



PECC Trade Forum

Strategies Towards the Development of New Regional Trading Arrangements in East Asia

Hadi Soesastro

**November 11-12, 2002
Vancouver, Canada**

Pacific Economic Cooperation Council

4 Nassim Road Singapore 258372 Tel: +65 67379822 Fax: +65 67379824 Email: info@pecc.org
www.pecc.org

PECC Trade Forum
Vancouver, 11-12 November 2002

**STRATEGIES TOWARDS THE DEVELOPMENT OF NEW REGIONAL TRADING
ARRANGEMENTS IN EAST ASIA**

Hadi Soesastro
CSIS, Jakarta

Introduction

The vision for an East Asian community has been articulated by the East Asian Vision Group (EAVG) in its Report, "Towards an East Asian Community", submitted to the ASEAN Plus Three (APT) Leaders at their Fifth Summit in Brunei Darussalam in November 2001. The vision is of an East Asia that moves "from a region of nations to a bona fide regional community with shared challenges, common aspirations, and a parallel destiny." Furthermore, the Report also stated that "[t]he economic field, including trade, investment, and finance, is expected to serve as the catalyst in the comprehensive community-building process."

In the field of economic cooperation, the vision is that of a progressive integration of the East Asian economy, ultimately leading to an East Asian economic community. Economic integration is to be pursued through the liberalization of trade and investment, development and technological cooperation, and information technology development.

In trade, it recommended the formation of an East Asia Free Trade Area (EAFTA), and the liberalization of trade should be well ahead of the Bogor Goal set by APEC. In investment, it proposed the establishment of an East Asian Investment Area (EAIA) by expanding the Framework Agreement on ASEAN Investment Area (AIA) to cover East Asia as a whole. In the area of finance, the recommendation towards greater financial integration was to adopt a staged, two-track approach, namely for the establishment of a self-help arrangement (e.g. an East Asian Monetary Fund) and for coordinating a suitable exchange rate mechanism amongst countries in the region.

The EAVG has also listed the various motivations for the development of an East Asian community. A great deal has been written on this. Three considerations have stood out. First, the need to establish a regional (institutional) identity, in view of the fact that other regions (Europe and the Americas) have established or are developing their own regional arrangement. Second, the need to amplify an East Asian voice on regional and global issues, in view of East Asia's increased stakes in regional and global developments. Third, the need to promote regional peace and prosperity through cooperation, given the region's own internal dynamics.

Despite this compelling rationale, difficulties and obstacles in creating an East Asian community have also been recognized. Three problems have been identified. First, the great diversities amongst countries in the region, and especially the large gaps in levels of economic development. Second, the lack of a mechanism (and tradition) for regional cooperation in Northeast Asia. Third, the prevailing politico security problems in the region (China-Taiwan, the Korean Peninsula, and to a much lesser extent the South China Sea).

The ASEAN Plus Three

In a way, ASEAN has taken the lead in developing the foundation for an East Asian Community. ASEAN Plus Three (APT) is perhaps the embryo of an East Asian regional organization. APT refers to a regional process involving the ten ASEAN countries and *three* Northeast Asian countries (China, Japan, and Korea). As suggested by its name, this emerging regional process is driven by ASEAN. APT meetings take place around ASEAN meetings. Some see this as a possible obstacle to the creation of a truly East Asian regional arrangement (Jayasuriya, 2000).

However, this East Asian process may not have come about had it not taken this route. The APT began as a modest undertaking. Foreign ministers from the three Northeast Asian countries initially came for an informal meeting over lunch during an ASEAN meeting. There was no specific agenda for those meetings. Soon enough, this process attracted the involvement of heads of state. The First APT Summit was held in December 1997 in Kuala Lumpur. The financial crisis in East Asia is regarded as having provided the impetus for this Summit. The APT process became a more serious one. While the process has been and is essentially driven by ASEAN, the agenda setting was monopolized by ASEAN.

In the Second APT Summit in Hanoi in November 1998, Korea's President, Kim Dae-jung proposed the establishment of an East Asia Vision Group to present a mid- to long-term vision for the cooperation. The Third APT Summit in Manila in November 1999 was held under the banner of "East Asian Cooperation". The meeting discussed various ways to promote cooperation and to cope with the new challenges of the

21st Century. APT heads of state adopted the “Joint Statement on East Asian Cooperation” suggesting cooperative measures in various areas including security, economy, culture and development strategy. This agreement led to the launching since 2000 of a series of APT meetings of finance and economic ministers, in addition to those of foreign ministers.

