

The Future Perspective of East Asian FTA

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Introduction

Real East Asian cooperation started after 1977 financial crisis with the new emerging spirit of regional cooperation between ASEAN and three Northeast Asian countries. “ASEAN +3” framework provides a large platform for cooperation among East Asian countries, ranging from economic to political cooperation. The foundation for the new cooperative spirit is increasing economic interdependence created by ever more exchanges of trade, investment and finance in East Asian region. So that, the regional economic cooperation intends to achieve two major progresses: market liberalization and financial stability. FTA is the major vehicle for realizing market liberalization, while regional financial architecture, for example starting with the Chiang Mai Initiative, creates a financial stabilizer against the possible crisis.

East Asian economic integration has been promoted by the market force which now requires more stable institutional building with the involvement of the governments. Considering the current multi-layered efforts in developing FTAs, East Asia urgently needs an integrated approach in establishing East Asian FTA (EAFTA). The achievement of EAFTA is essential in facilitating and deepening East Asian Community building. It is important to coordinate and integrate the current multi-layered arrangements into an integrated one. Now it is the time to design and promote the EAFTA.

I. Rationale for FTA

The basic reason for regionalism is that it provides more and better market access for the countries through preferential trade arrangement (PTA/FTA). Compared with the multilateral approach, regional arrangement is much more flexible, wider and also faster since problems that would take years to solve in global negotiations can be dealt with much quicker. PTA, also known as the close economic partnership (CEP)

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can cover the areas not yet covered or covered poorly by WTO arrangements, thus it plays a role as a WTO-plus movement.

CEP is a broad arrangement for cooperation among the partners, it usually includes:

Liberalization

- Market access for trade in goods through eliminating tariffs
- Reducing non-tariff measures on trade, e.g. import and export restrictions
- Investment liberalization, providing national treatment
- Market access for trade in services, opening service sector
- Open the government procurement on the mutual (or multiple) base

Facilitation

- Standards and conformance measures dealing with the technical barriers to trade, and sanitary measures
- The movement of natural and business persons
- Rules of origin, imposing value-added percentages as criteria to preferential treatment
- Transparency of laws and regulations.

Protection

- Safeguard measures, through restricting imports
- Dispute settlement procedures, disputes settling through consultations, conciliation, mediation before resorting to arbitration
- Protecting intellectual property rights
- Fair competition between imports and domestic produced goods.

Cooperation

- Economic dialogue on macro-economic level
- Financial and monetary measures
- Infrastructure development
- Sub-regional development
- Capacity building in human resource and management
- Economic assistance

FTA is the core part of the CEP. By establishing FTA, it does not just intend to provide gains in market access, but also efficiency through competition. In many cases, FTA was used as a strategy for the policy makers to facilitating domestic reform and restructure.

Furthermore, if regionalism goes to the direction of an integrated regional institution, it may increase bargaining power in international (WTO) trade negotiations.

The idea of East Asian regionalism started to emerge mostly after 1997, i.e. after the Asian financial crisis. The lesson of the crisis tells that only market functioned economic integration is very vulnerable and the regional cooperation strongly needs to deal with the crisis and to reduce the future risks.

The foundation for East Asian economic integration rests on its increasing economic shared interests based on the economic interdependence. Economic convergence in East Asia started mainly by a “flying geese model” lead by Japan and followed by “four dragons” (Korea, Singapore, Hong Kong, Taiwan), as well as some Southeast countries and later China. This model helped to build up a “vertical” chain through capital flow, technological transfer and supply of manufacturing parts, thus formulating a high level intra-regional integration based on market exchange. Until mid-1990s, intra-regional trade in East Asia was as high as 50%.

Nevertheless, during that period of time, there was few regional institutional building. ASEAN started its AFTA as early as in 1992, but its role as a leader in facilitating FTA in whole East Asia is marginal since its early goal of liberalization mainly aims on improving its own internal environment attracting to FDI.

