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Institute for
International Policy Studies

▪ Tokyo ▪

IIPS International Conference

**“Building a Regime of Regional Cooperation in
East Asia and the Role which Japan Can Play”**

Tokyo

December 2-3, 2003

**“Potential of Free Trade Agreements to Enhance
Regional Cooperation in East Asia”**

By

Dr. CHIA Siow Yue

Senior Research Fellow

Singapore Institute of International Affairs

Potential of Free Trade Agreements to Enhance Regional Cooperation
in East Asia

Dr CHIA Siow Yue
Senior Research Fellow
Singapore Institute of International Affairs

Brief paper for presentation at the Conference on Building a
Regime of Regional Cooperation in East Asia and
the Role which Japan can Play

Organized by the Institute for International Policy Studies
Tokyo
2-3 December, 2003

INTRODUCTION

East Asian economic regionalism is catching-up with regionalism trends in Europe, North America and Latin America. Prior to the 1990s, East Asia is the only major economic region in the world that has not established free trade areas (FTAs). This state of affairs changed with the decision by ASEAN in 1992 to establish the ASEAN Free Trade Area (AFTA). Since the mid-1990s, there has been a proliferation of cross-regional, sub-regional, and bilateral FTAs, some already implemented, but most still at the negotiating or study stages. The proliferation of FTAs in East Asia is shown in the attached table.

DRIVING FORCES IN EAST ASIAN ECONOMIC REGIONALISM

Both political and economic forces are driving the proliferation of FTAs in the region.

First, the end of the Cold War has led to improved political and economic relations. In Southeast Asia, ASEAN expanded to include Cambodia, Laos, Myanmar and Vietnam. In Northeast Asia, political and economic relations are normalising. In particular, the region's relations with China have improved dramatically.

Second, while East Asian economies remain fragmented, continental economic blocs have emerged in the Americas (NAFTA, Mercosur etc) and Europe (EU) and the Free Trade Area of the Americas (FTAA) is under negotiation. East Asian exporters are discriminated against in these markets and investors are diverted to Mexico to serve the NAFTA market and to central and eastern Europe to serve the EU market.

Third, the 1997-98 Asian financial crisis demonstrated the close economic and financial interdependence and interconnectivity among East Asian economies, as well as the need for regional cooperation to help maintain regional economic stability and resilience. There is also acute disappointment over the assistance provided by the IMF, US and EU. Also, the crisis created the opportunity for Southeast Asia and Northeast Asia to meet under the ASEAN+3 initiative for financial and monetary cooperation.

Fourth, disappointment with WTO and APEC. Trade liberalization under GATT/WTO has become increasingly difficult with the large and diverse membership. It took over 7 years to conclude the Uruguay Round negotiations. Efforts to launch a new WTO round at Seattle in 1999 failed. Although the Doha Development Round was launched in December 2001, the negotiations suffered a severe setback with the failure of the Cancun meeting in September 2003. There is also growing concern over the ineffectiveness of APEC in liberalizing trade and investment among its members.

Fifth, with the rise of China, there is growing realization that East Asia could form a large and dynamic economic bloc, able to harness regional resources to resolve regional problems, and seek a more effective voice in the global arena hitherto dominated by western interests. East Asia has one third of the world's population, one quarter of the world's GDP and two-fifths of the world's foreign reserves. China is showing growing interest in economic integration in East Asia and has proposed an FTA with Southeast Asia.

Sixth, Japan has abandoned its purely multilateral position. With loss of economic dynamism and

challenged to remain internationally competitive, Japanese businessmen want better access to overseas markets. Japan has since signed and implemented an FTA with Singapore and is negotiating bilateral FTAs with several countries, in addition to a framework agreement with ASEAN. Not to be isolated, South Korea has also been pursuing FTAs aggressively in recent years and proposed the formation of an East Asian economic community.

