

# Chapter 10

## Moving toward an Integrated Regional FTA System in East Asia

**Chang Jae Lee**

Korea Institute for International Economic Policy

December 2012

**This chapter should be cited as**

Lee, C. J. (2012), 'Moving toward an Integrated Regional FTA System in East Asia', in Zhang, Y., F. Kimura and S. Oum (eds.), *Moving Toward a New Development Model for East Asia- The Role of Domestic Policy and Regional Cooperation*. ERIA Research Project Report 2011-10, Jakarta: ERIA. pp.313-336.

## CHAPTER 10

# Moving toward an Integrated Regional FTA System in East Asia

CHANG JAE LEE

*Korea Institute for International Economic Policy*

*This chapter addresses the issue of forming a region-wide FTA in East Asia. After reviewing the current status of intra-regional trade in East Asia as well as the FTA web among East Asian countries, it underscores the rationales for a region-wide FTA in East Asia and highlights the impending challenges related to advancing its formation. On the basis of these analyses, it proposes several road maps towards a region-wide FTA in East Asia.*

**Keywords:** Trade, Economic Integration, Free Trade Area

**JEL classification:** F1, F15

## 1. Introduction

Economic regionalism began in Europe in the 1950s and became a worldwide phenomenon in the 1990s, when many developing countries and transition economies also began moves toward regionalism. However, it was only at the turn of the century that East Asian countries started to jump aboard the Free Trade Agreement (FTA) bandwagon.

In East Asia, the regional economic integration process had mainly been driven by market forces without much help from governments. However the Asian financial crisis of 1997-8 prompted the East Asian countries to seriously consider regionalism. First, the leaders of the Association of South East Asian Nations, (ASEAN) +3 (China, Japan and Korea) gathered in Kuala Lumpur in December 1997, then the ASEAN+3 Summit Meeting became an annual event. Thus, the ASEAN+3 framework, in which East Asian countries could discuss economic cooperation issues among themselves, was gradually established.

In addition, East Asian countries began to conclude FTAs, many of them with other East Asian countries. Within a relatively short period of time, they concluded so many bilateral and plurilateral FTAs that the so-called “spaghetti bowl phenomenon”<sup>1</sup> has become prevalent in East Asia.

In fact, the idea of forming a region-wide FTA in East Asia first emerged in the early 2000s. The East Asia Vision Group (EAVG) recommended the establishment of an East Asian Free Trade Area (EAFTA) in a report to the leaders of ASEAN+3 in October 2001,<sup>2</sup> and the East Asia Study Group (EASG) also proposed the formation of an EAFTA in November 2002.<sup>3</sup>

There have been two major joint expert studies on the feasibility of a region-wide FTA: the EAFTA Joint Expert Group Study<sup>4</sup> involved experts from ASEAN+3 countries, and CEPEA (the Comprehensive Economic Partnership in East Asia)

---

<sup>1</sup> Spaghetti bowl phenomenon or spaghetti bowl effect refers to a complication which arises from application of different rules of origin in concluding FTAs.

<sup>2</sup> East Asia Vision Group Report (2001).

<sup>3</sup> Final Report of the East Asia Study Group (2002).

<sup>4</sup> A Report by Joint Expert Group for Feasibility Study on EAFTA (2006); Final Report on EAFTA Phase II Study (2009).

Track II Study<sup>5</sup> included experts from the ASEAN+6 countries including India, Australia and New Zealand. The outcomes of their research were reported to the ASEAN+3 Economic Ministers (AEM+3) Consultations, held in Bangkok in August 2009. The Ministers welcomed the final reports of both EAFTA and CEPEA and agreed to upgrade the joint studies to government-level discussions on a region-wide FTA by forming working groups. Later, this decision was confirmed at the 12<sup>th</sup> ASEAN+3 Summit and the 4<sup>th</sup> East Asia Summit. However, since then, no real progress has been made for the establishment of a region-wide FTA in East Asia.

In the meantime, the world economy has suffered from two severe crises. The global financial crisis, considered the most serious financial crisis since the great depression, hit the world economy, affecting the advanced economies in particular. Immediately afterwards, before it had time to recover from the previous crisis, the world economy was facing a more formidable challenge. Unlike the global financial crisis, which originated in the United States, the ongoing European sovereign debt crisis involves many countries and is evolving gradually; so its negative effects on the world economy are likely to last longer.

East Asian economies are not immune to the deteriorating global economic environment. They have to face the new crisis, even though most have not entirely recovered from the previous one. East Asian economies therefore need to come up with region-wide coordinated and/or common responses in order to meet the new challenge from outside the region.

Under these circumstances, this chapter will review the current status of intra-regional trade in East Asia as well as the FTA web among East Asian countries. It will then strive to underscore the rationales for a region-wide FTA in East Asia and highlight the impending challenges related to advancing its formation, before proposing road maps to a region-wide FTA in East Asia.