1997 financial crisis ended the smooth “flying geese model” process since Japan was no longer a “locomotive” of East Asian economic growth. South East Asian region was plunged into the serious recession and economic difficulties because of financial crisis and political instability. With China’s continuous economic dynamism and increasing FDI flow to China, both the regional growth pattern and the convergence structure were changed. A broader network of production and service in East Asian region has been gradually developed with increasing share of

exchanges of parts, components and other intermediate products, reflecting the development of intricate intra-regional production networks, in which production processes are subdivided among many different countries.² FDI flow plays a key role in creating this network. The network based on exchange of trade and capital has profound impact to East Asian economic development since it has created a kind of “parallel development” for the region. This is different from the traditional “flying geese model” that based on the vertical and hierarchic transfer of technology.³ It was called as a phenomenon of “bamboo capitalism” since this culminating feature of FDI-driven supply chain has created diverse and vibrant local industries around the East Asian region. The further supply chains (the root system) are decomposed and extended geographically, the faster and more profuse will be the proliferation of new enterprises.⁴ This East Asian convergence goes beyond market integration by desiring governmental cooperation and institutional building.⁵

As a matter of fact, regionalism finds its rationale in not just economic benefits, but also political interests. Comparing with other regions, East Asia is late in forging regional FTA and other institutional establishments. Aside from intra-regional desire for a closer partnership, East Asian new regionalism is also considered to be a rational response to the progress of other regions, especially to the success of EU and establishment of NAFTA.⁶ By definition, East Asian economic integration started as early as from 1960s based on regional economic growth and by only market approach, while the process of regional cooperation through regional institutional arrangement or formation through governmental efforts began only from late 1990s. East Asian market based integration shows its vulnerability. Thus, this new initiative for regional cooperation helps to enhance and facilitate further integration of East

² The World Bank, East Asia Update: Looking beyond short term shocks, April 2003, p.15.

³ Chen Yu-shi, P. 10.

⁴ David Roland-Holst Iwan Aziz, Li Gang Liu: Regionalism and globalism: East and Southeast Asian trade relations in wake of China's WTO accession, ADB Institute Research Paper Series No. XX, January 2003, P.16

⁵ Shujiro Urata argued “a shift from market-led to institutional-led regional economic integration in East Asia”, paper prepared for the conference on Asian economic integration organized by Research Institute of Economy, Trade and Industry, Japan, April 22-23, 2002, Tokyo, P.1.

⁶ It is considered that Prime Minister Mahathir 's proposal of forming East Asian Economic Caucus (EAEC) is a direct response to NAFTA. Peter Drysdale & Kenichi Ishigaki editors, East Asian trade and financial integration, New issues, Asia-Pacific Press, Canberra, 2002, p.6.

Asian region.

II. FTAs in East Asia

EAFTA is one of the most important institutional buildings. However, the road toward EAFTA does not start from a totally new base since East Asian region has already multi-layered FTAs.

In East Asia, the first FTA proposal was put forward in 1998 for a Japan-Korean FTA, which is now still under negotiation. Later there are more FTAs in the region, both within East Asia, or with other countries, some concluded, some still under the negotiation. Japan-Singapore CEP (JSCEP) was a pioneer in making a new kind of FTA in the region since it covers more areas than traditional trade liberalization-covering trade, investment, services, the dispute settlement mechanism, and economic and technical cooperation on various functional levels between the two countries.

China took the lead in making a large scale FTA between China and ASEAN as a group. China-ASEAN CEP Agreement was signed in 2002, which started with an early harvest program focusing on liberalization of agricultural trade in goods and an agricultural cooperation agreement, and the FTA agreement for trade in goods was signed in November of 2004. In 2003, Japan signed CEP framework agreement with ASEAN and is now negotiating bilateral FTAs with some individual ASEAN economies (Thailand, Malaysia, Philippines) and is preparing an overall agreement with ASEAN as a group. Aside from the negotiation with Japan, Republic of Korea (ROK) decided to follow China and Japan to start the negotiation with ASEAN in 2005.