Seventh, the US had objected to earlier proposals by Malaysia to form an East Asian Economic Group (EAEG) and by Japan to establish the Asian Monetary Fund. Since then, the US has not voiced any objection to new initiatives such as ASEAN-China, ASEAN-Japan, ASEAN+3, and even the East Asia FTA. In fact, the US has signed a trade and investment agreement with Vietnam, is implementing an bilateral FTA with Singapore, and has proposed the Enterprise for ASEAN Initiative (EAI).

MAJOR EAST ASIAN INITIATIVES

ASEAN-China Comprehensive Economic Co-operation

China first proposed an FTA with ASEAN in November 2000. An ASEAN-China Expert Group was formed and recommended the following ---- an FTA within 10 years, preceded by an "early harvest" package of mutually agreed list of goods to be liberalized; trade and investment facilitation measures; technical assistance and capacity building for ASEAN members; co-operation in a wide range of economic and technical areas; special and differential treatment and flexibility for CLMV countries.

The *Framework Agreement on ASEAN-China Comprehensive Economic Cooperation*, signed in November 2002, broadly adopts the recommendations of the Expert Group. It commits ASEAN and China to an FTA covering trade in goods and services and investment liberalization and facilitation and other areas of co-operation. Negotiations on tariff reduction and rules of origin started in 2003. For products on the normal track, tariff reductions will begin in January 2005 and end in 2010 for ASEAN-6 and China, and in 2015 for CLMV. For products on the sensitive track, the tariff reduction schedule will be determined by mutual agreement. An "early harvest" package of tariff reductions in agricultural goods under HS1-HS8 has been implemented, with each ASEAN country having its own list of products.

What motivates China's offer and ASEAN's ready acceptance? China's motivations are both political and economic. China's political and diplomatic normalization with the ASEAN states was completed only in the late 1980s. The overture seeks to further secure the political relationship as well as allay ASEAN concerns over the China challenge in export markets and in attracting foreign investment. Economically, China is eyeing the ASEAN region for both its market and its raw materials, especially energy resources and minerals.

In turn, ASEAN governments readily welcomed the China initiative as a peace-seeking and friendly offer from a rising power. China is a rapidly growing market for ASEAN products and services (including tourism), and is serving as a new engine of growth to supplement the traditional Japanese engine which has been considerably weakened by a decade-long Japanese economic stagnation. Furthermore, ASEAN hopes to attract FDI to produce for the China market and to attract Chinese FDI as well. The FTA will create a huge economic region of 1.7 billion people, GDP of US\$2 trillion and trade of US\$1.2 trillion. A simulation study shows that the FTA will increase ASEAN's exports to China by 48 per cent and China's exports to ASEAN by 55 per

cent.

At the same time, ASEAN countries are concerned over China's competitive strengths and advantages, particularly competition in labour intensive products in domestic and third country markets, and in competition for FDI. Hence the October 2003 ASEAN decision to improve economic competitiveness, including accelerating the pace of ASEAN economic integration.

ASEAN-Japan Comprehensive Economic Partnership

Japan proposed an economic partnership agreement with ASEAN in January 2002, immediately after the signing of the bilateral agreement with Singapore and soon after the initiation of the ASEAN-China FTA. The *Japan-Singapore Economic Partnership Agreement (JSEPA)* was completed after only 14 months of negotiations, with the speed reflecting the strong political and economic ties as well as the economic complementarity of the two countries, particularly Singapore's lack of an agricultural sector. JSEPA is dubbed a New Age Economic Partnership as it covers not only liberalization of trade in goods, services and investment but also cooperation in areas such as information technology, science and technology, financial services, tourism, and human resource development.

In November 2002 ASEAN and Japan signed the *Joint Declaration* to develop the framework agreement and provide for separate bilateral partnership agreements. The *Framework Agreement for Comprehensive Economic Partnership between ASEAN and Japan* was signed in October 2003 with the following guiding principles. First, comprehensive coverage of countries and sectors. Second, special and differential treatment for ASEAN states, reflecting their lower economic development levels, and greater flexibility for the CLMV countries. Third, flexibility for the sensitive sectors of ASEAN and Japan. Fourth, early implementation of cooperation in areas which could provide more immediate benefits, such as technical assistance and capacity building to ASEAN, especially for the CLMV countries; trade and investment promotion and facilitation measures; trade and investment policy dialogue; business sector dialogue; measures to facilitate the mobility of business people; exchange and compilation of relevant data such as customs tariff and bilateral trade statistics; facilitation and cooperation programmes covering a wide field. Negotiations on trade in goods and services and in investment are scheduled to begin in 2004 and implemented by 2012.

