios have different impacts on member countries. For ASEAN, the gains are bigger under CEPEA, and under both scenarios, the largest percentage gains are by Thailand followed by Viet Nam and Malaysia; and the smallest gains are by Cambodia, Lao PDR, and Myanmar. For PRC, Japan, and Korea the gains are bigger under CEPEA and under both scenarios, Korea has the largest percentage gains. As non-members, Australia, India, and New Zealand experience losses (trade diversion effects) under EFTA, with the largest percentage loss by Australia. However, they gain as members in the CEPEA scenario, with New Zealand having the largest percentage gains.

Burdensome and Multiple Rules of Origin:

ROO are crucial in determining the true degree of liberalization of trade in manufactures. Some rules are deliberately restrictive to shelter domestic producers from competition from FTA partners. Restrictive ROO make it difficult for exporters to enjoy the tariff preferences. One indicator of this is the extent of utilization of tariff preferences by exporters. ROO can often be more important than tariff preferences in determining the degree of market access provided by the FTA. Costs imposed on exporters by ROO in record keeping and documentation, production down time, and switches to more expensive input mixes can more than offset the cost advantages of tariff preferences. Among manufactures, textiles and garments tend to be affected by restrictive and stringent ROO.

For manufactures, there are commonly three types of ROO to measure substantial transformation and qualification for FTA tariff preferences. These are value added content (VC), CTC, and specific process rules. There are also variations within each type of ROO. The VC rule is very demanding on sourcing, and cost information is required on a continuous basis; changing cost structures and exchange rates may result in not satisfying the required VC. There are also variations in regional VC rules arising from differences in the percentages of regional VC required, differences in the way regional VC is calculated, different cumulation provisions, and differences in the way that for some products the regional VC rules are combined with a specific process requirement. The CTC rules offer exporters much greater certainty, as tariff classifications do not change and there is complete certainty of satisfying the ROO. However, a single CTC rule based on the HS tariff lines may not be suitable for every product to measure substantial transformation. Hence, comprehensive application of the CTC rule typically requires the ROO for each tariff category to be specified, resulting in extremely lengthy ROO schedules. Variations in CTC rules arise from the different levels at which the change in customs classification is defined and the differences in the ways that CTC rules may be combined with specific processes or regional VC rules that must be satisfied simultaneously.

There are also variations in documentation and certification requirements. In some FTAs, origin must be importer-certified, while in others the requirement is for exporter-certification. The latter also differentiates between exporter–self-certification and certification by a designated official agency.

The majority of FTAs have adopted a combination of ROO rather than relying on a single rule. The simplest ROO are found in AFTA and the ASEAN–PRC FTA which both specify a 40% regional VC across all manufacturing sectors. Inconsistent ROO among multiple and overlapping plurilateral and bilateral FTAs in East Asia result in market fragmentation and the noodle bowl effect, which both add to business transaction costs, although an empirical

study on Singapore by Chia (2008) shows the effect is not as serious as claimed by some authors such as Baldwin (2006).

Nonetheless, a convergence of ROO would facilitate trade (Scollay 2007) It would be best to have a common template at the negotiating stage, although this poses severe difficulties because of different positions and sensitivities of potential FTA partners. Reaching consensus on a common ROO for existing FTAs across industries and products will be a very difficult task. One possible solution is for PRC, Japan, and Korea to follow the ASEAN (AEC) ROO template as far as possible to achieve EAFTA. The other alternative is to converge as far as possible the ROO in the ASEAN+1 FTAs.

EAFTA or CEPEA?