---

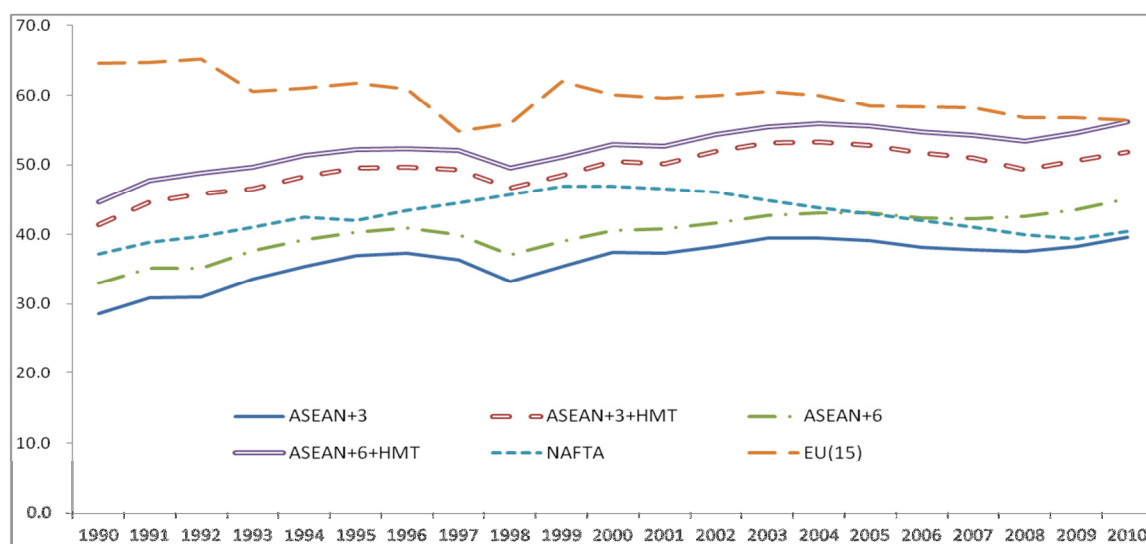
<sup>5</sup> Report of the Track Two Study Group on Comprehensive Economic Partnership in East Asia (CEPEA) (2008); Phase II Report of the Track Two Study Group on Comprehensive Economic Partnership in East Asia (CEPEA) (2009).

## 2. Current Status of Intra-regional Trade in East Asia

### 2.1. Trends in Intra-regional Trade in East Asia

Functional economic integration seems to have proceeded rather smoothly in East Asia. As a consequence East Asian countries are currently much more dependent on one another in terms of trade than 20 years ago. As shown in Figure 1, the share of intra-regional trade in East Asia has in general increased between 1990 and 2010. It rose from 28.6 percent in 1990 to 39.7 percent in 2010 among the ASEAN+3 countries, and from 33.0 percent to 45.1 percent among the ASEAN+6 countries during the same period.

**Figure 1: Trends in Intra-regional Trade in East Asia, North America and the European Union (Unit: percent)**



Source: Appendix Table 1.

Furthermore, the intra-regional trade dependency in East Asia increases even more when Hong Kong, Macao and Taiwan (HMT) are also included. The shares of intra-regional trade among ASEAN+3+HMT and ASEAN+6+HMT rose from 41.3 percent and 44.6 percent, respectively, in 1990 to 51.9 percent and 56.2 percent, respectively, in 2010.

The growing share of intra-regional trade in East Asia seems more evident when it is compared to those of NAFTA and EU. The share of intra-regional trade among the ASEAN+6 countries was lower than that of NAFTA (37.2 percent) in 1990, whereas the share of intra-regional trade of ASEAN+3 was close to that of NAFTA

(40.5 percent) in 2010. Additionally, it is notable that the share of intra-regional trade of ASEAN+6+HMT reached the level of the EU-15 (56.3 percent) in 2010. Thus, as of 2010, although the share of intra-regional trade of East Asia narrowly defined was comparable to that of NAFTA, when East Asia is broadly defined, its share of intra-regional trade was comparable to that of the EU-15.

## 2.2. Trade Interdependency among East Asian Countries

Despite the generally rising trend towards trade interdependency among East Asian countries, the level of trade dependency differs enormously from country to country. In 2010, the share of intra-regional trade in national total trade varied from 26.8 percent in China to 84.5 percent in Lao (among the ASEAN+3 countries), while it ranged from 29.7 percent in India to 94.3 percent in Brunei (among ASEAN+6 countries) (see Table 1).

ASEAN countries' intra-regional trade dependency is higher than that of China, Japan and Korea. Among the Northeast Asian countries, China has the lowest intra-regional trade dependency, and Korea has the highest, while Japan's intra-regional trade dependency has increased the most over the past 20 years. Australia's and New Zealand's, intra-regional trade dependencies are higher than those of the Northeast Asian countries, whereas India has the lowest intra-regional trade dependency level among the East Asian countries.

**Table 1: Intra-regional Trade Dependency Rates of East Asian Countries**

(Unit: percent)

	ASEAN+3		ASEAN+6	
	1990	2010	1990	2010
Brunei	81.7	77.5	83.4	94.3
Cambodia	68.6	60.8	71.6	61.5
Indonesia	51.6	58.4	55.9	66.1
Laos	85.7	84.5	86.5	85.7
Malaysia	49.6	60.6	53.8	65.6

	ASEAN+3		ASEAN+6	
	1990	2010	1990	2010
Myanmar	58.7	80.8	65.4	90.5
Philippines	32.8	58.1	36.1	60.3
Singapore	39.5	48.9	43.3	55.0
Thailand	42.6	50.4	45.6	56.6
Vietnam	27.8	52.7	28.6	57.2
China	21.3	26.8	23.2	32.0
Japan	21.2	41.5	26.1	47.0
Korea	29.1	45.7	32.5	50.5
Australia	-	-	42.9	63.5
India	-	-	17.7	29.7
New Zealand	-	-	44.1	58.8
East Asia	28.6	39.7	33.0	45.1

Source: Calculated from IMF (2011), *Direction of Trade Statistics*.