What motivates the Japanese overture and ASEAN's ready acceptance? Japan is concerned over China's growing influence in Southeast Asia. A formalized relationship between Japan and ASEAN will help consolidate Japan's trade and investment relations with Southeast Asia. In addition, a rejuvenated ASEAN would help Japan avoid putting all its investment eggs in the China basket. For ASEAN, the Japanese initiative on top of the China initiative is a reassurance of its central role in East Asia. ASEAN recognizes Japan as the second largest economy in the world and its role as the regional engine of growth. For the less developed ASEAN economies, Japan is the largest donor of technical and development assistance. But ASEAN is increasingly concerned over Japan's long drawn economic stagnation and the sharp decline in Japanese FDI and trade with ASEAN in recent years. The CEP will anchor Japanese interests in Southeast Asia and balance the rise of China. The Japan-ASEAN CEP is expected to expand ASEAN's trade to Japan by 44 per cent and Japan's trade to ASEAN by 28 per cent.

Japan's preference for a network of bilateral agreements under a general ASEAN-Japan Framework Agreement is perceived both positively and negatively. On the positive side, it

recognizes the difficulty of negotiating one comprehensive package and adopting a "one size fits all" formula with a group of economically diverse economies. Bilateral agreements would allow for flexible treatment of time frames and of sensitive sectors, including taking care of Japan's sensitivity on agricultural trade liberalisation. On the negative side, the bilateral approach could undermine ASEAN cohesiveness and negotiating leverage. It raises the issue of Japan "cherry picking". Japan has stated that the EPAs with other ASEAN countries would be modelled on the Japan-Singapore agreement. But some ASEAN countries would expect more opening of the Japanese agricultural market and would be reluctant to open up their financial services. Bilateral discussions are ongoing with Malaysia, Philippines, Thailand and Vietnam.

ASEAN+3 and an Emerging East Asian Community

The ASEAN+3 regional initiative was driven by the need for monetary and financial cooperation in the wake of the Asian financial crisis. The grouping adopted the Chiang Mai Initiative with two components, aimed at instilling regional financial stability and resilience. The first is a network of bilateral swap and repurchase agreement facilities to assist beleaguered central banks facing liquidity crunches. This sends an important signal to the market, particularly in the absence of any reforms in the international financial architecture. The second is a regional monitoring and surveillance process to ensure that the macroeconomic and financial fundamentals and policies of member countries do not fall into the danger zone that could signal another currency attack. The momentum for monetary and financial cooperation has also led to a revival of the Asian monetary fund proposal and even proposals for a common currency. Also, there have been ministerial meetings not only on finance, but also economics and trade, labour, agriculture and forestry, tourism, energy, and environment.

The ASEAN+3 process has spawned ideas for an eventual East Asian FTA or East Asian community. The South Korean proposal at the November 1998 Summit was followed by two studies to determine the forms and time-frames. The *Final Report of the East Asia Study Group* (EASG) identified the short, medium, and long-term measures to push forward East Asian co-operation. The short-term measures include formation of an East Asia Forum, an East Asia Business Council, and a network of East Asian eminent intellectuals, and the promotion of East Asian studies. The medium and long-term measures include an East Asia Summit and an East Asia FTA. It proposed that the East Asia Summit evolve from the ASEAN+3 process, so as to address ASEAN concerns that it may be marginalized if the pace is too fast, as well as the need to nurture a greater sense of ownership among the Northeast Asian countries. Economic ministers have been tasked to study and formulate options on the gradual formation of an East Asia FTA.