In May 2000, at the APT Finance Ministers Meeting, discussions on the need to build a regional financial framework led to the adoption of the so-called Chiang Mai Initiative. This initiative aims at creating a network out of existing currency swap arrangements of ASEAN and bilaterally between ASEAN members and the other Three countries.

In the Fourth APT Summit in Singapore in November 2000, Chinese Prime Minister Zhu Rongji suggested the main tasks for APT, which included cooperation in the development of Mekong River Basin transportation and communication infrastructure, cooperation in IT (information technology), human resources development, agriculture, and tourism. China also took the initiative to convene an APT agriculture and forestry ministers, and offered to host and agricultural technology and cooperation business forum.

The Singapore Summit concluded with a public statement by Prime Minister Goh Chok Tong highlighting the “two big ideas” that emerged from the discussion, namely the development of institutional links between Southeast Asia and Northeast Asia, and the setting up of a working group to study the merits of an East Asian free trade and investment area. He further stated: “I see no problem in ASEAN Plus Three evolving, if that’s the desire of leaders, into some kind of East Asia Summit. But there are implications. I myself would not recommend a hasty evolution.” (Thayer, 2000). However, Goh seemed to suggest that what was important was that the leaders of the thirteen countries were starting to think as “East Asian.”

At the Fifth APT Summit in Brunei Darussalam in November 2001, leaders endorsed the Report by the EAVG, including the development towards an East Asian Economic Community, among other means through the creation of an East Asian Free Trade Area. However, this meeting and the agreements reached were overshadowed by China’s “surprising” proposal for an ASEAN-China Free Trade Agreement. The Sixth APT Summit in Phnom Penh in November 2002 was also overshadowed by global terrorism issues as well as the signing of the Framework Agreement on ASEAN-China Comprehensive Economic Cooperation, which provides the basis for negotiating an ASEAN-China Free Trade Agreement (ACFTA). In addition, the leaders of ASEAN and Japan also issued a Joint Declaration on the Comprehensive Economic Partnership between ASEAN and Japan.

The Emergence of an ASEAN “Hub”?

It has been speculated that the ASEAN-China initiative was largely politically motivated. Strengthening of ASEAN-China relations is indeed a critical element in the development of an East Asian community. The search for an institutional identity in East Asia, as in other regions, tends to be dominated by ideas about regional trade structures, in particular FTAs. In a region as diverse as East Asia it will not be easy to establish a regional-wide free trade arrangement. There are suggestions that perhaps such a regional arrangement can result from the development of bilateral or sub-regional trading arrangements as its building blocks. Recent initiatives to form bilateral FTAs may be inspired by that idea.

There are various possible routes to developing an East Asian institutional identity (Soesastro, 2001). One possible route is through the formation of a Northeast Asian subregional FTA that subsequently could be linked to the one already in existence in Southeast Asia (AFTA), resulting in an East Asian Free Trade Area (EAFTA). A modified version of this is to extend AFTA's CEPT (common effective preferential tariffs) to the other Three. The other option, focusing on development cooperation, is to develop an OECD-type institution. This will require large resources to establish and to operate, and takes away much of the limelight from the political leaders. This option is a desirable one but not likely to be pursued in East Asia.

Still another route is through financial cooperation. Some observers have predicted the emergence of a “new monetary regionalism” in East Asia resulting from the financial crisis. In the context of APT cooperation, the most important is the Chiang Mai Initiative (CMI). ASEAN has also instituted a surveillance process and may invite other East Asian countries to join in the exercise at a later stage. The creation of an Asian Monetary Fund could be part of a regional financial architecture. In addition, ideas of creating some kind of a common currency basket have been proposed. It remains to be seen how these ideas and initiatives could bring about institutional integration as they deeply impinge on sovereignty issues that are still regarded as highly sensitive in many regional countries. Takatoshi Ito (2000) is of the opinion that this route may take 50 years. He raised two fundamental questions. First, is there a sequencing in regional cooperation that require trade cooperation to be forged before financial cooperation could be undertaken, thus calling for the establishment of a FTA before the creation of a monetary pact? Second, is APT, constituting the 13 East Asian countries, the right grouping?