- The East Asian and ASEAN economies are politically divided on their preference for either EAFTA or CEPEA. Kawai and Wignaraja (2007) argue that proper sequencing could start with ASEAN+3 (EAFTA) and then move on to ASEAN+6 (CEPEA). However, there are several challenges to be met:
- Once the template is set by the ASEAN+3 countries, it would be difficult for accession by Australia, New Zealand, and India to result in ASEAN+6. Hence it would be necessary to agree on a common template for ASEAN+6 countries, with a later time frame for negotiations for ASEAN+6.
- If the level of integration is confined to trade and investment, then progression from ASEAN+3 to ASEAN+6 over a period of time does not pose a serious problem as the more protectionist members would eventually conform. However, monetary and financial integration, community building, and a common political vision that includes Australia, India, and New Zealand would require a longer time frame.
- ASEAN must act as the regional hub. It is a non-threatening sub-group trusted by Australia, PRC, India, Japan, Korea, and New Zealand and can balance the hegemonic ambitions of the large countries. However, to counter the pull of extra-ASEAN economies from the ASEAN core, the ASEAN countries need to further deepen their own economic integration process.
- Substantial regional and international support is needed in the form of aid for trade and the building up of the capacity of the low-income ASEAN countries to overcome resistance to further market opening and to strengthen their supply-side capacity to take full advantage of the integrated regional markets.
- There are serious problems with consolidation and/or convergence of the various ASEAN, ASEAN+1 and bilateral FTAs in East Asia with respect to the scope and coverage of trade and services, lists of exclusions, rules of origin, technical barriers and product standards, mutual recognition of service providers, FDI, and other WTO-Plus provisions.
- Relationships with the US and EU are important for the region. One possible approach for East Asia is to strengthen economic ties with the US through East Asia–NAFTA or an Asia Pacific FTA, and with the EU through the Asia-Europe Meeting process. On the part of East Asia, there are reservations among some countries of an FTA with the US; likewise, on the part of the US there are possible reservations of an FTA that includes the PRC. Myanmar remains a problem in US and EU relations with ASEAN and East Asia.

An APEC FTA Option?

APEC was established in 1989 to promote voluntary and unilateral trade and investment liberalization in the APEC region, so as to attain the Bogor goals of free and open trade and investment for developed country members by 2010 and for developing country members by 2020. From time to time, however, there have been proposals for a formalized APEC FTA,

particularly as the prospects of realizing the Bogor goals recede and there is geopolitical concern of a split down the Pacific should East Asia proceed with its own region-wide FTA. However, to the extent that APEC still excludes some ASEAN countries, the Free Trade Area of the Asia and Pacific (FTAAP) would split ASEAN and so would not be desirable from the ASEAN perspective, unless Cambodia, Lao PDR, and Myanmar became members before the start of negotiations.

Bergsten (2007) has been a strong advocate of a FTAAP. He argues that an FTAAP would provide the largest single liberalization in history, and it would remove the problem of FTA proliferation and the noodle bowl effect in the Asia Pacific. It would also prevent competitive liberalization in the Americas and Asia and also the threatened split in the Pacific. Finally, it would provide a framework for the PRC and US to head off trade tensions and help revitalize APEC.

However, Argharwal (2007) argues that successful negotiation of a high quality FTAAP is not politically feasible at present or in the near future. First, the US Trade Promotion Authority expired in July 2007. Growing protectionist tendencies were reinforced by the outcome of the November 2006 Congressional elections. There is also the highly controversial American trade deficit with the PRC. Priority interests in the PRC and Japan appear to favor an East Asia FTA. And even if there was a unity of vision among PRC, Japan, and US, the negotiations would take several years and would tie-up negotiating resources and cause postponement of other negotiations that are of high priority to some key APEC economies. In ASEAN, some countries are not at all prepared politically or otherwise to enter into an undertaking of the magnitude of FTAAP. Second, to be of high quality, the FTAAP must also cover highly sensitive sectors such as agriculture and complicated behind-the-border issues. However, the FTAAP is so large and diverse it encompasses many protectionist interests. To achieve a high quality FTAAP would be much more politically demanding than the goals of the Doha Round; hence, there is no particular advantage to the FTAAP. The FTAAP carries high risks of diverting rather than galvanizing the Doha Round.

Stephenson (2007) draws possible lessons for the FTAAP from the failure of the Free Trade Area of the Americas:

- A common vision is necessary among the major economies.
- The time frame of the negotiating process must not be too long.
- Objectives must be realistic and achievable.
- There must be minimal interference from other FTA negotiations.
- Chairmanship of the process should not be given to the major players.
- Prior understanding must be achieved on how to treat labor and environment.
- There must be a willingness and identified capacity to finance and support the negotiating process.

An Expanded Trans-Pacific Strategic Economic Partnership Option?