### 2.3. Export Structure of East Asian Countries in Terms of Production Process

As shown in Table 2, below, intermediate goods constitute about half of East Asian countries' total exports. Their share in intra-regional exports, however, in particular those destined for ASEAN+3 countries, is relatively higher and increasing over time, representing 61.9 percent in 2009. , Consumer goods on the other hand constitute around 22-23 percent of the total exports of East Asian countries, but their share in intra-regional exports is lower and decreasing, representing about 14 percent in 2009.

**Table 2: Structures of East Asian Exports in Terms of Production Process**

Destination	Production Process		ASEAN+3		ASEAN+6	
			1995	2009	1995	2009
East Asia	Intermediate	Parts	26.2	26.3	24.2	23.7
		Semi-finished	32.0	35.6	32.8	34.7
	Capital		19.3	18.3	17.9	16.9
	Consumption		17.2	14.1	17.6	13.9
EU	Intermediate	Parts	27.3	20.2	25.3	18.8
		Semi-finished	16.6	18.9	17.7	21.1
	Capital		27.1	28.3	24.9	25.7
	Consumption		26.8	31.0	28.2	31.9
US	Intermediate	Parts	33.2	19.7	32.3	19.1
		Semi-finished	10.5	13.5	11.5	14.6
	Capital		26.0	28.4	25.2	27.3
	Consumption		28.8	37.4	29.4	37.8
World	Intermediate	Parts	26.4	23.7	24.6	21.7
		Semi-finished	24.4	26.9	25.7	28.0
	Capital		22.9	24.2	21.3	22.3
	Consumption		23.1	22.2	23.6	22.4

*Source:* Calculated from the UN Comtrade Database.

When it comes to East Asia's exports destined for the EU and the US, the situation is quite different. In 2009, for instance, the shares of intermediate goods and consumer goods in ASEAN+3 countries' exports destined for the EU represented



39 percent and 31 percent, respectively, while those destined for the US represented 33 percent and 37 percent, respectively.

### **3. FTA Webs among East Asian Countries**

East Asian countries have concluded many FTAs, and most of them have already gone into effect. In addition, there are quite a few FTAs under negotiation or under preparation involving East Asian countries (see Table 3).

The first Regional Trade Agreement (RTA) concluded among Asia-Pacific countries was the Asia-Pacific Trade Agreement (APTA)<sup>6</sup>, which was signed by Bangladesh, India, Korea, Laos and Sri Lanka in 1975 and went into effect in June 1976. Then the Laos-Thailand Preferential Trading Arrangement was concluded in 1991. These two agreements were reported to the General Agreement on Tariffs and trade (GATT) as preferential trade agreements under the ‘Enabling Clause’.

The ASEAN Free Trade Area (AFTA) was signed among six ASEAN countries, namely, Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand, in January 1992. Vietnam joined in 1995, Laos and Myanmar in 1997, and Cambodia in 1999. The AFTA was also reported under the Enabling Clause but was additionally reported to the GATT as an FTA.

However, it was around the turn of the century when East Asian countries joined the worldwide trend of regionalism by concluding FTAs under GATT article 24. The New Zealand-Singapore Closer Economic Partnership (ANZSCEP) went into effect in January 2001 and the Japan-Singapore Economic Agreement for a New-Age Partnership (JSEPA) went into effect in November 2002.

The countries of East Asia have subsequently concluded many FTAs among themselves as well as with non-regional countries. As shown in Table 3, most ASEAN countries, with the exception of Singapore, have concluded FTAs mostly

---

<sup>6</sup> The APTA was previously known as “the Bangkok Agreement” until it was renamed in November 2005. China joined in 2001.

with regional countries, while Korea, China, Japan as well as India and Australia have also concluded quite a few FTAs with non-regional partners.

Among the many FTAs concluded among regional countries, it is noteworthy that ASEAN have concluded FTAs with China, Korea and Japan, as well as with Australia, New Zealand and India. ASEAN signed a Trade in Goods Agreement (November 2004), a Trade in Services Agreement (January 2007) and an Investment Agreement (August 2009) with China. ASEAN also signed separately a Trade in Goods Agreement (August 2006), a Trade in Services Agreement (November 2007) and an Investment Agreement (June 2009) with Korea. With Japan, ASEAN signed the Comprehensive Economic Partnership Agreement in June 2008.<sup>7</sup> In addition, the ASEAN-Australia and New Zealand FTA was signed in February 2009, and the ASEAN-India Trade in Goods Agreement was signed in August 2009.<sup>8</sup>

**Table 3: FTAs involving East Asian Countries and Regions**

	Concluded		Under Negotiation		Proposed	Total
	Signed and in Effect	Signed but not in Effect	Framework Agreement Signed/ Under Negotiation	Under Negotiation		
ASEAN	6(6)	0	0	1(0)	3(2)	10
Singapore	18(13)	3	1	9	5(2)	36
Thailand	12(11)	0	3(1)	4	6(3)	25
Malaysia	10(9)	2	1	5(1)	7(3)	25
Indonesia	7(7)	2	1	4(2)	6(2)	20
Brunei	8(8)	0	2	1	5(2)	16
Philippines	7(7)	0	0	1	5(2)	13

<sup>7</sup> Since the ASEAN-Japan CEP does not contain anything substantial regarding trade in services and investment, it is regarded as a de facto trade in goods agreement.

<sup>8</sup> <http://www.aseansec.org/4920.htm>.