The route that is currently being taken, namely along the pragmatic, develop-as-you-go approach, is perhaps the only feasible one. However, there needs to be a clear vision and **strategy** as to how the APT process can be strengthened by the bilateral initiatives.

The ASEAN-China agreement and the ASEAN-Japan initiative will now take the center stage. A great deal of energies and attention will be devoted by the ASEAN bureaucracies to these initiatives. ASEAN will effectively become a “hub”. In September 2002, a Joint Ministerial Declaration on Closer Economic Partnership (CEP) has been signed between ASEAN and the CER countries (Australia and New Zealand). In late October 2002, at the occasion of the APEC meeting in Mexico, President Bush also proposed the “Enterprise for ASEAN Initiatives” that will provide a framework for the US to negotiate both bilateral and regional free-trade agreements with Southeast Asia. At the First ASEAN-India Summit in November 2002, India too has offered to start free trade talks and to have a free trade agreement (FTA) working within 10 years. Australia has also courted ASEAN to have an ASEAN-Australia Summit.

Can one conclude that the region has effectively embarked on bilateral agreements as building blocks towards an East Asian Community? ASEAN appears to have become more inclined to develop bilateral initiatives. A region-wide initiative does not seem to be the preferred option. Perhaps there are concerns in ASEAN that in a region-wide arrangement it would be overwhelmed by the much larger Northeast Asian region. The combined GDP of the three Northeast Asian countries is currently about 13 times larger than ASEAN’s GDP. At the ASEAN Economic Ministers Meeting in September 2002, Singapore Trade and Industry Minister, George Yeo, stated that “[i]t has long been a position of ASEAN that we deal separately with China, with Japan, with Korea in order to secure a certain position for ourselves.” (*The Sunday Times*, 15 September 2002). It is not immediately clear what this statement exactly means, but the preference for bilateral initiatives is unmistakable.

Indeed, ASEAN’s strategy seems to have been reinforced by the favorable response from a number of its economic partners. All of a sudden ASEAN has been brought to the lime light (again). ASEAN will definitely exploit this opportunity in order to be able to come out from the back stage, where it has been pushed to since the financial crisis. As has been reported, Singapore’s Prime Minister Goh Chok Tong is now talking about “[t]he ASEAN jumbo jet [that] has one wing in the making in the East, through agreements with China and Japan. India’s proposal provides the second wing. With this, we can take off” (*The Strait Times*, 6 November 2002). In fact, an ASEAN-US initiative will be much more significant for ASEAN. Singapore officials have also speculated that Korea, which has not offered to enter an FTA with ASEAN, may get into the act next year (*The Straits Times*, 6 November 2002). This may be the case. At the APT Economic Ministers Meeting in September 2002 in Brunei Darussalam, it was reported that South Korean Trade Minister Hwang Doo-yun stated that his country was doing a study on the pros and cons of entering into such an agreement with ASEAN (*The Sunday Times*, 15 September 2002). Lee Yock Suan, a minister in the office of the Singapore Prime Minister, believes that “[s]lowly but surely, we are seeing the emergence of an East Asian community.” (*International Herald Tribune*, 4 November 2002).

In addition to going bilateral, it appears that there has emerged an ASEAN understanding that any economic cooperation arrangement today, be it bilateral, sub-regional or inter-regional, cannot have a narrow agenda. Any FTA initiative today will have to be of a “new age” type. It can be given any label, FTA, CEP (Closer Economic Partnership) or EPA (Economic Partnership Arrangement), but whatever it is called it is going to have a broad, comprehensive agenda that covers a host of non-border measures in addition to border liberalization efforts.

Can ASEAN Meet the Challenge?

As ASEAN has come to the center stage, and as it emerges as a hub, the big question is whether ASEAN can effectively manage the process. Prime Minister Goh of Singapore rightly asked the question of whether ASEAN can sustain the interests of its partners (*The Straits Times*, 6 November 2002). It is clear that ASEAN has to put its house in order first. It has to formulate a comprehensive and coherent AFTA Plus as the basis for developing external, bilateral, and inter-regional linkages. He has proposed to accelerate ASEAN’s economic integration towards an ASEAN Economic Community (AEC) as a common market, along the lines of the European Economic Community, by 2020. This, it is argued, is simply a “logical extension of AFTA”.

