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“FTA and Regional Co-operation in East Asia”

By

Dr. Narongchai Akrasanee

**Former Minister of Commerce,
Chairman & CEO of Seranee Holding Co. Ltd,
Thailand**

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By

Narongchai Akrasanee, Ph.D.

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Narongchai Akrasanee, Ph.D.

The year 2003 will be remembered for the Year of East Asia Economic Cooperation (EAEC).

What happened in 2003 that signalled the emergence of EAEC ?

And, what will be the impact of the numerous FTAs involving the countries in East Asia on the process of EAEC ?

This brief note intends to address FTAs and the emergence of EAEC.

Emergence of EAEC

There were several events during 2003 which signalled the emergence of EAEC. To name a few,

1. Malaysia hosted the first Congress on EAEC during 4-6 August, with a very large attendance, and a commitment to pursue the establishment of EAEC.
2. The ASEAN Summit during 8-9 October in Bali, Indonesia, witnessed the signing of a cooperation scheme among ASEAN and China, Japan and South Korea, altogether instead of individually.

3. The 11th APEC Leaders Meeting during 20-21 October in Bangkok, Thailand, endorsed a financial cooperation scheme involving mainly East Asian economies.

In addition, ASEAN has been playing a pivotal role in the formation of EAEC, by having bilateral agreements with each of the three North East Asian countries. These agreements include the Treaty of Amity between ASEAN and China, with the same being contemplated between ASEAN and Japan, and many other FTAs or economic partnership agreements.

It seems the three North East Asian countries have wanted to see EAEC evolving from their bilateral agreements with ASEAN. This is a way of avoiding a certain political sensitivity between China and Japan, and between South Korea and Japan. But the event in Bali on 9th October suggests that the Northeast Asian countries realize the inevitability and the desirability of East Asia economic cooperation.

Why is this so ?

Observers of the development of East Asia have been seeing the process of economic integration growing first gradually, then rapidly, since the opening up of China in the 1980s. Since then, because of the almost unlimited supply of low cost workers and technicians, China has become one of the most competitive manufacturing centers in the world. All

industries in other countries, in order to remain competitive in some areas, have had to engage manufacturing facilities in China in one way or another.

Thus the integration of manufacturing production in East Asia.

Another important development is the growing foreign exchange reserve in East Asia. As of August 2003, the combined FX reserve of East Asia stood at US\$ 1,600 billion, accounting for 64 % of global reserve.

Following the Asian financial crisis of 1997/1998 many countries in East Asia came to realize the problems relating to the volatility of global finance. Such features of global finance could bring about the instability of the exchange rates and capital flows, to the detriment of the local economy. In fact in 1998 the Hong Kong dollars also came under attack. Only with the strong support of China that the hedge funds attacking the Hong Kong dollars had to back off.

So since the Asian financial crisis of 1997-1998s the East Asian countries have been introducing financial cooperation schemes to help minimize the instability effects of global finance. These schemes include the currency swap arrangements at the amount of US\$ 54.50 billion, and the development of the bond market, which encompasses many aspects of the development of the capital market in East Asian.

Now that East Asia is moving towards production and financial integration, what is of interest is how the various cooperation schemes will influence the pattern and the direction of EAEC.

FTAs and EAEC

First is the proliferation of FTAs.

In East Asia the first FTA is the ASEAN Free Trade Agreement (AFTA) which came into effect in 1993 and is almost fully implemented in 2003. For ASEAN, cooperation under AFTA will be deepened and broadened, to include also trade in services.

Then there are many other FTAs, at various stages of development including :

- ASEAN - China
- ASEAN - Japan
- ASEAN - South Korea
- Japan - South Korea
- Japan - Thailand
- Japan - Singapore
- Japan - Malaysia
- China - Thailand
- China - Malaysia
- South Korea - Thailand

etc., etc.

These agreements and the financial cooperation schemes

mentioned earlier will help enhance the growth of production and financial integration in East Asia.

Although all FTAs are meant to facilitate the flows of goods and services between the contracting economies, it must be realized that FTAs are discriminatory to the non-contracting economies. Fortunately in East Asia most economies seem to be contracting economies, directly or indirectly. Thus FTAs are likely to have trade creation effect for the whole of East Asia, although the effects will vary from case to case.

FTAs of China and of Japan

For each FTA there are certain different features, with important economic and political implications.

Take the case of ASEAN – China VS ASEAN Japan, or the case of Thailand – China VS Thailand-Japan as examples.

In the pursuit of FTA China seems to move much faster than Japan. This is due to the fact that China is considered to be a developing country, thus allowed to utilize the WTO enabling clause to apply a gradual coverage under FTA. Japan, on the other hand, has to have a substantial coverage under FTA, because it is a developed country.

Another reason why China can move faster than Japan could be political, The political system in China allows the Chinese government to make a decision faster than the Japanese government.

So in November 2001, China and ASEAN agreed to negotiate an FTA. And only in January, 2002 Japan proposed an economic partnership agreement with ASEAN.

By November 2002, ASEAN and China already agreed on a timeframe for FTA for certain sectors. In the meantime ASEAN and Japan are still consulting up until now.

A similar development can be observed in Thailand-China and Thailand-Japan FTAs.

In October 2003 Thailand and China started to implement free trade agreements in fruits and vegetables. At this time Thailand and Japan are still negotiating.

An exception is Japan – Singapore FTA. As Singapore is basically a free-trade economy, Japan could achieve a very comprehensive FTA with Singapore.

Obviously FTAs with China are producing results much faster than FTAs with Japan, in general. To the general public, they see China to be more serious than Japan in the promotion of free flow of goods.

FTAs and Regional Integration

At the end of the day what is important is whether FTAs would lead to the enhancement of political will to integrate regionally.

As of today FTAs are not coordinated regionally. So it appears that certain countries, particularly Singapore, Thailand, and also China, are going their own way to conclude FTAs. In

the short run the anomalies in the tariff and trade regimes are bound to occur, creating distortion in relative prices and thus limiting potential welfare gains of FTAs.

Perhaps the leaders of East Asia saw these potential distortions. They, therefore, agreed on 9th October in Bali to hold consultation on cooperation for East Asia.

It is difficult to say whether the leaders gained political will to integrate regionally because of the proliferation of FTAs. What is more likely is that the leaders already saw the need for EAEC. But because of certain political sensitivity, they went at EAEC in a roundabout way, utilizing bilateral FTAs.

With many FTAs at various stages of development, it became obvious that a more efficient approach would be EAEC.

Economic Integration and Regional Security

Economic integration in East Asia, which has been on going even without official agreement to that effect, has been the result of individual decision and action to minimize economic risk, and thus maximizing economic security.

Under global market capitalism businesses are faced with risks due to slow demand growth, lower cost competition, and sudden applications of trade interference measures, and financial risks.

In addition businesses are also faced with non-traditional risks such as international terrorism and epidemic.

To minimize the traditional risks, businesses have relied on China, for example, for production net-working, and for new demands.

And business have also made use of AFTA for their production net-working.

An East Asia-wide official cooperation in trade, investment, and finance would facilitate the need for businesses to integrate among themselves.

As for the non-traditional risks, the official cooperation is required.

Thus for both traditional and non-tradition risks, deepening economic relations officially and business-wise would obviously help minimize these risks.

This conclusion is made with an important proviso that measures to counter international terrorism are designed specifically for the facilitation of commercial transactions.