Realization of an East Asian FTA or Community faces several political and economic challenges. First, politically there is as yet no common political vision for East Asia, as is the case with the founding members of the European Union. Countries have to be convinced that there is a common destiny and that the political and economic gains of "being together" outweigh the pull of national sovereignty. Many countries would not wish to surrender the degree of national sovereignty necessary for the creation of common institutions and common rules and disciplines. The historical baggage of mistrust still exists, particularly between China and Japan. Confidence building and community building are long processes. And for countries that see a continuing strong need for the US security umbrella, there would be hesitation in forming an East Asian bloc that undermines relations with the US.

Second, the wide differences in development levels and economic competencies pose obstacles to

free intra-regional movement of goods, services, investments, capital and people. Countries would want to open up at different paces and exclude different sensitive sectors. Economic diversity, however, should not be an insurmountable obstacle, as such diversity makes for economic complementarity and provide opportunities for all. More importantly, not all perceive an East Asian FTA or community as absolutely necessary for national economic growth and prosperity, notwithstanding the growing intra-regional economic ties. There are still strong linkages to North America, Europe and Australia-New Zealand for trade, investments, finance and technology.

Given its growing weight in regional economics and politics, China will have to play a pivotal role in the emergence of an East Asian FTA or Community. However, Chinese hegemony could cause unease among its smaller and lesser neighbours. Instead, a stable East Asian bloc should rest on three foundations, namely that of China, Japan and ASEAN.

One challenge is that East Asian economic integration should not splinter the world into three antagonistic economic blocs and undermine the multilateral trading system embedded in the WTO. Hence it is healthy that strong inter-regional links be maintained and developed. It is also necessary that East Asian economies maintain a strong commitment to the WTO process.

Regional and Bilateral Trading Arrangements in East Asia

	Membership	Status
REGIONAL		
AFTA, AFAS, AIA	ASEAN-10	Implemented
AFTA-CER Closer Economic Partnership (no FTA)	ASEAN-10 , Australia-New Zealand	Ministerial Declaration September 2002
ASEAN-China Comprehensive Economic Cooperation (with FTA)	ASEAN-10, China	Framework Agreement signed in November 2002,
ASEAN-Japan Comprehensive Economic Partnership (with bilateral FTAs)	ASEAN-10, Japan	Framework Agreement signed in October 2003; JSEPA implemented; other bilaterals under official discussion
ASEAN-India Comprehensive Economic Cooperation (with FTA)	ASEAN-10, India	Framework Agreement signed in October 2003; negotiations begin in January 2004.
ASEAN-South Korea Comprehensive Economic Partnership (with FTA)	ASEAN-10, South Korea	Official discussions ongoing
ASEAN-US Enterprise for ASEAN Initiative (with FTA)		
ASEAN+3 (monetary and financial cooperation)	ASEAN-10, China, Japan, South Korea	Implemented Chiang Mai Initiative
East Asia FTA	ASEAN-10, China, Japan, South Korea	East Asia Vision Group Report completed; official discussions ongoing
China-Japan-Korea FTA	China, Japan, South Korea	Under consideration
BILATERAL		
China bilaterals	with Hong Kong, South Korea	Official discussions ongoing
Hong Kong bilaterals	with China, New Zealand	Official discussions ongoing
Japan bilaterals	with Canada, Chile, Mexico, Malaysia, Singapore, Thailand	Only Japan-Singapore implemented; others official discussions ongoing
South Korea bilaterals	with Australia, China, Chile, Japan, Mexico, New Zealand, US	None implemented yet; official discussions ongoing
Malaysia bilaterals	with Japan, US	Official discussions ongoing
Philippines bilaterals	with US	Official discussions ongoing
Singapore's bilaterals	with Australia, Canada, EFTA, India, Japan, Jordan, Mexico, New Zealand, Sri Lanka, South Korea, US	Bilaterals with Australia, EFTA, Japan and New Zealand implemented; others under official discussion
Thailand's bilaterals	with Australia, Bahrain, Chile, China, Croatia, Czech Republic, India, Japan, Mexico, New Zealand, Peru, South Africa, South Korea, US	None implemented yet; official discussions ongoing