There is as yet insufficient confidence in the region itself that ASEAN can effectively take up this new agenda. Comments refer to the fact that ASEAN “remains so fragmented that any meaningful package within the region seems elusive” (*The Jakarta Post*, 6 November 2002). The outgoing ASEAN Secretary General, Severino, in his report to the ASEAN Summit called for political commitment within ASEAN to achieve economic integration. He suggested that ASEAN “seems to have become stuck in framework agreements, work programmes and master plans”, and it needs to translate them into concrete actions.

The Strategy

ASEAN must have a strategy for creating both an ASEAN Economic Community and the East Asian community. They have to be pursued in parallel. In essence, it needs to assure that: (a) bilateral initiatives become building blocks towards an East Asian community; (b) the various bilateral and sub-regional arrangements will strengthen economic reform efforts within the ASEAN economies. This strategy has to be supported by other East Asian countries. In fact, it should be adopted as an East Asian strategy.

Elements (and principles) of such a strategy have been formulated first by a high-level Task Force on an

AFTA-CER FTA, which was headed by Cesar Virata. In addition to WTO consistency, the elements include:

- (a) *Comprehensiveness*: it must cover trade in all goods, services (covering all modes of supply), investment, technical barriers to trade, and mutual recognition agreements (MRAs);
- (b) *Speed*: the pace of liberalization should proceed faster than that of APEC;
- (c) *Flexibility*: some elements of the agreement can be achieved earlier than others (early harvest);
- (d) *Simplicity*: the rules of origin in relation to the FTA element must be as liberal as possible and should be simplified and standardized;
- (e) *Facilitation*: trade and investment facilitation are to be pursued continuously;
- (f) *Capacity building* is an integral part of the arrangement.

Comprehensive coverage is illustrated by the Singapore-Japan New Age Partnership (JSEPA), which was signed in January 2002. It has two main components. The first is *liberalization and facilitation*. This component covers: trade in goods (including elimination of tariffs), rules of origin, MRAs, trade in services, investment, movement of natural persons, intellectual property rights, paperless trading, competition policy, government procurement, and customs procedures. The second is *closer economic partnership*, which includes: ICT, human resources development, trade and investment promotion, SMEs, tourism, financial services, science and technology, and broadcasting.

The ASEAN-Japan bilateral initiative, as proposed by Prime Minister Koizumi in January 2002, has also led to a Joint Declaration on Comprehensive Economic Partnership, signed at the Sixth APT Summit in November 2002. The declaration proposed the comprehensiveness not only of sectors but also of *countries*, although allowing for the development of bilateral economic partnerships between Japan and individual ASEAN countries. In addition, it stipulated the following guiding principles: reciprocity and mutual benefits, special and differential treatment (and additional flexibility to the new ASEAN members), to begin in areas where implementation is feasible. The declaration stated that the Partnership agreement would include “elements of a possible free trade area” that “should be completed as soon as possible within 10 years, taking into account the economic levels and sensitive sectors in each country”. A framework agreement is to be endorsed by the leaders in 2003.

It may well be that the ASEAN-Japan Framework Agreement be modeled and expand on the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China, signed in Phnom Penh on 4 November 2002.

The Agreement consists of 16 Articles. Article 2 lists the measures for comprehensive economic cooperation to establish an ASEAN-China FTA within 10 years. These include:

- (a) progressive elimination of tariffs and non-tariff barriers in substantially all trade in goods;

- (b) progressive liberalization of trade in services with substantial sectoral coverage;
- (c) establishment of an open and competitive investment regime that facilitates and promotes investment within the ASEAN-China FTA;
- (d) provision of special and differential treatment and flexibility to the newer ASEAN members;
- (e) provision of flexibility in the negotiations to address their sensitive areas in the goods, services and investment sectors with such flexibility to be negotiated and mutually agreed based on the principle of reciprocity and mutual benefits;
- (f) establishment of effective trade and investment facilitation measures, including, but not limited to, simplification of customs procedures and development of mutual recognition arrangements;
- (g) expansion of economic cooperation in areas as may be mutually agreed upon that will complement the deepening of trade and investment links and formulation of action plans and programs in order to implement the agreed sectors/areas of cooperation; and
- (h) establishment of appropriate mechanisms for the purposes of effective implementation of the Agreement.