Vietnam	7(7)	1	1	1	7(3)	17
Laos	8(8)	0	0	1	3(2)	12
Myanmar	6(6)	0	1	1	3(2)	11
Cambodia	6(6)	0	0	1	3(2)	10
China	12(8)	0	2(1)	4	7(6)	25
Japan	12(9)	1	0	2(1)	8(6)	23
Korea	8(4)	1	2	5(2)	15(10)	31
Australia	8(4)	0	2(1)	8(5)	3(1)	21
New Zealand	9(8)	0	1	5(2)	4(3)	19
India	13(6)	0	4(1)	9(3)	7(2)	33
Hong Kong	2(2)	1	0	0	1	4
Taipei	5(1)	0	1	1	2(1)	9
Mongolia	0	0	0	0	3(3)	3

*Note:* As of January 2012; figures in parentheses are FTAs among East Asian economies.

*Source:* ADB (<http://aric.adb.org/10.php>).

**Table 4: FTAs among East Asian economies**

	Signed and in Effect	Under Negotiation	Proposed
ASEAN	AFTA, Australia and New Zealand, India, Japan, Korea, China		EAFTA, CEPEA
Singapore	AFTA, <u>Korea, China, Japan, India, Australia- New Zealand</u> , New Zealand, Australia, Korea, China, Japan, India, TPSEPA		EAFTA, CEPEA

	<b>Signed and in Effect</b>	<b>Under Negotiation</b>	<b>Proposed</b>
Thailand	AFTA, <u>Korea</u> , <u>China</u> , <u>Japan</u> , <u>India</u> , <u>Australia- New Zealand</u> , Japan, Laos, China, Australia, New Zealand	India	Korea, EAFTA, CEPEA
Malaysia	AFTA, Korea, China, Japan, India, Australia-New Zealand, Japan, India, New Zealand	Australia	Korea, EAFTA, CEPEA
Indonesia	AFTA, Korea, China, Japan, India, Australia-New Zealand, Japan	Australia, India	EAFTA, CEPEA
Brunei	AFTA, Korea, China, Japan, India, Australia- New Zealand, Japan, TPSEPA		EAFTA, CEPEA
Philippines	AFTA, Korea, China, Japan, India, Australia- New Zealand, Japan		EAFTA, CEPEA
Vietnam	AFTA, Korea, China, Japan, India, Australia- New Zealand, Japan		Korea, EAFTA, CEPEA
Laos	AFTA, Korea, China, Japan, India, Australia- New Zealand, APTA, Thailand		EAFTA, CEPEA
Myanmar	AFTA, Korea, China, Japan, India, Australia- New Zealand		EAFTA, CEPEA
Cambodia	AFTA, Korea, China, Japan, India, Australia- New Zealand		EAFTA, CEPEA

	<b>Signed and in Effect</b>	<b>Under Negotiation</b>	<b>Proposed</b>
China	APTA, Hong Kong, Macau, ASEAN, New Zealand, Singapore, Thailand, Taiwan	Australia	India, Korea, Mongolia, CJKFTA, EAFTA, CEPEA
Japan	Singapore, Malaysia, Philippines, Thailand, Brunei, Indonesia, ASEAN, Vietnam, India	Australia	Korea, New Zealand, Mongolia, CJKFTA, EAFTA, CEPEA
Korea	APTA, Singapore, ASEAN, India	Australia, New Zealand	Japan, China, Indonesia, Malaysia, Thailand, Vietnam, Mongolia, CJKFTA, EAFTA, CEPEA
Australia	New Zealand, Singapore, Thailand, ASEAN	China, Japan, Korea, Indonesia, Malaysia, India	CEPEA
New Zealand	Australia, Singapore, Thailand, China, ASEAN, Malaysia, TPSEPA, Hong Kong	Korea, India	Japan, CEPEA, Taipei
India	APTA, ASEAN, Singapore, Korea, Japan, Malaysia	Thailand, Australia, New Zealand, Indonesia	China, CEPEA
Hong Kong	China, New Zealand		
Taipei	China		New Zealand
Mongolia			China, Japan, Korea

*Note:* As of January 2012; Underlined countries are under ASEAN+1 FTAs.

*Source:* ADB (<http://aric.adb.org/10.php>).

Singapore has concluded bilateral FTAs with all regional countries, in addition to its FTAs under ASEAN. Japan has also concluded separate bilateral FTAs with the ASEAN-6 members and Vietnam. Additionally, other bilateral FTAs concluded that involve ASEAN members include the Thailand-China FTA, the Thailand-Australia FTA, the Thailand-New Zealand FTA, the Malaysia-New Zealand FTA and the Malaysia-India FTA. Among ASEAN dialogue partners, there are the Australia-New Zealand FTA, the Korea-India CEPA, the Japan-India FTA and the China-New Zealand FTA; when other economies in the region are included, the list of concluded FTAs extends to the China-Hong Kong Closer Economic Partnership Arrangement (CEPA), the China-Macao CEPA, the New Zealand-Hong Kong Closer Economic Partnership Agreement and the China-Taipei Economic Cooperation Framework Agreement (see Table 4).

In addition, the Thailand-India FTA, the Malaysia-Australia FTA, the Indonesia-Australia FTA, the Indonesia-India FTA, the China-Australia FTA, the Japan-Australia FTA, the Korea-Australia FTA, the Korea-New Zealand FTA, the Australia-India FTA and the New Zealand-India FTA are under negotiation, and many other FTAs are under preparation.<sup>9</sup>

Apart from these FTAs, the Trans-Pacific Strategic Economic Partnership Agreement (TPSEPA)<sup>10</sup> was signed among Singapore, Brunei, New Zealand and Chile in June 2005 and went into effect in May 2006. The United States, Australia, Vietnam, Peru and Malaysia have also begun negotiations with the original P4 countries (Brunei, Chile, New Zealand and Singapore) to join the Trans-Pacific Partnership (TPP).