Importantly, the role for the development of East Asian FTAs is to make rules and to develop the legal mechanism among countries in the region. The arrangements and agreements both on the bilateral or sub-regional levels are rules making in nature in considering the principle of international standards, or “WTO consistent”. In East Asian relations, this has profound significance since both “rule of standards” and “rule of law” will help to improve the systems of the regional members and to create a

reliable foundation for the regional cooperation process. Thus, the regional arrangements will help to develop a new regional system based on increasing common or shared interests and rules among all parties. The institutional building in the region creates “ public property” for countries in the region to maximize their interests.

III. An Integrated Approach

Due to its diversity, East Asian FTA development started with a multi-layered approach. This approach can provide incentives for individual countries and the sub-region group like ASEAN in realizing their best-expected gains. However, it also creates new barriers in the regional trade and investment:

- The regional market becomes divided because of different arrangements, which will reduce the gain from the scale of the regional market
- Business cost will increase due to the complicated or contradicted regulations (for example, rules of origins), which is counter-productive to the network based economic integration
- The region will not be possible to realize the goal of the community building if without an integrated regional market.

All theoretical study shows that a larger FTA can create more benefits than a smaller one. That is to say, in East Asia, benefits of EAFTA exceed any other FTA, either any bilateral FTA, or AFTA, or any “10+1” FTA. The study result presented here shows that every country will gain from EAFTA. The foundation of EAFTA lies in the high level integration characterized by FDI-trade network relations. But the potential of the integration is far from realized fully due to the barriers either by tariff or non-tariff measures.

Welfare change in various FTA scenarios (million US\$)*

	ASEAN Total	China	Japan	ROK
ASEAN-China	17,718	6,136	-5,380	-972
ASEAN-China-Japan	20,669	9,502	52,969	-3,342
ASEAN-China-Korea	19,216	7,856	-6,194	40,709
EAFTA	21,900	11,050	57,209	38,714

* CGE modeling results

Source: The author's project on EAFTA.

By calling for an integrated approach in moving toward EAFTA, it does not intend to stop all existing bilateral arrangements. What we try to do here is to search a feasible roadmap for approaching to EAFTA.

The foundation of EAFTA has been gradually built up through the following developments:

Firstly, economic integration is increasing. This encourages all members of the region to approach EAFTA. Close economic integration has resulted two effects: one is economic interdependence and also common interests, while another is desire for market liberation so as making economic transactions faster and more efficient. Currently, based on increasing intra-regional FDI flow, a new regional network of production and service has been developed, which has further enhanced the level of integration and common interests. Economic integration also calls for strengthening governmental cooperation in providing a better economic development environment and reducing the market risk and preventing from the crisis. Business community becomes active in pressing the governments to take fast steps moving to the regional FTA.

Secondly a multi-layered framework of sub-regional and bilateral FTAs may serve as a kind of capacity building in rule making and good governance for the region that is essential for a pan-regional FTA in the future since almost all countries in the region have no experience in forging any regional trade and investment arrangement (RTIA) before. Due to its great diversity, East Asian trade and investment arrangements have to be gradual and flexible. Currently, we have witnessed three different structures in RTIAs: the developed-the developed economies, represented by Japan-Singapore CEP, Japan-ROK (to be concluded); the developed-the developing economies, represented by Japan-ASEAN countries (with individual economies as well as with ASEAN as a whole in the future) and the developing-the developing economies, represented by China-ASEAN FTA. These different types of arrangements provide rich experiences for negotiating an integrated

regional FTA in the future.

The above factors help East Asian countries to build up consensus on moving toward an EAFTA. As a matter of fact, this consensus already exists. What it needs to be done is how to design it and how to make the consensus conscience into the actions and to establish EAFTA in an early time.

1. Policy setting one: how to do?

The ideal option is to negotiate EAFTA on the bases of three “10+1” FTAs, i.e. China-ASEAN FTA, Japan-ASEAN FTA and ROK-ASEAN FTA. The three FTAs will set the basic structure, principles and contents for an EAFTA, and the major issues relating to EAFTA will be settled down by three separate FTAs. It means that the modality of the future EAFTA will be a combination of three FTAs. This may be the most feasible approach for establishing EAFTA.