Substantive articles in the Agreement are: Article 3 on Trade in Goods and Article 6 on Early Harvest. Negotiations in the area of goods trade will involve a gradual reduction or elimination of substantially all products. In the *Normal Track*, the listed products will have their respective applied MFN tariff rates gradually reduced or eliminated in accordance with specified schedules and rates (to be mutually agreed upon) over a period from 1 January 2005 to 2010 for ASEAN 6 and China, and from 1 January 2005 to 2015 in the case of the newer ASEAN members. In regard to the *Sensitive Track*, the respective MFN tariff rates will be reduced (and eliminated) in accordance with the mutually agreed end rates and end dates or timeframes. The number of products in the Sensitive Track is subject to a maximum ceiling. The negotiations will also cover other detailed rules, e.g. reciprocity; rules of origin; treatment of out-of-quota rates; non-tariff measures; safeguards; subsidies and countervailing measures and anti-dumping measures; as well as facilitation and promotion of effective and adequate protection of TRIPs.

An Early Harvest program has been agreed upon. The products covered by this program include all agricultural products (chapters 01 to 08) at the 8/9 digit level (HS Code), except those in the Exclusion List. Additional, specific products, negotiated bilaterally, have also been included in the program (a number of ASEAN countries have not concluded their negotiations). Products under this program are divided into 3 categories for tariff reduction and elimination:

- a) Category 1: products with MFN tariff rates higher than 15% for China and ASEAN 6, and 30% or higher for the newer ASEAN members.
- b) Category 2: products with MFN tariff rates between 5% and 15% for China and ASEAN6, and between 15% and 30% for the newer ASEAN members.

c) Category 3: products with MFN tariff rates lower than 5% for China and ASEAN 6, and lower than 15% for the newer ASEAN members.

For China and ASEAN 6, the following will be the implementation timeframes:

Product category	Not later than 1/1/04	Not later than 1/1/05	Not later than 1/1/06
1	10%	5%	0%
2	5%	0%	0%
3	0%	0%	0%

For the newer ASEAN members the timeframe is stretched out to 1 January 2010. Vietnam will begin the process before 1 January 2004, while Laos, Myanmar and Cambodia before 1 January 2006. Cambodia's elimination of tariffs will be slower than that by Laos and Myanmar (by one year).

Many observers have expected that the Early Harvest program will be more substantial than finally agreed upon. The program covers about 10% of all tariff lines, involving 600 products that belong to the following categories: live animals, meat and edible meat offal, fish, dairy produce, other animal products, live trees, edible vegetables, edible fruits and nuts. Trade between ASEAN and China in products covered by the program amounted only to about US\$ 860,000 in 2001.

The fact that the Early Harvest program was not a major "bang" suggest how difficult the follow-up negotiations will be. Future negotiations will be conducted by the ASEAN-China Trade Negotiation Committee (ASEAN-China TNC). One wonders whether the Committee has the ability to deal with the total package covered by the Framework Agreement so as not to get bogged down in the FTA negotiations and yet still be able to produce a significant outcome. This is why the broad-based, comprehensive agreement is so critical to the success of the undertaking. The institutional arrangement must match this task.

References

Ito, Takatoshi (2000), "Regional Cooperation in Asia: Theoretical Framework, Recent Movements, and

Prospects,” presentation at the East Asian Economic Association Conference, Singapore, August (?).

Jayasuriya, Kanishka (2000), “Asia-Pacific regionalism in the form of ‘minilateralism’”, *The Straits Times*, Singapore, 18 November.

Soesastro, Hadi (2001), “Towards an East Asian Regional Trading Arrangement”, in Simon SC Tay, Jesus Estanislao, Hadi Soesastro (eds.), *Reinventing ASEAN* (Singapore: Institute of Southeast Asian Studies), pp. 226-242.

Thayer, Carlyle A. (2000), “ASEAN Ten Plus Three: An Evolving East Asian Community?” *Pacific Forum CSIS Comparative Connections*, an e-journal on East Asian bilateral relations, 4th quarter.