---

<sup>9</sup> In addition, the China-Korea FTA has been under negotiation since May 2012, and the China-Japan-Korea FTA negotiation was agreed to be launched within 2012.

<sup>10</sup> Also called P4.

## **4. Rationales, Challenges and Roadmap for a Region-wide FTA in East Asia**

### **4.1. Discussions on a Region-wide FTA in East Asia**

The idea of a region-wide FTA in East Asia first emerged in October 2001, when the East Asia Vision Group (EAVG) recommended the establishment of an East Asian Free Trade Area (EAFTA) in a report to the leaders of ASEAN+3; the East Asia Study Group (EASG) also proposed the same thing in November 2002. The ASEAN+3 Economic Ministers (AEM+3) decided to set up an expert group initiated by China to conduct a feasibility study on an EAFTA in 2004. The Joint Expert Group reported the outcome of the study to the AEM+3 in August 2006. Then, Korea proposed a follow-up in-depth study, which was welcomed by the leaders at the 10<sup>th</sup> ASEAN+3 Summit in January 2007. The outcome of the EAFTA Phase II Study was presented at the AEM+3 Consultations in Bangkok on August 15, 2009.

At the second East Asia Summit (EAS) in January 2007, however, the leaders also agreed to launch a Track Two study on Comprehensive Economic Partnership in East Asia (CEPEA), to deepen integration among EAS participants. This was initiated by the Japanese government<sup>11</sup>. The outcome of the Track Two study on CEPEA was also presented at the AEM+3 Consultations in Bangkok on August 15, 2009.

The Ministers welcomed the final reports of both EAFTA and CEPEA and, on the basis of their recommendations, the Ministers agreed to upgrade to government-level discussions the joint studies on a region-wide FTA in East Asia conducted by the region's experts, by establishing working groups on rules of origin, tariff nomenclature, customs-related issues, and economic cooperation. Later, this decision was confirmed at the 12<sup>th</sup> ASEAN+3 Summit and the 4<sup>th</sup> East Asia Summit.

### **4.2. Rationales for a Region-wide FTA in East Asia**

As in other FTAs, a region-wide FTA in East Asia would produce economic

---

<sup>11</sup> Namely the ASEAN+6 countries' including India, Australia and New Zealand in addition to ASEAN+3 countries. The United States and Russia joined the Summit at the sixth EAS in October 2011.

benefits to all participating countries. However, given its regional nature, it would also provide political benefits. According to the Report by the Joint Expert Group submitted to the AEM+3 in August 2006, the rationale for an EAFTA lies firmly in both the economic and political interests of all East Asian countries. Its economic benefits would exceed those from any bilateral and sub-regional arrangements. At a minimum, an EAFTA would increase overall Gross Domestic Product (GDP) of East Asian countries by 1.2 percent.<sup>12</sup> In addition, an EAFTA would increase awareness of a common destiny, institutionalize dialogues and contacts, and increase mutual understanding and cooperation.<sup>13</sup>

Second, the economic logic of a region-wide FTA in East Asia seems evident considering the high level of economic dependency among East Asian countries. As mentioned above, the share of intra-regional trade increased from 28.6 percent in 1990 to 39.7 percent in 2010 among the ASEAN+3 countries, while it rose from 33.0 percent to 45.1 percent among the ASEAN+6 countries during the same period.

Third, a unique rationale for a region-wide FTA in East Asia comes from the growing number of bilateral and plurilateral FTAs among East Asian countries. With differing rules of origin (ROOs) and tariff reduction/elimination schedules, the multitude of FTAs has already created a spaghetti bowl phenomenon, increasing transaction costs for intra-regional trade and raising production costs for production networks in East Asia.

Last but not least, new developments in the wake of the global financial crisis and the European fiscal crisis provide an additional rationale. In fact, the trade volumes of East Asian countries declined significantly after the global financial crisis. Moreover, the European fiscal crisis has already affected negatively not only the financial sector but also the real sectors in most East Asian countries. Due to the global financial crisis and the ongoing European fiscal crisis, the world markets (those of the EU and the US, in particular) are not likely to recover in the near future. In order to compensate for those contracted markets, East Asian countries need to increase their trade volume within the region. Thus, a region-wide FTA would help

---

<sup>12</sup> According to the Report of the Track Two Study Group on CEPEA, a CEPEA would increase overall GDP of East Asian countries by 1.30 percent or 2.11 percent [Report of the Track Two Study Group on Comprehensive Economic Partnership in East Asia (CEPEA) (2008)].

<sup>13</sup> A Report by Joint Expert Group for Feasibility Study on EAFTA (2006)



enhance the resilience of the East Asian regional economy against external shocks and sustain regional economic growth.

#### **4.3. Challenges to be Met in Forming a Region-wide FTA in East Asia**

In order to realize a region-wide FTA in East Asia, East Asian countries will need to overcome existing obstacles and meet new challenges. The income gap issue is one of them. In fact, East Asian countries differ significantly in terms of the size of their populations and economies as well as in their levels of economic development. In particular, the huge gap in per capita GNI between Singapore (US\$ 43,117), Japan (US\$ 42,783) and Brunei (US\$ 29,675), on the one hand; and Myanmar (US\$ 742), Cambodia (US\$ 814) and Laos (US\$ 1,004), on the other; should be taken into consideration in the process of forming a region-wide FTA in East Asia (see Annex Table 2). (Data relate to 2010)

A recent pending issue impeding the process of forming a region-wide FTA in East Asia has been choosing which countries would participate in the four working groups, namely, the ASEAN+3 countries or the ASEAN+6 countries. This dilemma was also revealed in Chairman's Statements of both the 12<sup>th</sup> ASEAN+3 Summit and the 4<sup>th</sup> East Asia Summit, when they stated that "EAFTA and CEPEA could be examined and considered in parallel."