This needs three “10+1” FTAs facilitate their processes and conclude on the committed timetable (2007). The cooperation of Northeast Asian three countries is important to secure the quality of EAFTA. While it seems difficult for the three to negotiate a trilateral FTA among them selves ahead of EAFTA initiative, they should agree on the strategy and approach on the agenda of EAFTA through the trilateral cooperation mechanism under “10+3” process.

2. Policy setting two: who are the members?

East Asian cooperation started from “10+3” process, so that, “10+3” should be the core of EAFTA, and it is crucial to make it successful. Considering the fact of the multi-layered FTAs in the region, the establishment of EAFTA, by its nature, is to unify the separated arrangements into an integrated framework though it needs newly defined negotiation.

The challenge is that East Asian Summit will be held in December of 2005 with the participation of three non-East Asian countries. The illusion may be appeared that EAFTA immediately extends to all Summit members. The author’s view is that EAFTA should be accordant to the “ 10+3” framework. The extension to all East Asian members may be considered in two ways: one is to absorb the two identical economies: Hong Kong and Taiwan. Hong Kong is a free city economy. It should not

be difficult for it to participate. Nevertheless, Taiwan's participation needs political environment, i.e. political improvement of the Taiwan Strait relations. Another is to integrate Mongolia, as well as North ROK gradually.

The linkage between EAFTA and CER could be considered in two ways: one is to encourage Australia and New Zealand joining EAFTA through separate negotiation after the conclusion of EAFTA negotiation, while another is to integrate the two FTAs together. India is active to develop economic cooperation with ASEAN and other East Asian countries. It has shown strong interest to participate EAFTA and called on developing Asian FTA (also Asian Community). Considering the scope of an Asian FTA, Indian participation of EAFTA should be specially defined and handled as a individual case.

IV. The Road Map and Modality

Considering the economic development level of ASEAN and China, CAFTA may be a feasible model for the future EAFTA, which is characterized by a gradual approach: liberalization of trade for goods first, investment and service second; more developed economies moving faster, and less developed economies slower; liberalization of competitive sectors first, sensitive sectors later. Until 2010, the majority trade goods (85%) will be liberalized (zero tariff).

Since the best approach of EAFTA may be a combination of three "10+1" FTAs, it is appropriate to negotiate a comprehensive EAFTA based on them. Within three ready "10+1" FTAs, all difficult problems, like liberalization of agriculture sector, labor mobility, rule of origin, as well as special treatment of less developed countries, was settled down in the separate agreement. EAFTA is actually to restructure the three agreements into an integrated one.

If taking three "10+1" FTAs as the foundation, the timetable to negotiate an "10+3" based EAFTA is after 2007 when all negotiations of three FTAs concluded. It is desirable to start the negotiation of EAFTA from 2008 and conclude the negotiation by 2010 and to be completed before 2020.⁷

⁷ We considering two important events in setting this timetable: one is ASEAN Economic Community, another is APEC Bogor goal for trade and investment liberalization in the Asia-Pacific.

As any “10+1” FTA starts with a CEP, EAFTA should also follow this approach, for example, a framework agreement of CEP in 2008. The content of this framework agreement may include:

- A comprehensive early harvest program based on the list of common early liberalization commitments

- Unilateral preferential treatment from three Northeast Countries to CLMV

- Time framework for EAFTA negotiation

- Economic cooperation priority areas.

As for EAFTA, generally it should be finally realized the following goals:

- Liberalized market for goods, services, investment and capital (zero tariff for 95% mechanized goods transactions and minimum NTMs)

- Open market for the movement of skilled labors

- Harmonization of customs procedures, standards (consistent with international standards) and rules of origins

- A regional dispute settlement mechanism

However, EAFTA should be accomplished along with other progresses, for example, regional financial cooperation, macro-economic cooperation, as well as political cooperation.

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