Launched in October 2002, the Trans-Pacific Strategic Economic Partnership (known as TPP or P4) encompasses four small and open Pacific economies. Chile, New Zealand, and Singapore signed the agreement in July 2005, followed by Brunei Darussalam a month later. The agreement came into force on 1 January 2006. Economically, TPP promotes trade and investment liberalization among four small and already very open APEC economies that are also engaged in other plurilateral and bilateral FTAs (except for Brunei Darussalam). So the value added effect of the agreement seems small.

The unique features of P4 are its trans-Pacific membership and its “*big bang*” approach of immediate and comprehensive goods liberalization. Singapore has MFN zero tariffs, New Zealand would immediately eliminate all tariffs; Chile would immediately eliminate 89.3% of

its tariffs (the remaining, 9.57% within 3 years, and 1.13% within 6 years. There are breakthroughs in agricultural trade liberalization, which are notable as Chile and New Zealand are both southern hemisphere agricultural exporters. For services trade liberalization, TPP adopts the more liberalizing negative list approach. There is no investment chapter. There are cooperation commitments in various areas as well as a memorandum of understanding on labor cooperation and an Environment Cooperation Agreement.

TPP has an open accession clause. It could be the building block for an eventual FTAAP through an initial *coalition of the willing*. However, its “*big bang*” approach conflict with the realities of political and economic sensitivities that characterize many less open APEC economies. Further, the trade flows involved are very small; hence, the *competitive liberalization* effect of TPP is limited. TPP would appeal to a larger group of countries if some major economies such as the US, PRC, and Japan express interest in joining the group. At the APEC Summit in Singapore in November, US President Obama signaled US interest in engaging TPP members. Likewise Australia, Peru, and Viet Nam expressed interest.

6. CONCLUSION

Most countries in East Asia are currently pursuing a three-tier trade policy of multilateralism, regionalism, and bilateralism, with regionalism and bilateralism initiatives becoming increasingly dominant. Thankfully, in spite of the effects of the global financial and economic crisis, governments in the region have not succumbed too much to protectionist pressures from vested groups, although there are reports of murky protectionism in stimulus packages and bailouts of struggling firms and industries (Baldwin and Evenett 2009). With pressures to rebalance growth strategies, there is also a growing emphasis on redirecting export demand from Europe and North America towards regional and domestic demand.

This paper focuses on regional trade policy and architecture and does not analyze the wider aspects of regional integration. Policy priorities should focus on the following:

- A speedy conclusion of the Doha Round. East Asia, more than any other region in the world, is heavily dependent on a healthy and open world trading environment. Countries in Asia, particularly PRC, India, and Japan, will have to ensure that the Doha Round achieves at least a modest success, as the round cannot afford to fail.
- Promotion of a large integrated and dynamic regional market. This requires a coherent regional trade policy and support for regional investments and regional infrastructure links. An integrated regional market can be realized by hastening the progress of the ASEAN Economic Community and by early establishment of a region-wide FTA in East Asia. For the latter, CEPEA is preferable to EAFTA but it would be more difficult to achieve. Hence, a phased approach is recommended, with the establishment of EAFTA to be followed by CEPEA. Either option would require addressing the incoherence and inconsistency of multiple and overlapping FTAs in provisions, commitments, exclusions, and rules of origin and standards. A region-wide FTA should be of high quality and WTO consistent. To prevent a split down the Pacific, parallel negotiations could be launched for an expanded TPP, leading eventually to an APEC-wide FTA.
- Adequate provision of support for the poorer and less competitive economies so that they can also benefit from an integrated market through better supply capabilities. This would require investments and technical and financial assistance from the more developed economies, as well as from international and regional organizations.
- Trade possibilities are constrained by the lack of trade financing during the current crisis and by an inadequate linking infrastructure. International and regional

organizations as well as private sector resources should be tapped to ensure adequate trade finance. Investments in physical infrastructure (road, rail, seaport, and airport) and logistics and telecommunications networks should be sped up through the development of infrastructure funds, and through investment liberalization and investor protection to elicit private sector support.

- The adoption of common FTA templates. Plurilateral and bilateral FTAs will continue to proliferate, whatever the Doha Round outcome. However, adopting best practices and common templates will help to minimize the costs and maximize the benefits of multiple and overlapping FTAs. Countries could also undertake domestic structural and economic reforms to ensure that their less competitive sectors and groups became more globally competitive.

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