In order to break the deadlock, China and Japan agreed to establish three new working groups for trade and investment liberalization under the EAFTA and CEPEA and this joint proposal was accepted by ASEAN. Consequently, the decision was made at the 19<sup>th</sup> ASEAN Summit to establish three Working Groups (WGs) in the areas of Trade in Goods, Trade in Services and Investment.<sup>14</sup>

Additionally, at the 19<sup>th</sup> ASEAN Summit, the ASEAN leaders agreed on the ASEAN Framework for Regional Comprehensive Economic Partnership (RCEP) to establish an ASEAN-led process by setting out principles under which ASEAN will engage interested ASEAN FTA partners in establishing an RCEP agreement, and then subsequently engage external economic partners. ASEAN thus reconfirmed its

---

<sup>14</sup> Chairman's Statement of the 19<sup>th</sup> ASEAN Summit, Bali, 17 November 2011. The Working Group on Trade in Goods is supposed to follow up on the outcome of ASEAN Plus Working Groups on Rules of Origin, Tariff Nomenclature and Customs Procedures.

intention to assume a leading role in establishing a regional FTA.

However, ASEAN's efforts could run into obstacles in various forms. First, with regard to the new ASEAN + WGs, many questions have yet to be answered. How will they function differently compared to the old ones? Could China and Japan be more cooperative in the new WGs? In what way will ASEAN demonstrate its leadership in the new ASEAN + WGs? How can the balance between ASEAN centrality and other participants' rights be achieved?

In addition, there remains a fundamental obstacle. Although ASEAN+1 FTAs were concluded between ASEAN and China, Korea and Japan, respectively, there is still no FTA among the three Northeast Asian countries, where the biggest trade flows in the region take place. However, a significant breakthrough was recently made in this regard. At the Trilateral Summit Meeting which was held in Beijing in May 2012, the leaders of China, Japan and Korea agreed to launch the China-Japan-Korea FTA (CJKFTA) negotiation by the end of 2012. This new development could influence enormously the formation process of a region-wide FTA in East Asia.

Lastly, the Trans-Pacific Partnership (TPP) could also affect the formation of a region-wide FTA in East Asia. As mentioned above, in addition to four original members, namely Brunei, Chile, New Zealand and Singapore; there are five countries including the US, Australia, Vietnam, Peru and Malaysia; have been negotiating to join the TPP. So, four out of ten ASEAN members and six out of 16 ASEAN+6 countries are already involved in the TPP process. In addition, Japan has many times showed its interest in joining the group. Therefore, the TPP could affect the formation of a region-wide FTA in East Asia and, could even be its competitor.

#### **4.4. Role of a Region-wide FTA**

After the global financial crisis and the European fiscal crisis, East Asia is expected to become the engine of growth for the world economy. In order to meet such high expectations, East Asia should maintain its economic dynamism by raising its economic efficiency as well as by enlarging its internal market.

In this regard, a region-wide FTA would promote intra-regional trade by lowering transaction costs. In fact, despite, perhaps also because of, the

proliferation of bilateral and plurilateral FTAs among East Asian countries, businesses in the region are not able fully to benefit from them due to the complexity of differing rules of origin in the FTAs. A region-wide FTA would mitigate this spaghetti bowl effect. In particular, a region-wide FTA with simple and liberal rules of origin would allow more businesses to benefit from the FTA by lowering the transaction costs involved in intra-regional trade. Furthermore, a region-wide FTA would create an East Asian market that would be comparable in scale to those of the EU and NAFTA.

Additionally, one of the main characteristics of East Asian economic cooperation is its substantial and growing production networks. A region-wide FTA would also greatly stimulate production networks in East Asia. It would make existing production networks more efficient by lowering their production costs.

Another key characteristic of East Asia is the huge income gaps among the countries. As mentioned earlier, in 2010, the per capita GNIs for Singapore and Japan were US\$ 43,117 and US\$ 42,783, respectively, while those of Myanmar and Cambodia stood at US\$ 742 and US\$ 814, respectively. It is a fact that there are less developed countries in East Asia, and a region-wide FTA will have to take this reality into account. They might not be able to fully realize the benefits from FTAs because of their insufficient administrative capacities. Therefore, a region-wide FTA should include some trade facilitation measures such as the ones related to rules of origin and customs procedures, backed up by appropriate funding mechanisms and adequate resources. In this way, a region-wide FTA could narrow the development gaps between East Asian countries.

Lastly, unlike bilateral or plurilateral FTAs, a region-wide FTA could increase community spirit among East Asian countries; this means that it could become a key element in the East Asian Economic Community and the first step toward building the East Asian Economic Community and the East Asian Community.

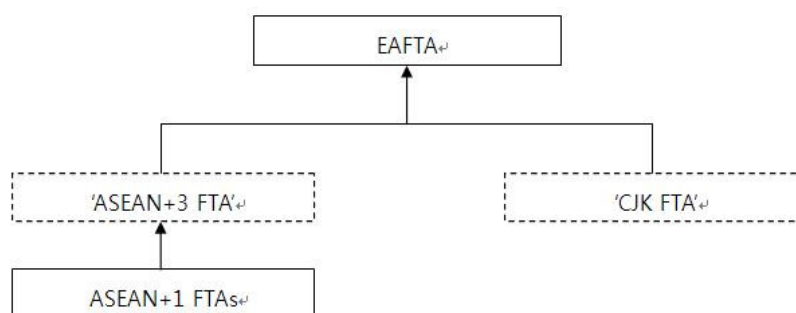
#### **4.5. Roadmap towards a Region-wide FTA in East Asia**

As mentioned earlier, many FTAs have been concluded among East Asian countries. The most important of the region-wide and ASEAN+1 FTAs are those between ASEAN and China, Japan, Korea, Australia, New Zealand and India, Given these

ASEAN+1 FTAs, it would be realistic to utilize them as the basis upon which to form a regional FTA. In fact, the leaders of the East Asian countries have noted that the ASEAN Framework for Regional Comprehensive Economic Partnership “sets out the general principles for broadening and deepening ASEAN’s engagement with its FTA partners, using as a basis the ASEAN Plus One FTAs and the template that would be developed taking into account the EAFTA and CEPEA initiatives ...”<sup>15</sup>

The key question would therefore be how to move from the group of ASEAN+1 FTAs to a region-wide FTA in East Asia. The first option would be to form an EAFTA by consolidating the three ASEAN+3 FTAs, namely those between ASEAN and China, Japan and Korea.

**Figure 2: Concept of Forming an EAFTA from ASEAN+1 FTAs**



As shown in Figure 2, we denominate the consolidated status of the ASEAN+1 FTAs as ‘ASEAN+3 FTA.’ Since the three Northeast Asian countries are also involved, in addition to ASEAN, in this process of consolidation, the ‘ASEAN+3 FTA’ can be regarded as an FTA at the ASEAN+3 level. But, in the absence of an FTA among the three Northeast Asian countries, it would be a conceptual FTA for ASEAN countries only.

In order to achieve an EAFTA, therefore, the consolidation of the ASEAN+1 FTAs will not suffice. An FTA arrangement will be needed between China, Japan and

---

<sup>15</sup> Chairman’s Statement of the 14<sup>th</sup> ASEAN Plus Three Summit, Bali, Indonesia, 18 November 2011; Chairman’s Statement of the 6<sup>th</sup> East Asia Summit, Bali, Indonesia, 19 November 2011.

Korea that we can nominate as a 'China-Japan-Korea FTA (CJK FTA)'; this could be a China-Japan-Korea FTA, a series of bilateral FTAs, or a de facto FTA among the three countries. In fact, without some kind of an FTA between the three countries, the consolidation of the ASEAN+1 FTAs would be meaningless. Only when both the 'ASEAN+3 FTA' and the 'CJK FTA' are concluded can we achieve an EAFTA by consolidating them. In fact, the EAFTA Phase II study addressed the 'ASEAN+3 FTA,' and the working groups mentioned in its recommendation were also likely to deal mostly with an 'ASEAN+3 FTA.'

In fact the leaders of the three countries agreed in May 2012 on the launch of a CJK FTA negotiation within the year, and the China-Korea FTA negotiation began in May 2012. The lack of FTAs between China, Japan and Korea that constituted, in my view, the most fundamental obstacle to the formation of a region-wide regional FTA is therefore beginning to disappear.

Considering the urgent, growing need for a region-wide FTA in East Asia, due to the continuing proliferation of FTAs among East Asian countries as well as the global financial crisis and the European fiscal crisis, this option of starting with the ASEAN+3 countries seems to have a definite advantage. It is also in line with the recommendations of the EAVG, EASG and EAFTA reports. It could later be extended to the ASEAN+6 countries, and others.

The second option is forming a CEPEA by consolidation of the five existing ASEAN+1 FTAs. In this case, instead of an 'ASEAN+3 FTA,' and a 'CJK FTA,' we would need an 'ASEAN+6 FTA' and a 'CJK FTA.' In addition, we would need a series of bilateral FTAs between China, Japan, Korea Australia, New Zealand and India. Thus, although the difference would not be enormous from the perspective of ASEAN, the whole process would be much more complex than using the EAFTA route.

The third option is to set a template for the Regional Comprehensive Economic Partnership, led by ASEAN, which countries could join separately. This might be in line with the ASEAN Framework for the RCEP. A problem might arise if ASEAN wanted to include many countries in the RCEP, because ASEAN partner members may choose to utilize bilateral FTAs among themselves and even with ASEAN countries, so that the RCEP could become a rather symbolic regional FTA along with

many effective bilateral FTAs in a multi-layered structure of FTAs

## **5. Policy Recommendations**

There were two impediments to forming a region-wide FTA in East Asia: one was a pending issue and the other was the fundamental obstacle. The former was the initial membership issue of ASEAN+3 vs. ASEAN+6. The latter was the lack of FTAs between China, Japan and Korea. Recent new developments have, however, taken place on both fronts. On the 'fundamental obstacle' front the leaders of China, Japan and Korea agreed on the launch of the Trilateral FTA negotiation by the end of 2012, and the first China-Korea FTA negotiation took place in May 2012. On the 'pending issue' front, in order to overcome the deadlock related to initial membership China and Japan jointly proposed the three new ASEAN Plus Working Groups, while ASEAN proposed the ASEAN Framework for Regional Comprehensive Economic Partnership.

Of course, it is likely to take several years to realize a CJK FTA or a series of FTAs among the three Northeast Asian countries. One remaining problem is that it is still not clear whether these proposals could overcome the membership issue. Which countries will attend the new WGs, will they be the ASEAN+3 or the ASEAN+6 countries? And who will devise the template for the Regional Comprehensive Economic Partnership, ASEAN, ASEAN+3 or ASEAN+6?

In my view, given the increasingly urgent need for a region-wide FTA, if East Asian countries want to move forward within a relatively short period of time, they should start with the EAFTA among the ASEAN+3 countries, because it would be relatively simple, unless the three Northeast Asian countries were unable to form FTA(s) among themselves. In this case, the three Northeast Asian countries should realize the fact that a prompt realization of a CJK FTA would greatly facilitate the formation of a region-wide FTA in East Asia. Furthermore, they should also have the EAFTA in mind when they negotiate their Trilateral FTA, especially regarding the rules of origin they choose.

In order to realize a CEPEA, along with efforts to prepare its formation among

the ASEAN+6 countries, ASEAN FTA partner countries should strive to conclude bilateral FTAs among themselves. In addition to FTA(s) among the three Northeast Asian countries, the following missing links need to be completed: India-China, India-Australia, India-New Zealand, Australia-China, Australia-Japan, Australia-Korea, New Zealand-Japan and New-Zealand-Korea.

## References

- A Report by Joint Expert Group for Feasibility Study on EAFTA (2006), *Towards an East Asia FTA: Modality and Road Map*. Bangkok: The International Institute for Asia-Pacific Studies, Bangkok University.
- ADB (2012), *FTA Status by Country, 2012*. Asia Regional Intefation Center [online]. Available at: <http://aric.adb.org/10.php> (Accessed 22May 2012).
- ASEAN Secretariat (n.d.) 'AFTA & FTA', ASEAN Secretariat [online]. Available at: <http://www.aseansec.org/4920.htm>. (Accessed 23 November 2011)
- Chairman's Statement of the 14<sup>th</sup> ASEAN Plus Three Summit*, Bali, Indonesia, 18 November 2011
- Chairman's Statement of the 19<sup>th</sup> ASEAN Summit*, Bali, 17 November 2011
- Chairman's Statement of the 6<sup>th</sup> East Asia Summit*, Bali, Indonesia, 19 November 2011
- East Asia Vision Group Report (2001), *Towards an East Asian Community: Region of Peace, Prosperity and Progress*. Tokyo: MOFA.
- Final Report of the East Asia Study Group (2002), ASEAN+3 Summit, 4 November 2002, Phnom Penh, Cambodia. Tokyo: MOFA.
- Final Report on EAFTA Phase II Study (2009), *Desirable and Feasible Option for an East Asia FTA*. Bangkok: The International Institute for Asia-Pacific Studies, Bangkok University.
- IMF (2011), *Direction of Trade Statistics*. IMF [online]. Available at: <http://elibrary-data.imf.org/FindDataReports.aspx?d=33061&e=170921>
- IMF World Economic Outlook Database [online] (Accessed 14 July 2011).
- Taiwan Bureau of Foreign Trade, Trade Statistics [online] (Accessed 19 October 2011).
- UN Comtrade Database (Accessed 21 June 2011).
- UN National Accounts [online] (Accessed 14 July 2011).

**Annex Table 1: Trends of intra-regional trade in East Asia**

(Unit: Percent)

	ASEAN+3	ASEAN+3 +HMT	ASEAN+6	ASEAN+6 +HMT	NAFTA	EU(15)
1990	28.6	41.3	33.0	44.6	37.2	64.5
1991	30.9	44.6	35.2	47.8	38.9	64.7
1992	31.0	45.8	35.1	48.8	39.7	65.2
1993	33.7	46.6	37.7	49.6	41.0	60.6
1994	35.4	48.4	39.3	51.3	42.4	61.0
1995	36.9	49.6	40.3	52.2	42.0	61.7
1996	37.4	49.6	40.9	52.3	43.4	60.9
1997	36.4	49.3	39.9	52.1	44.4	54.8
1998	33.2	46.7	37.1	49.5	45.7	55.9
1999	35.4	48.5	39.0	51.1	46.8	62.0
2000	37.4	50.5	40.6	52.9	46.8	60.0
2001	37.3	50.1	40.7	52.6	46.6	59.5
2002	38.3	52.0	41.6	54.3	46.0	59.9
2003	39.4	53.1	42.7	55.4	44.8	60.6
2004	39.5	53.3	43.1	55.8	43.7	59.9
2005	39.1	52.7	43.0	55.5	43.0	58.4
2006	38.2	51.7	42.3	54.7	42.0	58.2
2007	37.8	51.0	42.2	54.2	41.0	58.1
2008	37.5	49.3	42.6	53.3	40.0	56.7
2009	38.3	50.6	43.5	54.6	39.4	56.7
2010	39.7	51.9	45.1	56.2	40.5	56.3

Sources: Calculated from IMF (2011), *Direction of Trade Statistics* and Taiwan Bureau of Foreign Trade, Trade Statistics [online].



**Annex Table 2. Diversity among East Asian countries**

(As of 2010)

	Population (Millions)	GDP (Billions of USD)	Per Capita GDP (USD)
Brunei	0.4	12.4	29,674.8
Cambodia	14.3	11.6	813.8
Indonesia	237.6	706.7	2,974.0
Lao PDR	6.4	6.4	1,003.7
Malaysia	28.2	237.9	8,423.2
Myanmar	61.2	45.4	742.4
Philippines	94.0	199.6	2,123.0
Singapore	5.1	222.7	43,116.7
Thailand	63.9	318.9	4,992.4
Vietnam	88.2	103.6	1,173.5
China	1,341.4	5,878.3	4,382.1
Japan	127.6	5,458.8	42,782.5
Korea	48.9	1,014.5	20,756.2
ASEAN	599.3	1,865.2	3,112.3
C·J·K	1,517.9	12,351.6	8,137.3

*Sources:* IMF World Economic Outlook Database [online]; UN National Accounts [online]